



## Durham E-Theses

---

# *INVESTORS' RIGHTS, TRANSPARENCY AND INFORMATION IN EQUITY BASED ISLAMIC FINANCE: AN EXPLORATION INTO ISLAMIC PRIVATE EQUITY IN THE GCC*

AL-MANNAI, MUNA,AHMED

### How to cite:

---

AL-MANNAI, MUNA,AHMED (2017) *INVESTORS' RIGHTS, TRANSPARENCY AND INFORMATION IN EQUITY BASED ISLAMIC FINANCE: AN EXPLORATION INTO ISLAMIC PRIVATE EQUITY IN THE GCC* , Durham theses, Durham University. Available at Durham E-Theses Online: <http://etheses.dur.ac.uk/12437/>

### Use policy

---

The full-text may be used and/or reproduced, and given to third parties in any format or medium, without prior permission or charge, for personal research or study, educational, or not-for-profit purposes provided that:

- a full bibliographic reference is made to the original source
- a [link](#) is made to the metadata record in Durham E-Theses
- the full-text is not changed in any way

The full-text must not be sold in any format or medium without the formal permission of the copyright holders.

Please consult the [full Durham E-Theses policy](#) for further details.

---

Academic Support Office, Durham University, University Office, Old Elvet, Durham DH1 3HP  
e-mail: [e-theses.admin@dur.ac.uk](mailto:e-theses.admin@dur.ac.uk) Tel: +44 0191 334 6107  
<http://etheses.dur.ac.uk>

## ABSTRACT

### INVESTORS' RIGHTS, TRANSPARENCY AND INFORMATION IN EQUITY BASED ISLAMIC FINANCE: AN EXPLORATION INTO ISLAMIC PRIVATE EQUITY IN THE GCC

Muna Ahmed Al Mannai

Islamic principles encourage the use of risk-sharing modes of financing and private equity is one of the organizational formats that uses these instruments. However, there has been no in-depth study on Islamic private equity (IPE) that examines the issues arising in implementing equity-based financing. IPE involves an investment where Islamic Financial Institutions (IFIs) and investors are bound together by a contractual relationship that is greatly influenced by trust. Private equity relationships involve investments in different projects and ventures on a risk-sharing basis with not much known, especially about the post-investment period. Furthermore, private equity is considered to be one-sided agreements since there is no room to negotiate pre-investment, little or no voting power post-investment, a process to resolve conflict of interest matters is lacking and accounting is off the balance sheet. All of the above gives rise to a potential conflict of interest and makes the availability of market information essential to the investors. Thus, enhancing the transparency and flow of information can be the strategic factor in developing the Islamic private equity market (IPE). Moreover, in IPE investors depend highly on the *Shari'ah* Supervisory Board (SSB) supervision and oversight for ensuring *Shari'ah* compliance, yet the independence of SSB is questioned.

Given the above, the aim of the study is to explore the relationship between the investors and IFI investing in IPE across the GCC, reflecting on investors' rights and compliance with the principles and goals of *Shari'ah*. The study followed an inductive approach, using a mixed model, combining qualitative and quantitative data collection and analysis techniques. Participants: investors (Islamic and conventional), IFIs and *Shari'ah* scholars, were selected using sampling and judgmental techniques. The results were analysed using descriptive and inferential statistical methods. The findings indicate that transparency and investor communication is lacking and IFIs need to improve on the disclosure mechanism towards their investors. The governance of the investment structure and of the IFI management, the ability to negotiate, and the independence of *Shari'ah* supervision and review are some of the key issues that would need to be addressed/strengthened to enhance the investors' confidence. Regulations are to be navigated towards enhancing transparency, publicity and accountability. The desire is not only for regulations on the availability of information, but also to ensure they are enforced and consequences may result from non-compliance. In addition, in introducing an independent set-up, SSB independence can be enhanced. Furthermore, with the concept of IPE investment being a contractual agreement, an effective supervision, contract enforcement and legal system is required.

***INVESTORS' RIGHTS, TRANSPARENCY AND INFORMATION IN  
EQUITY BASED ISLAMIC FINANCE: AN EXPLORATION INTO  
ISLAMIC PRIVATE EQUITY IN THE GCC***

By

**Muna Ahmed Al Mannai**

Thesis submitted in fulfilment of the requirement for the degree of Doctor of  
Philosophy

Durham University Business School  
Durham University

June 2017

## TABLE OF CONTENTS

<b>LIST OF TABLES .....</b>	<b>I</b>
<b>LIST OF FIGURES .....</b>	<b>VI</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>VIII</b>
<b>DECLARATION .....</b>	<b>X</b>
<b>COPYRIGHT .....</b>	<b>X</b>
<b>ACKNOWLEDGEMENTS .....</b>	<b>XI</b>
<b>DEDICATION .....</b>	<b>XII</b>
<b>INTRODUCTION .....</b>	<b>2</b>
<b>1.1 RESEARCH BACKGROUND .....</b>	<b>2</b>
<b>1.2 MOTIVATION AND SIGNIFICANCE OF THE STUDY.....</b>	<b>ERROR! BOOKMARK NOT DEFINED.</b>
<b>1.3 RESEARCH AIM AND OBJECTIVES .....</b>	<b>7</b>
<b>1.4 RESEARCH QUESTIONS.....</b>	<b>8</b>
<b>1.5 RESEARCH SCOPE.....</b>	<b>8</b>
<b>1.6 RESEARCH METHODOLOGY .....</b>	<b>9</b>
<b>1.7 OVERVIEW OF THE CHAPTERS .....</b>	<b>10</b>
<b>PRIVATE EQUITY IN CONVENTIONAL FINANCE .....</b>	<b>13</b>
<b>2.1 INTRODUCTION .....</b>	<b>13</b>
<b>2.2 DEFINITION AND BREIF OVERVIEW.....</b>	<b>14</b>
<b>2.2.1 Private Equity.....</b>	<b>14</b>
<b>2.2.2 The Legal Structure.....</b>	<b>16</b>

2.2.3 The Relationship between the Limited and General Partners .....	17
2.2.4 Collective Investment Schemes.....	18
2.3 THEORIES ABOUT THE PRINCIPAL-AGENT RELATIONSHIPS .....	20
2.3.1 Agency Theory .....	21
2.3.1.1 Asymmetry in the Agency Relationship.....	23
2.3.2 Formal and Real Authority Theory .....	26
2.3.3 Knowledge Sharing and Procedural Justice Theory .....	27
2.3.4 Interactionism Theory .....	30
2.3.4.1 Moral Hazard and Ethical considerations.....	30
2.3.4.2 Trust and social culture.....	32
2.3.4.3 Social Capital and Social Network Embeddedness .....	37
2.3.5 Contract Theory.....	39
2.4 CONCLUDING REMARKS .....	47
PRIVATE EQUITY IN ISLAMIC FINANCE: PRINCIPLES AND FEATURES .....	48
3.1 INTRODUCTION .....	48
3.1 MAQASID <i>AL SHARI'AH</i> AND FINANCIAL PRINCIPLES: A BRIEF OVERVIEW .....	48
3.1.1 <i>Maqasid Al Shari'ah</i> .....	48
3.1.2 Transactions as per <i>Shari'ah</i> Principles .....	51
3.2 THE ISLAMIC ECONOMY .....	53
3.2.1 The Islamic Economy and the Individual.....	55
3.3. ISLAMIC FINANCE.....	56
3.3.1. Islamic Financial Contracts .....	58
3.4 PRIVATE EQUITY AND ISLAMIC FINANCE .....	63
3.4.1. <i>Mudarabah</i> Contracts .....	64
3.4.2. <i>Musharakah</i> Contracts .....	65
3.4.3. <i>Musharakah</i> and <i>Mudarabah</i> intermingled .....	66

3.4.4. Islamic Private Equity .....	66
3.5. CONTRASTING THE ISLAMIC AND CONVENTIONAL PRIVATE EQUITY .....	67
3.5.1 Similarities of Islamic and Conventional Private Equity .....	68
3.5.2 Differences between Islamic and Conventional Private Equity .....	68
3.6. CHALLENGES FACING ISLAMIC PRIVATE EQUITY.....	69
3.6.1. Arrangement Structure of IPE .....	69
3.6.2. Legal Structure of the IPE .....	71
3.6.3. Transparency of the IPE .....	72
3.6.4. <i>Shari'ah</i> Knowledge and Understanding.....	73
3.6.5. <i>Shari'ah</i> Perspective .....	73
3.7. CONCLUDING REMARKS .....	74
PRIVATE EQUITY REGULATIONS: PRINCIPLES AND STATUS IN THE GCC.....	77
4.1 INTRODUCTION .....	77
4.2 FRAMEWORK AND TYPES OF REGULATIONS.....	78
4.2.1 Relationship Regulation versus Rule Based Regulation .....	79
4.2.2 Principle-Based Regulation Verses Market-Based Regulation .....	80
4.2.3 Framework of Regulation .....	82
4.2.3.1 Industry-based versus National-Oriented Regulations .....	83
4.2.3.2 Compliance and Regulation .....	84
4.2.3.3. Smart Regulation .....	85
4.3 REGULATIONS ON PRIVATE EQUITY .....	87
4.4 GOVERNANCE IN PRIVATE EQUITY .....	91
4.5 SHARI'AH REGULATIONS AND GOVERNANCE ON PRIVATE EQUITY.....	94
4.5.1. <i>Shari'ah</i> Regulations.....	95
4.5.2. <i>Shari'ah</i> Governance/ Compliance.....	98

<b>4.6 GCC REGULATIONS ON PRIVATE EQUITY .....</b>	<b>104</b>
<b>4.7 CONCLDING REMARKS .....</b>	<b>118</b>
<b>RESEARCH METHODOLOGY .....</b>	<b>121</b>
<b>5.1 INTRODUCTION .....</b>	<b>121</b>
<b>5.2 PLANING STAGE .....</b>	<b>122</b>
<b>5.2.1 Research Background.....</b>	<b>122</b>
<b>5.2.2 Research Aim, Objectives and Questions .....</b>	<b>124</b>
<b>5.2.2.3 Research Questions.....</b>	<b>125</b>
<b>5.3 RESEARCH PHILOSOPHY AND FRAMEWORK .....</b>	<b>126</b>
<b>5.3.1 Research Methodology .....</b>	<b>127</b>
<b>5.3.1.2 Research Design .....</b>	<b>128</b>
<b>5.4. RESEARCH METHOD FOR COLLECTION OF DATA.....</b>	<b>129</b>
<b>5.4.1. Research Method Instruments.....</b>	<b>129</b>
<b>5.4.1.1. Data Collection Tools.....</b>	<b>131</b>
<b>5.4.1.2. Level of Measurement .....</b>	<b>131</b>
<b>5.4.2. Sampling Process .....</b>	<b>133</b>
<b>5.4.2.1. Determining the Sampling Methods.....</b>	<b>133</b>
<b>5.4.2.2. Research Population and Sample Size .....</b>	<b>134</b>
<b>5.4.3. Questionnaire Content and Interview Format.....</b>	<b>135</b>
<b>5.4.3.1. Questionnaire Content.....</b>	<b>135</b>
<b>5.4.3.2. Interview Format .....</b>	<b>136</b>
<b>5.4.4. Pilot Testing.....</b>	<b>137</b>
<b>5.4.5. The Fieldwork .....</b>	<b>138</b>
<b>5.4.5. Data Quality and Reliability .....</b>	<b>142</b>
<b>5.4.5.1. Strategies for Validating the Findings .....</b>	<b>142</b>
<b>5.5. RESEARCH METHODS FOR DATA ANALYSIS.....</b>	<b>144</b>



<b>5.5.1. Descriptive and Inferential Analysis .....</b>	<b>144</b>
<b>5.5.2. Textual and Content Analysis.....</b>	<b>144</b>
<b>5.5.3. Non-Parametric Inferential Statistics Methods .....</b>	<b>145</b>
<b>5.6. CHALLENGES AND OBSTACLES/LIMITATIONS/CONSTRAINTS.....</b>	<b>146</b>
<b>5.6.1. Ethical Issues .....</b>	<b>146</b>
<b>5.6.2. Limitations of Qualitative Research.....</b>	<b>147</b>
<b>5.7. CONCLUDING REMARKS: .....</b>	<b>148</b>
<b>INVESTORS APPROACH TO ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND ANALYSIS.....</b>	<b>149</b>
<b>6.1 INTRODUCTION .....</b>	<b>149</b>
<b>6.2 INVESTOR PROFILE .....</b>	<b>150</b>
<b>6.2.1 Investor Type and Domicile .....</b>	<b>150</b>
<b>6.2.2 Investors' Investment .....</b>	<b>151</b>
<b>6.3 INVESTORS APPROACH.....</b>	<b>154</b>
<b>6.3.1 Personal Source of Information.....</b>	<b>155</b>
<b>6.3.2 Impersonal Source of Information .....</b>	<b>156</b>
<b>6.3.3 Obtaining Market Information .....</b>	<b>159</b>
<b>6.3.4 Environmental, Social and Governance Matters.....</b>	<b>160</b>
<b>6.4 PRE-INVESTMENT INVESTORS' RELATIONSHIP WITH FINANCIAL INSTITUTIONS.....</b>	<b>161</b>
<b>6.4.1 Type and Language of Documents Received.....</b>	<b>161</b>
<b>6.4.2 Information Vs Trust.....</b>	<b>168</b>
<b>6.4.3 Agreement Signed .....</b>	<b>175</b>
<b>6.5 INVESTORS RELATIONSHIP WITH FI POST INVESTMENT .....</b>	<b>184</b>
<b>6.5.1 Maintaining Relationship with FI .....</b>	<b>184</b>
<b>6.5.2 Permitted to Vote .....</b>	<b>187</b>

6.5.3 FI Frequency of Updates .....	190
6.5.4 FI Method of Updates .....	195
6.5.5 Risk in Private Equity .....	199
6.5.6 Investing in Islamic Private Equity .....	201
6.5.6.1 <i>Shari'ah</i> Risk .....	201
6.5.6.2 <i>Shari'ah</i> Definition and Compliance .....	202
6.6 REGULATORY REQUIREMENTS .....	206
6.7 MEETING EXPECTATIONS AND FUTURE PLANS .....	209
6.7.1 Pairwise of Meeting Expectations and Future Plans .....	213
6.7.2. Form of Investment Going Forward .....	216
6.8 PRIVATE EQUITY INDUSTRY GOING FORWARD .....	218
6.8.1 Private Equity Impact on the Market .....	218
6.8.2 Key Issues in IPE/CPE .....	219
6.8.3 Regulating IPE/CPE .....	223
6.8.3.1 Beneficial to Regulate IPE/CPE Market .....	223
6.8.3.2 Who to Regulate IPE/CPE Market .....	225
6.8.3.3 How to Regulate IPE/CPE Market .....	227
6.9 CONCLUDING REMARKS .....	229
<b>IFI APPROACHES TO ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND ANALYSIS .....</b>	<b>231</b>
7.1 INTRODUCTION .....	231
7.2 INVESTMENT APPROACH .....	231
7.2.1 Investors Being Approached .....	232
7.2.2 IFI Approach .....	233
7.3 TRANSPARENCY AND GOVERNANCE .....	239
7.3.1. IFI Participation .....	239

7.3.2 Investors Voting Rights .....	242
7.4 POST INVESTMENT RELATIONSHIP .....	247
7.4.1 Format of communication between IFI and the investor.....	248
7.4.2 Frequency and Format of Disclosure.....	250
7.4.2.1 Frequency of Disclosure .....	250
7.4.2.2 Format of Disclosure.....	252
7.5 DUE DILIGENCE .....	255
7.6 SHARIA’H COMPLIANCE AND SHARI’AH SUPERVISORY BOARD .....	257
7.6.1 <i>Shari’ah</i> Compliance .....	257
7.6.2 Process of <i>Shari’ah</i> Approval and <i>Shari’ah</i> Review.....	260
7.6.2.1 Process of <i>Shari’ah</i> Approval .....	260
7.6.2.2 <i>Shari’ah</i> Review .....	264
7.6.3 <i>Shari’ah</i> Supervisory Board (SSB).....	267
7.6.3.1 SSB Independence.....	267
7.6.3.2 Appointment of SSB .....	269
7.6.4 <i>Shari’ah</i> Risk .....	272
7.7 REGULATORY REQUIREMENTS.....	274
7.7.1 Pre-Regulatory Requirement.....	274
7.7.2 Post-Investment Regulatory Requirements.....	277
7.7.3 IFIs’ Opinion on Regulations.....	280
7.7.3.1 IFIs’ Opinion on IPE Regulations .....	280
7.7.3.2 IFIs’ Opinion on Capital Adequacy Regulations.....	282
7.8 CONCLUDING REMARKS .....	284
<b>SHARI’AH SCHOLAR ROLE IN IFI INVESTING IN ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND FINDINGS.....</b>	<b>286</b>
8.1 INTRODUCTION .....	286

<b>8.2 TERMS OF REFERENCE AND RESPONSIBILITIES .....</b>	<b>286</b>
8.2.1 Terms of Reference.....	286
8.2.1.1 Contractual Agreement.....	287
8.2.1.2 Appointment.....	290
8.2.1.3 Mandates and Responsibilities .....	293
<b>8.3 SSB MEMBER’S PERFORMANCE AND INDEPENDENCE .....</b>	<b>296</b>
8.3.1 SSB Member’s Performance-Function.....	296
8.3.2 SSB Member’s Independence .....	301
<b>8.4 SHARI’AH COMPLIANCE AND SHARI’AH RISK .....</b>	<b>305</b>
8.4.1. <i>Shari’ah</i> Compliance Reporting.....	305
8.4.2 <i>Shari’ah</i> Risk .....	308
<b>8.5 CONCLUDING REMARKS .....</b>	<b>311</b>
<b>CONTEXTUALIZATION THE RESULTS AND FINDINGS.....</b>	<b>313</b>
<b>9.1 INTRODUCTION .....</b>	<b>313</b>
<b>9.2 TRANSPARENCY AND INFORMATION.....</b>	<b>316</b>
9.2.1 Pre-Investment and Transparency & Information .....	316
9.2.1.1 Pre-Investment Stage.....	316
9.2.2 Transparency and Information Pre-Investment Regulatory Requirements.....	322
9.2.3 Post Investment and Transparency & Information .....	324
9.2.3.1 Post Investment .....	324
9.2.3.2 Transparency & Information Post Investment Regulatory Requirement .....	327
9.2.4 Post Investment .....	327
9.5 Investor’s views on the Investment Relationship.....	328
9.2.5 Key Transparency & Information Issues .....	331
<b>9.3 SHARI’AH.....</b>	<b>334</b>
9.3.1 <i>Shari’ah</i> Awareness .....	334

9.3.2 <i>Shari'ah</i> Compliance .....	337
9.3.3 Regulations Related to <i>Shari'ah</i> Compliance.....	339
9.3.4. Issues of concern in the Framework of IPE with Regards to <i>Shari'ah</i> .....	340
9.4 REGULATING PRIVATE EQUITY MARKET .....	342
9.5 CONCLUDING REMARKS .....	345
CONCLUSION AND RESEARCH RECOMMENDATIONS.....	347
10.1 INTRODUCTION .....	347
10.2 IMPLICATIONS FOR IFIS .....	348
10.2.1 Transparency, Information and Investor Communication Recommendations.....	348
10.2.2 Governance of the Investment .....	349
10.3 IMPLICATIONS FOR REGULATORS.....	350
10.3.1 Transparency, Information and Investor Communication Recommendations.....	350
10.3.2 <i>Shari'ah</i> Governance of the Investment .....	352
10.4 LIMITATIONS.....	353
10.5 SUGGESTIONS FOR FUTURE RESEARCH.....	355
10.6 EPILOGUE .....	356
APPENDICES.....	357
Appendix 1: Investor's Documents .....	358
Appendix 2: Islamic Financial Institution's Documents .....	385
Appendix 3: <i>Shari'ah</i> Scholar's Documents.....	391
Appendix 4: Participating Islamic Financial Institution's and <i>Shari'ah</i> Scholar's Profile .....	402
BIBLIOGRAPHY.....	403

## LIST OF TABLES

Table 5. 1-Sample Size and Regional Coverage	139
Table 5. 2-Reliability Testing: Cronbach Alpha	143
Table 6. 1-Investor Type and Domicile of Investor	150
Table 6. 2-Investor Type and Investment Carried Through	151
Table 6. 3-Investor Type and Familiar in Equity Financing	153
Table 6. 4-Investor Type and Personal Source	155
Table 6. 5-Investor Type and Personal Source Investing Based On	156
Table 6. 6-Investor Type and Impersonal Source	157
Table 6. 7-Investor Type and Impersonal Source Investing Based On	159
Table 6. 8-Investor Type and Obtaining Market Information	160
Table 6. 9-Investor Type and Environmental Social Governance Issues Effect Investment Decisions	161
Table 6. 10-Investor Type and Documents Provided to Investors	162
Table 6.11-Investor Type and Language of Agreement and Document Comprehensiveness	163
Table 6.12-Break-up of Conventional Investor Group and Language of Agreement and Document Comprehensiveness	163
Table 6. 13-Investor Type and Reading of Documents	164
Table 6. 14-Investor Type and Issues Discussed with FI	166
Table 6. 15-Investor Type and Benchmarking of Sufficient Information/Trust	169
Table 6. 16-Investor Type and Source of Information	170
Table 6. 17-Investor Type and Based on Trust in FI	175
Table 6. 18-Investor Type and Satisfied with Agreement	176
Table 6. 19-Investor Type and Opportunity to Negotiate Contractual Clauses	178
Table 6. 20-Opportunity to Negotiate Contractual Clauses and Investor Type	179
Table 6. 21-Amount Invested and Opportunity to Negotiate Contractual Clauses by Investor Type	181
Table 6. 22-Investor Type and the Independence of Subscribing and Proxy	182
Table 6. 23-Break-up of Conventional Investor and the Independence of Subscribing and Proxy	182
Table 6. 24-Investor Type and FI Participation in the Investment	183
Table 6. 25-Investor Type and Relationship with FI	185
Table 6. 26-Investor Type and Document Process with FI	186
Table 6. 27-Investor Type and Voting on Key Issues	189
Table 6. 28-Investor Type and How Often FI Gets in Touch	191
Table 6. 29-Investor Type and Reason For Not Getting in Touch	192
Table 6. 30-Investor Type and the Effect of Information/Report Received on Investors	193
Table 6. 31-Investor Type and Reporting Provision Part of Formal/Informal Agreement	194
Table 6. 32-Reporting Back Part of Formal/Informal Agreement and Investment Carried Out	195
Table 6. 33-Investor Type and Information Received Easily Analyzed	196

Table 6. 34-Investor Type and Method of Reporting	196
Table 6. 35-Investor Type and Information Like to be Reported	198
Table 6. 36-Details of The Top 3 Information Update Like to be Reported	199
Table 6. 37-Investor Type and Concern PE Risk	200
Table 6. 38-Concern PE Risk and Document Addressed Risk	200
Table 6. 39-Investor Type and Importance of <i>Shari'ah</i> Risk	201
Table 6. 40-Investor Type and Investor <i>Shari'ah</i> Definition	202
Table 6. 41-Investor Type and What Happens When <i>Shari'ah</i> Non-Compliance	204
Table 6. 42-Investor Type and Ensuring Maintaining <i>Shari'ah</i> Compliance	204
Table 6. 43-Aware Investment Overseen by SSB and Perceptive to Ethical and/or Legal Issues	205
Table 6. 44-Investor Type and Aware of FI have Regulatory Requirements	206
Table 6. 45-Investor Type and Regulatory Requirements Effectively Enforced	207
Table 6. 46-Investor Type and Regulatory Requirement on Investor	209
Table 6. 47-Investor Type and Investment Meeting Expectations	210
Table 6. 48-Investor Type and Going Forward Expect to Continue	212
Table 6. 49-Investment Initially Carried Through and Investment Going Forward Cross-tabulation Across Type of Investor	217
Table 6. 50-Investor Type and PE Impact	219
Table 6. 51- Investor Type and Key Issues in PE	221
Table 6. 52-To Regulate Pre-Investment and To Regulate Post-Investment Cross-tabulation Across Investor Type	223
Table 6. 53-Who to Regulate Pre-Investment and Who to Regulate Post-Investment Cross-tabulation Across Investor Type	226
Table 6. 54-Investor Type and How Should They Regulate	228
Table 6. 55-Investor Type and Have an Investor Advisory Committee Representative	229
Table 7. 1-Investors Being Approached	232
Table 7. 2- Focused Coding 1 For Investors Being Approached	232
Table 7. 3-Focused Coding 2 For Investors Being Approached	233
Table 7. 4-How IFI Approach Investors	234
Table 7. 5-Focused Coding For How IFI Approach Investors	234
Table 7. 6-Focused Coding For How IFI Approached Investors	235
Table 7. 7-Focused Coding 3 For How IFI Approached Investors	236
Table 7. 8-Basis of Investors Investment Decision	237
Table 7. 9-Focused Coding 1 For Investors Invested Based On	237
Table 7. 10-Focused Coding 2 For Investors Invested Based On	238
Table 7. 11-Factors Affecting IFI's Participation in the Investment	239
Table 7. 12-Focused Coding 1 For Factors Affecting IFI's Participation in the Investment	239
Table 7. 13-Focused Coding 2 For Factors Affecting IFI's Participation in the Investment	240
Table 7. 14-Focused Coding 3 Factors Affecting IFI's Participation in the Investment	240

Table 7. 15-Focused Coding 4 For Factors Affecting IFI's Participation in the Investment	241
Table 7. 16-What is the IFI Participation Amount?	241
Table 7. 17-Focused Coding 1 For What Decides the IFI Participation Amount in the Investment?	241
Table 7. 18-Focused Coding 2 For What Decides the IFI Participation Amount in the Investment?	242
Table 7. 19-How Do You Maintain the Investors' Interest and Voting Rights?	243
Table 7. 20-Focused Coding 1 For How Do You Maintain the Investors' Interest and Voting Rights?	243
Table 7. 21-Focused Coding 2 For How Do You Maintain the Investors' Interest?	244
Table 7. 22-Focused Coding 3 For How Do You Maintain the Investors' Interest?	244
Table 7. 23-Focused Coding 4 For How Do You Maintain the Investors' Interest?	245
Table 7. 24-Do You Ever Go Back to the Investor on Any Decisions to be Made?	246
Table 7. 25-Focused Coding 1 For Do You Ever Go Back to the Investor on Any Decisions to be Made?	246
Table 7. 26-Focused Coding 2 For Do You Ever Go Back to the Investor on Any Decisions to be Made?	247
Table 7. 27-How is the Communication Maintained Post Investment	248
Table 7. 28-Focused Coding 1 For How is the Communication Maintained Post Investment?	248
Table 7. 29- Focused Coding 2 For How is the Communication Maintained Post Investment?	249
Table 7. 30- Focused Coding 2 For How is the Communication Maintained Post Investment?	250
Table 7. 31-What is the Frequency of the Information Provided to the Investor?	251
Table 7. 32-Focused Coding 1 For What is the Frequency of the Information Provided to the Investor?	251
Table 7. 33-Focused Coding 2 For What is the Frequency of the Information Provided to the Investor?	252
Table 7. 34-What Information is Provided to the Investor?	253
Table 7. 35-Focused Coding 1 For What Information is Provided to the Investor?	253
Table 7. 36-Focused Coding 2 For What Information is Provided to the Investor?	253
Table 7. 37-Focused Coding 3 For What Information is Provided to the Investor?	254
Table 7. 38-Due Diligence Process Undertaken	255
Table 7. 39-Focused Coding 1 For How is the Due Diligence Process Undertaken?	255
Table 7. 40-Focused Coding 2 For How is the Due Diligence Process Undertaken?	256
Table 7. 41-Focused Coding 3 For How is the Due Diligence Process Undertaken?	256
Table 7. 42- <i>Shari'ah</i> Department and <i>Shari'ah</i> Compliance Officer	257
Table 7. 43-Focused Coding 1 For Is There <i>Shari'ah</i> Department/Unit Within the Institution? Is There a <i>Shari'ah</i> Compliance Officer?	258
Table 7. 44-Focused Coding 2 For Is There a <i>Shari'ah</i> Department/Unit Within the Institution? Is There a <i>Shari'ah</i> Compliance Officer?	258
Table 7. 45-Approval Process	260
Table 7. 46-Focused Coding 1 For What is the Process in Which the <i>Shari'ah</i> Consultation/Approval is Obtained at Your Institution?	261
Table 7. 47-Focused Coding 2 For What is the Process in Which the <i>Shari'ah</i> Consultation/Approval is Obtained at Your Institution?	262
Table 7. 48- <i>Shari'ah</i> Review	264
Table 7. 49-Focused Coding 1 For What is the Institution's Process of Monitoring the Consistency of its <i>Shari'ah</i> Compliance? How Does it Manage any <i>Shari'ah</i> Compliance Risk that May Arise Over Time?	264
Table 7. 50-Focused Coding 2 For What is the Institution's Process of Monitoring the Consistency of its <i>Shari'ah</i> Compliance? How Does it Manage any <i>Shari'ah</i> Compliance Risk that May Arise Over Time?	265



Table 7. 51-Whether Any of the SSB members Have Any Relationship or Link With the IFI it is Supervising?	267
Table 7. 52-Focused Coding 1 For Are Any of the SSB Members on BOD, on Board Committees, a Client, or a Shareholder?	268
Table 7. 53-Focused Coding 2 For Are Any of the SSB Members on BOD, on Board Committees, a Client, or a Shareholder?	268
Table 7. 54-Appointment of SSB	269
Table 7. 55-Focused Coding 1 For Who Appoints the SSB?	270
Table 7. 56-Focused Coding 2 For Who Appoints the SSB?	270
Table 7. 57-Focused Coding 3 For Who Appoints the SSB?	271
Table 7. 58- <i>Shari'ah</i> Risk	272
Table 7. 59-Focused Coding 1 For What Do You Consider as <i>Shari'ah</i> Risk For Islamic Private Equity (IPE)?	272
Table 7. 60-Focused Coding 2 For What Do You Consider as <i>Shari'ah</i> Risk For IPE?	273
Table 7. 61-Pre-Regulatory Requirements	274
Table 7. 62-Focused Coding 1 For Are There Any Regulatory Requirements on Your Institution With Regards to Promoting and Selling IPE?	275
Table 7. 63-Post Investment Regulatory Requirements	277
Table 7. 64-Focused Coding 1 For Are There Any On-Going Regulatory Requirements With Regards to Disclosure and Transparency That Your Institution Requires to Abide by, Once the Investment has Been Offered?	278
Table 7. 65-Focused Coding 2 For Are There Any On-Going Regulatory Requirements With Regards to Disclosure and Transparency That Your Institution Requires to Abide by, Once the Investment has Been Offered?	279
Table 7. 66-Opinion of IPE Regulations	280
Table 7. 67-What is Your Opinion With Regards to These Regulations?	280
Table 7. 68-Opinion of Capital Adequacy Regulations	283
Table 7. 69-What is Your Opinion on the Regulations on Capital?	283
Table 7. 70-What is Your Opinion on the Regulations on Capital?	283
Table 8. 1- <i>Shari'ah</i> Scholar Contractual Agreement	287
Table 8. 2-Focused Coding 1 For Does the Agreement of Appointment that You Signed Clearly State the TOR Regarding Your Mandates and Responsibilities?	287
Table 8. 3-Focused Coding 2 For Does the Agreement of Appointment that You Signed Clearly State the TOR Regarding Your Mandates and Responsibilities?	289
Table 8. 4- <i>Shari'ah</i> Scholar Appointment	290
Table 8. 5-Focused Coding 1 For Who Do You (as SSB) Usually Report to? i.e. Who Appoints You and to Whom Do You Report to?	291
Table 8. 6-Focused Coding 2 For Who Do You (as SSB) Usually Report to? i.e. Who Appoints You and to Whom Do You Report to?	292
Table 8. 7-Mandates and Responsibilities	293
Table 8. 8-Focused Coding 1 For What are Your Mandates and Responsibilities?	293
Table 8. 9-Focused Coding 2 For What are You Mandates and Responsibilities?	295
Table 8. 10-SSB Member's Performance-Function	296

Table 8. 11-Focused Coding 1 For How Do You as a Member of the SSB Operate With Regards to Meeting Your Duties and Responsibilities?	297
Table 8. 12-Focused Coding 2 For How Do You as a Member of the SSB Operate With Regards to Meeting Your Duties and Responsibilities?	299
Table 8. 13-SSB Member's Independence	301
Table 8. 14-Focused Coding 1 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?	301
Table 8. 15-Focused Coding 2 For In Your Association With the IFI as a Member, How Do You Try and Maintain your Independence?	302
Table 8. 16-Focused Coding 3 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?	303
Table 8. 17-Focused Coding 4 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?	304
Table 8. 18- <i>Shari'ah</i> Compliance Reporting	306
Table 8. 19-Focused Coding 1 For Have They Been Documented/Reported? Have They Been Made Available to Shareholders, Investors and Local Authorities?	306
Table 8. 20-Focused Coding 2 For Have They Been Documented/Reported? Have They Been Made Available to Shareholders, Investors and Local Authorities?	308

## LIST OF FIGURES

Figure 2. 1-Structure of a Private Equity Investment Vehical	16
Figure 3. 1-Structure of <i>Maqasid AlShari'ah</i> : Interrelated (Left) & Contemporary (Right)	51
Figure 3. 2-Relationship Between Islamic Banking & Financial System and <i>Shari'ah</i>	56
Figure 3. 3-Contracts of Islamic Law (Selection)	63
Figure 3. 4-Simple <i>Mudarabah</i> Structure	67
Figure 3. 5-Simple <i>Musharakah</i> Structure	67
Figure 3. 6- <i>Shari'ah</i> Requirement and Product Categories	74
Figure 4. 1- The Legal Governance Framework	83
Figure 4. 2- The Spectrum of Governance: From Formal to Informal	84
Figure 4. 3-The Three Aspects of Smart Regulation	86
Figure 4. 4-Mechanism of <i>Shari'ah</i> Compliance Process	100
Figure 5. 1-Process Model of Research Process	121
Figure 5. 2-Research Method Choice	130
Figure 5. 3-Hierarchy of Level of Measurements	132
Figure 5. 4-Methodological Continuum	134
Figure 5. 5-Textual Analysis	145
Figure 6. 1-Recent Year of Investment	152
Figure 6. 2- Post hoc Test on the Distribution of Familiar with Equity Finance Across the Type of Investor Group	154
Figure 6. 3-Post hoc Test on the Distribution of Impersonal Source	158
Figure 6. 4-Post hoc Test on the Distribution of Discussed Alignment of Interest Across the Type of Investor Groups	167
Figure 6. 5-Post hoc Test on the Distribution of Discussed Governance Across the Type of Investor Groups	168
Figure 6. 6-Post hoc Test on the Distribution of Management Team (Source of Information)	172
Figure 6. 7-Post hoc Test on the Distribution of Applicable Law (Source of Information)	172
Figure 6. 8-Post hoc Test on the Distribution of Consultant Recommendation (Source of Information)	173
Figure 6. 9-Post hoc Test on the Distribution of Personal Experience (Source of Information)	174
Figure 6. 10-Post hoc Test of the Distribution of Satisfied with the Agreement Across the Type of Investor Groups	177
Figure 6. 11-Post hoc Test on the Opportunity to Negotiate Contractual Clauses Across the Type of Investor Groups	180
Figure 6. 12-Post hoc Test on the Distribution of Clearly Documented Process Regarding Consultation on Conflict of Interest Across Type of Investor Groups	187
Figure 6. 13-The Method of Reporting and The Need to Go Back to FI/GP With Questions or Further Information	198
Figure 6. 14-Important <i>Shari'ah</i> Principles as per Investor's Point of View	203
Figure 6. 15-Post hoc Test on Regulatory Requirement Fully Enforced	208

Figure 6. 16-Post hoc on Going Forward Expect to Continue	212
Figure 6. 17-Post hoc Test on the Distribution of Investment Meet Expectation on Procedures-Approach Across the Categories of Going Forward Expect to Continue	214
Figure 6. 18-Post hoc Test on the Distribution of Investment Meet Expectation on Risk-Return Across the Categories Going Forward Expect to Continue	215
Figure 6. 19-Post hoc Test on the Distribution of Investment Meet Expectation on <i>Shari'ah</i> Purpose-Compliance Across the Categories Going Forward Expect to Continue	216
Figure 6. 20-Post hoc Test on the Distribution of FI/GP Management Key Issues	222
Figure 6. 21-Post hoc Test on the Distribution of Regulations Key Issue	222
Figure 7. 1-IFI Perception on the Important <i>Shari'ah</i> Principles	274
Figure 8. 1- <i>Shari'ah</i> Scholar's Association with the IFI	302
Figure 8. 2-The <i>Shari'ah</i> Scholar's Opinion on the <i>Shari'ah</i> Principles	309
Figure 9. 1-Research Questions	315

## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization For Islamic Financial Institutions
AED	United Arabs Emirates Dirham
AGM	Annual General Meeting
BOD	Board of Directors
BVCA	British Private Equity and Venture Capital Association
CAC	Cronbach Alpha Coefficient
CBB	Central Bank of Bahrain
CBK	Central Bank of Kuwait
CBO	Central Bank of Oman
CIS	Collective Investment Scheme
CMAK	Capital Markets Authority of Kuwait
CMAO	Capital Markets Authority of Oman
CMAS	Capital Markets Authority of Saudi Arabia
CPE	Conventional Private Equity
DFSA	Dubai Financial Service Authority
DIFC	Dubai International Financial Centre
DI	Direct Investment
ESCA	External <i>Shari'ah</i> Compliance Audit
ESF	External <i>Shari'ah</i> Firm
ESG	Environmental Social and Governance
EVCA	European Venture Capital Association
FI	Financial Institution
GCC	Gulf Cooperation Council Countries
GP	General Partner
HNW	High Net Worth
HNWI	High Net Worth Individual
IA	Investment Advisor
IAC	Investor Advisory Committee
IAH	Investment Account Holder
IEF	Islamic Equity Finance
IFI	Islamic Financial Institution

IFR	Islamic Finance Rule Book
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Service Board
IIFM	International Islamic Financial Market
ILPA	Institutional Limited Partner Association
IN	Indirect Investment
INMA	Investment Management and Advisory
IPE	Islamic Private Equity
ISAE	International Standards on Assurance Engagement
K-W	Kruskal-Wallis
KYC	Know Your Client
LP	Limited Partner
MOCI	Ministry of Commerce and Industry
MW	Mann-Whitney
NAV	Net Asset Value
Nvivo-11	Computer Software used to aid qualitative analysis
PCC	Protective Cell Companies
PE	Private Equity
PEF	Private Equity Fund
PEFF	Private Equity Funds of Funds
PIU	Private Investment Undertaking
QFC	Qatar Financial Centre
QFCRA	Qatar Financial Centre Regulatory Authority
QFMA	Qatar Financial Markets Authority
SAMA	Saudi Arabia Monetary Authority
SAR	Saudi Arabia Riyal
SB	<i>Shari'ah</i> Board
SBB	<i>Shari'ah</i> Supervisory Board
SCA	Securities Commodities Authority
ShSc	<i>Shari'ah</i> Scholar
SPC	Special Purpose Company
SPSS-20	Computer Programme used to aid statistical analysis
SPV	Special Purpose Vehicle
UAE	United Arab Emirates

### **DECLARATION**

*I hereby declare that no portion of the work that appears in this study has been used in support of an application of another degree in qualification to this or any other university or institution of learning.*

### **COPYRIGHT**

*The copyright of this thesis rests with the author. No quotation from it should be published without the author's prior written consent, and information derived from it should be acknowledged.*

## ACKNOWLEDGEMENTS

*First and foremost, all praise to Allah, the Most Gracious and the Most Merciful for guiding me, giving me the will and all the patience I needed to finish this thesis, Alhamd Allah.*

I would like to start by acknowledging and expressing my thanks to my supervisors: Prof. Habib Ahmed and Dr. Maria Dimona-Cookson. Further gratitude is extended to Prof. Habib Ahmed, as this study could not have been pursued without his back up and support in my area of interest. He knew that it would be a challenging journey and for his patience throughout I thank him.

My sincere gratitude goes to my parents for their continuous support and for providing me with an education in the first place, which was a stepping stone towards my PhD. I am especially grateful to my mother, for whom learning is a never-ending process, for cultivating in me the thirst for continuous knowledge.

I would like to acknowledge the guidance received from my eldest sister, Dr. Haya AlMannai, Dr. Seref Turen, and Dr. Sayed Farook for making it seem possible when I decided to do my PhD.

Special gratitude goes to my beloved son Mohamed, for his patience, support and for bearing with me during the endless days and nights of work.

I would also like to thank my dearest friends for being there and for their continuous support and my colleagues at work, for taking responsibility while I took study leave. I would also like to extend my appreciation to H.E. Rasheed Al Maraj, Governor of the Central Bank of Bahrain and to my late Director, Ali Thamer for allowing me to pursue my PhD and take leave.

My appreciation extends to my brothers Khalid and Abdulla for assisting in establishing contact and to all my brothers, sisters and nephews for taking over the family responsibilities while I was busy with my research work. I would also like to thank my nephew Khalifa for taking the time to accompany me on some of my travels when undertaking the interviews.



I would like to thank the Market Players that helped in establishing my first contact with my participants, to whom I am extremely grateful, as without their help this research would not have got off the ground. As much as I would like to acknowledge them by name, I would not like to jeopardise confidentiality. Once again, thank you very much.

My utmost thanks also goes to all the participants who responded to the questionnaire and for agreeing to being interviewed. I am thankful for their participation in the research, and for sharing their experience and contributing towards improving Islamic finance, and in particular the area of private equity.

Last but not least, thank you to the LinkedIn network, through which I was able to reach out to my participants.

## **DEDICATION**

**To my loving and caring parents *Ahmed & Aameena Al Mannai***

## Chapter One:

### INTRODUCTION

#### 1.1 RESEARCH BACKGROUND

Starting in the mid-1970s, Islamic finance is a fairly new concept and is continuing to grow and expand globally. Reacting to the growth of the industry, regulators are catching up on the challenges in regulating and supervising Islamic financing. The Islamic Financial Service Board (IFSB) was established in 2002 with a mandate to provide standards and guidelines for the supervision of Islamic banks to be applied internationally. Since its establishment, it has developed guidelines on capital adequacy, risk management and corporate governance. Its work continues as it identifies the various areas that require guidance and supervision on the different types of Islamic finance and on “issues that have not been addressed in other international standards” (Archer & Abdul Karim 2007:3). Archer & Abdul Karim (2007:3) maintain that the main challenge for the IFSB is “to develop a framework that is common and applicable to all jurisdictions” (Archer and Abdul Karim 2007). As these guidelines/standards are in the infancy stage, in comparison to the international standards applicable to conventional banks, they have not been adopted by all regulators in different jurisdictions. Some central banks believe that Islamic financial institutions should be regulated and supervised completely differently from conventional banks, whilst others believe that they should be the same as conventional banks with some modifications (Hawary, Grais, and Iqbal 2004).

However, it is difficult to compare Islamic finance to their conventional counterparts, even though the issues of corporate governance, risk management, and capital adequacy are common. They differ mainly in the contracts used for carrying out various activities such as the mobilization of funds and financing different assets. There is a lot of project financing involved (mostly private investments) and hence, the emphasis on risk associated with Islamic financing differs from conventional financing. Greater investment and operational risk management is required, as the risk is not only associated with debt holders but also with equity investors. The risks to be addressed are based on the investor-entrepreneur relationship along with the debtor-creditor relationship. Thus, the relationship between the investors (equity owners) and IFIs (entrepreneurs) and their rights needs to be maintained: a balance has to be struck between the IFI's (entrepreneur's) interests and the investors' interests while meeting *Shari'ah* principles.

Although the profit-loss and risk sharing methods of financing (*musharaka* and *mudaraba*) are the preferred modes of Islamic financing for their contribution to the economy, most of the current Islamic forms of financing are in the form of debt-type modes (such as *murabaha* and *ijarah*). This is due to the fact that the partnership form of financing is not clearly understood by the participants in the industry and in particular the investor. One particular area in which equity-based modes are used more extensively is the private-equity segment. Prior to the financial crisis in 2007, the size of the private equity market in the MENA and North Africa region had reached more than US\$6.2bn. With the financial crisis, the market had dropped to US\$700m by 2009 (EMPEA, 2015). Notwithstanding the sharp drop, the market started to pick up and is reported to have reached US\$1.09bn in 2014 (EMPEA, 2015). However, the rise was short lived and the total funds raised in the MENA region continued its drop from US\$992m in 2015 to US\$582m in 2016, the lowest in four years (MENA Private Equity Association, 2016). The slowdown was due to the drop in oil prices and the uncertain conditions in the market, leading private equity investors to adopt a wait and see approach. The figures reported include all private equity, both conventional and Islamic. Recent market information, specifically on Islamic private equity is not available.

## **1.2 MOTIVATION AND SIGNIFICANCE OF THE STUDY**

This study is motivated by the growth in private equity form of Islamic financing, particularly in the Middle East region. The Islamic private equity financing is modelled on the conventional equity model. Even though the Islamic private equity sector reflects key features of Islamic financial contracts, there is very little research carried out on it. The conventional private equity model, the non-leverage version of the model, is well suited to the concept of Islam and the profit/loss-risk sharing principles and directing money into the real economy. Although, the economic tools of analysis such as scarcity, choice, opportunity cost, marginal efficiency of capital, discount rate and profit might be the same as in the conventional equity model, they are looked at from a different perspective in Islamic financing. The Islamic financing system views them from the dimensions of economic, social and moral aspects (Abdul Mannan, 2002:215).

For such a form of financing to grow, especially at a time when the countries of the GCC<sup>1</sup> region are working on developing their countries and its infrastructure, and where there will be potential opportunities to contribute to the real economic developments through the use of such

---

<sup>1</sup> GCC-Gulf Cooperation Council Countries.

investments, there is a need to improve the overall regulatory environment to increase confidence in private equity financing. Confidence is obtained through increasing the awareness and understanding of the process of investment, and the data availability of the private equity market.

Private equity, as the names suggests is a private market, where even in the conventional system not much data is available in comparison to other investment sectors of the financial market. Among others, there is a lack of adequate disclosure and transparency in the private equity markets. In this regard, associations such as The European Private Equity, the Venture Capital Association (EVCA), the British Private Equity and Venture Capital Association (BVCA) and the Institutional Limited Partners Associations (ILPA) have been established to counter issues that impact private equity such as information, transparency, risk management and corporate governance.

For private equity to succeed as a form of Islamic financing as being both permissible and valid from a *Shari'ah* perspective, and not to be suppressed by the conventional system, it would need to fulfil the form or “content” and substance or “spirit” of *Shari'ah*. It is possible that something is *Shari'ah* compliant, yet it is inconsistent with the broader *Shari'ah* objectives. There are many measurements for maintaining the *Shari'ah* form of compliance, such as: the investment activity (*halal*), the investment decisions (financial ratios), type of share issue (limitation on preference shares), and profit/risk sharing ratio. However, little (or comparatively less) is discussed on the *Shari'ah* substance: being valid and conforming to *Shari'ah* principles from the aspect of Islamic values/morals, which mainly deal with the relationship between the investors and the IFI (Abdul Mannan, 2002:213-215). These would include issues such as avoiding *Gharar*, which among other things means “misleading, deception, beguiling and delusion” (Nehad & Khanfar, 2016:3), avoiding *Jahala* or ignorance due to lack of disclosure/transparency, and moral hazard that affect the investor’s rights.

From my experience, during my work at the central bank, the popular form of Islamic private equity financing that offers High Net-Worth Investors (HNWI) the opportunity to invest is not simple and straightforward. The mechanism of raising capital for such financing is made by the IFI which creates a Special Purpose Vehicle (SPV) to pool the HNWI’s funds. The IFI pools the HNWI’s funds by selling to the HNWI’s portions (at times the majority/all) of their ownership in the SPV they created. The IFI, using the SPV, then invests in local/overseas project

companies. The SPV created is usually incorporated offshore, where the home regulator has no authority, and is not consolidated into the IFI financial accounts. The HNWI have no or minimal governance rights that are usually associated with equity ownership. In addition, the information flow and level of investor awareness appeared opaque. As a capital market regulator, where investor protection is key, such matters were of concern. This is where the motivation for this study is generated. Does the process (investors' expectations, entering into partnership, investing, initial and on-going reporting, etc.) of private equity investments taken up by IFI meet and conform to the Islamic substance of the format of such financing? This is particularly with regards to transparency and investors' rights.

The private equity financing relationship is characterised by information asymmetry. There are two levels of information asymmetry that can appear in a principal-agent framework (Abdlkhail & Presley, 2002:112):

1. Pre-investment: adverse selection problem whereby one party to the contract has less information than the other which can be mitigated by full disclosure of the proposed investment.
2. Post-investment: moral hazard occurs after the contract is signed and the agent acts in ways that enhance his interests at the cost of the principal. This problem can be resolved by ensuring transparency on the progress of the investment in accordance with the plan and by providing information on any failures in meeting targets.

The IFI and the investor have a principle-agent relationship and such a relationship gives rise to agency problems. The agency problems arise due to the parties involved having different goals which leads to conflicting behaviour. The agent's/IFI's interest is to maximise income (as it effects his performance fees), while the principal's/investor's interest is to maximise returns (Saam, 2007). Moreover, with such a private industry, not much is known about the on-going relationship between the investment/fund managers and the investors after they have entered/contracted into a private equity relationship. To the best of the researcher's knowledge, no research has studied the information related issues in Islamic private equity relationships. Past and recent studies have mainly been on conventional private equity and on the buyout model (Harris, Jenkinson & Kaplan, 2013; Gompers, Kaplan & Mukharlyamov, 2015), or on the values and returns of private equity (Gompers & Lerner, 1999; Cumming & Walz, 2010; Kaplan, 2005; Metrick & Yasuda, 2010; Komala, 2016). With regards to studies on Islamic private equity (IPE), there does not appear to be much research, other than in general, such as the IPE structure versus the conventional or on the industry and how to structure it, conducting

due diligence and dealing with business issues (Chatti & Yousif, 2010; Siddiqui, 2010; Elsiefy, 2014). In view of the relationship, most studies (including conventional ones) performed in the past on pre-contractual relationships examine how to arrive at an agreement that satisfies both parties. However, the post-contractual relationship is opaque and less transparent (Müller, 2008:5). Furthermore, Müller (2008) identified such a gap in the research area and accordingly undertook to study the on-going relationship between the financial institution and the investor (conventional). Yet, although her study was based on primary data, (unlike most of the other studies) the group of investors under study were institutional investors only. In addition, even though the Islamic model is based on the conventional model, most studies have been confined to the USA, UK, European and somewhat less in the Asian regions. Studies on IPE and the first-hand experience of investors (inclusive of individuals) in the GCC region are lacking.

Information, disclosure and transparency are important elements in the development and growth of financial markets in general and more so in the Islamic financial market due to the main elements of Islam stated above. On-going monitoring, updating and being transparent improves confidence, builds trust and helps in maintaining the flow of finance, which in turn would reflect positively on the growth of the Islamic finance industry and the economy. Therefore, for such an industry to grow and be *Shari'ah* compliant<sup>2</sup>, while maintaining the *Shari'ah* principles, and to overcome the technical challenges associated with the Islamic contracts that govern the mobilisation of funds, greater transparency, disclosure and understanding are required, even if it is a private form of investment. Furthermore,

“The uniqueness of such [financing] should lie not only in integrating economic, social and moral dimensions in every transaction but also in controlling their results and directing their consequences to achieve the desired economic and social welfare within the framework of the totality of the human situation at an earthly macro level and the dual notion of accountability (life on earth and life Hereafter) on the spiritual level” (Abdul Mannan, 2002:214).

Thus, with the intention of assisting the growth in this industry and such a form of financing, the aim of this PhD research is to study, within the GCC region, the issues arising in the relationship between the investors (both institutional and individual) and the IFI investing in IPE that affect the investor's rights and their compliance with the principles and goals of *Shari'ah*. As indicated, in an agency relationship the investor (principal) only knows what the

---

<sup>2</sup> The definition of “*Shari'ah* compliant” versus “*Shari'ah* based” is discussed in Chapter 3, section 3.6.5.

agent informs him of which leads to issues related to information asymmetry (highlighted above) and raises the following question: what kind and how accurate and/or complete information does the principal/investor receive? Hence, the interest in exploring the Islamic private equity relationship.

### **1.3 RESEARCH AIM AND OBJECTIVES**

The aim of this research is to explore the areas of weakness in the relationship between the investors and Islamic private equity firms in the GCC and suggest ways in which these can be strengthened. In this regard, the status of the issues related to transparency, *Shari'ah*, and regulation in the private equity relationships between the investors and firms will be examined. This will be done by collecting information through surveys with key stakeholders, which includes Islamic private equity firms, investors and *Shari'ah* scholars. Since this is one of the first studies on Islamic private equity finance, the study will provide insights into the weaknesses and strengths of this sector with the intention of suggesting policies to promote the growth of this industry. Moreover, to have a richer understanding of the issues, some insight from conventional investors' experience in private equity is also explored.

In an attempt to realise the aim of the study, the following research objectives are formulated:

1. To review the literature on private equity (PE) and identify the issues arising in the relationship between the investors and Islamic private equity (IPE) firms.
2. To identify certain specific issues related to agency problems and investors' rights from a transparency, *Shari'ah* and regulatory perspective.
3. To ascertain the views of investors regarding the specific issues (transparency, *Shari'ah*, and regulation) in IPE and assess their awareness of such issues.
4. To examine the operations of IFI (acting as an IPE firm) related to the specific issues of transparency, *Shari'ah*, and regulation.
5. To come up with some recommendations with regards to transparency, *Shari'ah* and regulations on improving the investor and IFI (acting as an IPE firm) relationship in IPE.



## 1.4 RESEARCH QUESTIONS

The research questions were sub-divided into three themes: transparency and information, *Shari'ah* and regulation of the private equity market. Accordingly, research questions were formulated to assist in framing the path of the study in order to achieve the aim and objectives of the research.

### A. Transparency and Information

- A.1. How do the FI and investors handle the pre-investment stage?
- A.2. What are the pre-investment regulatory requirements?
- A.3. How do the FI/investors handle the post-investment stage?
- A.4. What are the post-investment regulatory requirements?
- A.5. What are the investors' views on the investment relationship?
- A.6. What are the issues of concern in the framework of PE with regards to transparency and information?

### B. *Shari'ah*

- B.1. What is the FI/investor's/*Shari'ah* scholar's level of *Shari'ah* understanding?
- B.2. How is *Shari'ah* compliance maintained?
- B.3. What are the *Shari'ah* regulatory requirements?
- B.4. What are the issues of concern in the framework of PE with regards to *Shari'ah*?

### C. Regulating Private Equity Market

- C.1 What are the views of investors and IFIs on regulating the PE market?

Further details of the research questions and sub-questions are covered in Chapter 5, section 5.2.2.3.

## 1.5 RESEARCH SCOPE

While Islamic private equity initiatives exist in different parts of the world, the study focuses on the GCC countries due to the following reasons. Private equity had grown very rapidly in the GCC prior to the financial crisis, and although it is a reasonably new asset class in the GCC region, not much information is available in the market on private equity in general. It is a form of investment that is “driven by a closed network resulting in a restricted information flow...

the information environment still relies heavily on informal sources” (Strategy &, 2010:3). Moreover, the IPE projects that took place in the region prior to the crisis were offered/promoted by IFI to investors in the region. The investors who participated were from the region, rather than specifically from just one country. Thus, it was considered that by widening the scope of study to include the six GCC countries, the researcher would be able to get a better insight into the investors’ experience who invested in IPE.

Furthermore, while acknowledging the importance of the different aspects of governance and management of private equity operations, the focus of the research is on the relationships with the investors. Investors form a focal point in the study, as in private equity they play a major role even though it is not an active one. Nevertheless, they are the capital contributors. They play an important part in the relationship and in the development of this industry. Without their confidence and their awareness, the stakeholders’ awareness progress towards development in this market will be slow. The greater the awareness of the issues of concern experienced the clearer the route for the parties/stakeholders towards advancing the private equity market in general and IPE in particular.

## **1.6 RESEARCH METHODOLOGY**

As the purpose of the study is to explore issues arising in the relationship between the investors and the IFI, an inductive approach was taken up. The social constructivism and interpretive method, whereby the researcher’s own experience was bracketed out<sup>3</sup>, was employed. The triangulation method with a mixed model of combining qualitative and quantitative data collection and analysis techniques was used in the research. The data was collected through surveys using both the sampling and judgmental technique: sampling through networking and judgmental through approaching experts related to the area of study. The respondents were from the GCC region: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE.<sup>4</sup>

The sample was divided into three categories of respondents: investors, Islamic financial institutions (IFI) and *Shari’ah* scholars (ShSc). The first two were selected due to being part of the investment relationship to be studied, and the third (ShSc) was selected due to the study being related to IPE. Also, the ShSc’s input into the *Shari’ah* matters relevant to the research

---

<sup>3</sup> At the time of undertaking the research, the researcher was working at the Capital Markets Directorate at the Central Bank of Bahrain.

<sup>4</sup> Stated in alphabetical order.

was of importance. Moreover, as the IPE is similar to the conventional private equity (CPE), investors that invested in conventional private equity were also included within the sample of investors. The total sample size constituted 51 investors (35 IPE and 16 CPE), 15 Islamic financial institutions and 13 *Shari'ah* scholars who were interviewed. While investors responded to a set of questions from a questionnaire, the IFI and ShScs were interviewed. Details of the process of research and fieldwork are covered in Chapter 5, section 5.4.

The methods of analyses carried out were descriptive and inferential, whereby textual and content analysis was done on qualitative information and non-parametric statistics were performed on data that could be quantified. Details of the analytical methods used are discussed in detail in Chapter 5, section 5.5. The results and findings of the surveys are presented in Chapters 6, 7 and 8.

## **1.7 OVERVIEW OF THE CHAPTERS**

Following the introduction of the research aim, the questions and methodology above, this section provides a brief overview of the chapters of the thesis/research study. The thesis is divided into 10 chapters, of which the current chapter is the first. Chapters 2 to 4, in meeting the first objective of the study, set the basis of the research by reviewing the related literature to identify the issues arising in the relationship between the investors and IFIs investing in IPE. After which the appropriate research methodology and the research design was decided in Chapter 5. Chapters 6 to 8 report the results and findings of the three groups of participants under study. The findings are contextualised with the literature in Chapter 9 and Chapter 10 reports on the conclusion and recommendations of the research. A brief overview of the chapters is given below.

### **Chapter 2 - Private Equity in Conventional Finance (A Literature Review)**

The chapter defines and gives a brief overview of private equity as a form of investment. It looks into the various forms and the legal structure of private equity. The chapter then discusses the various theories related to the private equity form of investment. This chapter sets the basis upon which the Islamic private equity form of investment is compared to.

### **Chapter 3 - Private Equity in Islamic Finance: Principles and Features (A Literature Review)**

The chapter starts by giving an introduction to *Maqasid AlShari'ah* and the *Shari'ah* principles. It then also provides an overview of the Islamic economy and Islamic finance. After presenting various forms of contracting in Islamic finance, the chapter then looks into the similarities between investing in conventional private equity (CPE) and Islamic private equity (IPE). The chapter concludes with the challenges facing IPE.

### **Chapter 4 - Private Equity Regulations: Principles and Status in the GCC (A Literature Review)**

This chapter provides an insight into the various regulatory frameworks and different types of regulations in the market. It then looks into the regulations and governance of the private equity market, in addition to the *Shari'ah* regulations and governance. This is followed by a closer look at the private equity regulations and governance in the GCC.

### **Chapter 5 - Research Methodology**

The research framework, methodology and methods undertaken in the study to address the research questions are discussed in this chapter. It also provides an insight into the fieldwork undertaken and the challenges and obstacles faced during the research.

### **Chapter 6 – Investors' Approach to Islamic Private Equity Investment: Results and Analysis**

This chapter presents the results and the findings of the investors' response to the questionnaire. It displays the relevant descriptive and inferential analyses that were performed on the responses of the open- and closed-ended questions of the questionnaire.

### **Chapter 7 - IFI Approaches to Islamic Private Equity Investment: Results and Analysis**

The responses of the face-to-face interviews conducted with IFI were analysed and presented in this chapter. Specifically, the qualitative results and findings of textual and content analysis derived from the interviews are discussed.

## **Chapter 8 - *Shari'ah* Scholar Role in IFI Investing In Islamic Private Equity**

### **Investment: Results and Findings**

This chapter presents the results and findings of the responses of the face-to-face interviews conducted with *Shari'ah* scholars. It shows the results and findings of the textual and content analyses that were performed.

### **Chapter 9 - Contextualisation the Results and Findings**

In this chapter the results and findings of the participants in the study were interpreted and cross-referenced with the theories and literature reviews covered in the earlier chapters. The chapter shows how the research questions were addressed in the empirical part of the thesis by presenting, discussing and interpreting the results.

### **Chapter 10 - Conclusion and Research Recommendations**

The chapter gives an overall conclusion of the study drawn from the contextualisation and interpretation of the previous chapter. It reflects on the implications and recommendations derived from the study, the limitations, the possible future research and puts forward the researcher's suggestions.

## **Chapter Two:**

### **PRIVATE EQUITY IN CONVENTIONAL FINANCE**

#### **(A LITERATURE REVIEW)**

##### **2.1 INTRODUCTION**

Any form of development and growth within an economy, whether it be building bridges, recreation centres or starting up or expanding a business requires financial capital. Whether it be governments, firms or individuals they are not necessarily able to afford the required capital or even at times have the apt knowledge (the technical and legal knowhow, and the network connections). Private equity is a form of finance through which some of these deficiencies can be treated. Notwithstanding the dips the global private equity market encountered, following the financial crisis, it kept regaining momentum. Aggregate capital raised through private equity globally has, after having experienced a fall in 2003 to US\$74bn (from US\$207 in 2000) and then again in 2009, dropping to US\$208bn from a peak of US\$408bn, has regained its drive and reached US\$347bn at the close of 2016<sup>5</sup> (Prequin, 2017).

Private equity offers a source of capital/finance without placing an obligation such as guarantees and payment of fixed interest on the seekers of the funds. It provides assistance through the exchange of capital and guidance, in return for a stake in the company/partnership, sharing in the growth and returns generated from the investment. However, since the supporting role that the private equity form of financing offers, and because its methods are not well known, especially among entrepreneurs and in particular small and medium sized enterprises (SMEs), they fail to capitalise on such a form of financing.

This practice of investment partnership between a provider of capital and a business/entrepreneur owner (Labib, 1969), originates from the Muslim medieval period and despite its upturns and downturns, it looks to be a growing industry in the coming years. In their attempts to level with global developments, emerging markets are working to develop their infrastructure (government) and economy (entrepreneurs and government) to support growth. This requires offering opportunities to institutions and individual investors, and the

---

<sup>5</sup> The data covers all private equity investments, both conventional and Islamic. The researcher was unable to find information specifically on Islamic private equity.

private equity market (whether conventional or Islamic) to grow; provided that awareness and information about such a form of financing is improved and made more available. Therefore, to grasp and extend the achievements of the past, there is a need to increase knowledge and provide greater transparency on Islamic private equity financing, along with studying, identifying and improving any drawbacks that have occurred or may occur.

This chapter examines the literature on private equity in the conventional system, since the Islamic private equity forms have been derived from the conventional. The chapter starts by defining private equity and how the investment is transacted, to get a better understanding of the process of such an investment. This will help later when I come to study the private equity set-up practiced by Islamic Financial Institutions (IFI). It then reviews the issues generated from such a form of investment. After which it looks at the theories behind the possible causes of the identified concerns.

The discussions on literature on the different theories dealing with the problems faced by such investments, starting with the agency problems, followed by knowledge sharing and procedural justices, and interactionism are presented. The chapter then looks into the literature review of the contract theory, since the transaction/relationship is a contractual one, before it ends with a conclusion.

## **2.2 DEFINITION AND BRIEF OVERVIEW**

In this section private equity is defined and its legal structure and the relationship between the investment parties are presented. The section also touches on Alternative Investment Schemes, since this appears to be the way that most regulators are moving towards, especially after the recent financial crises (2007/2008), of which private equity is considered to form part of such schemes.

### **2.2.1 Private Equity**

Private equity deals with investing in non-public companies. It is basically where investors, usually private and public institutions, and High Net Worth Individuals (HNWI) invest in the private company with large sums of money for a reasonable period of time. These companies are usually in need of funds, either due to being new start-ups with new technologies, or already

established companies that require some injection of working capital to grow, or companies that are experiencing difficulties and need to be bailed out and turned around.

Various stages of funding are labelled differently. Investing in start-ups is referred to as Venture Capital. While injecting working capital is known as minority equity investment, investment in mature companies is referred to as Growth Capital. Leverage Buyouts (Cumming & Walz, 2010) is where equity investment from private investors, along with some debt leverage is used to buy a company, turn it around, improve on its balance sheet and its management, and then sell the company off as an exit strategy. There is also a form of Mezzanine Capital, which has a debt structure rather than equity, whereby the investors invest in subordinated debt or preferred stock of the company, without taking voting control of the company.

Nowadays, most investments of private equity are made through Private Equity Funds (PEF) or Private Equity Funds of Funds (PEFF) as investors do not have the time and/or knowledge of various potential investing markets (Cendrowski et al. 2008) (Müller 2008). In the PEF the investors with the managers come together in a form of partnership. The funds are pooled into a separate legal identity created by the investment manager as a result of the partnership with a specific purpose for a set investment mandate. In the PEFF, the investors rather than investing in the asset class directly, by partnership they invest through the intermediary, the investment manager (the private equity firm) (Talmor and Vasvari 2011).

The private equity firm/fund (whether by acting as a vehicle or by creating a vehicle) pools the funds and acts as a General Partner or an Investment Manager in return for a management fee. The Private Equity Firm with the pooled funds from the investors, and at times some of its funds, works on achieving the mandates of the investment, which could be acquiring an interest in a company. “Once the target amount of capital has been raised ... The private equity investment managers then seek high-growth companies to invest in, following the investment strategy they proposed to the institutional investors” (EVCA, 2007:10).

Those that invest in private equity realise their investments usually in one of the following ways: selling the company to the public through an initial public offering, selling the company to another company (a strategic buyer), merging with another company, and recapitalisation and changing the capital structure of the company (Cendrowski et al. 2008). Whereby the portfolio

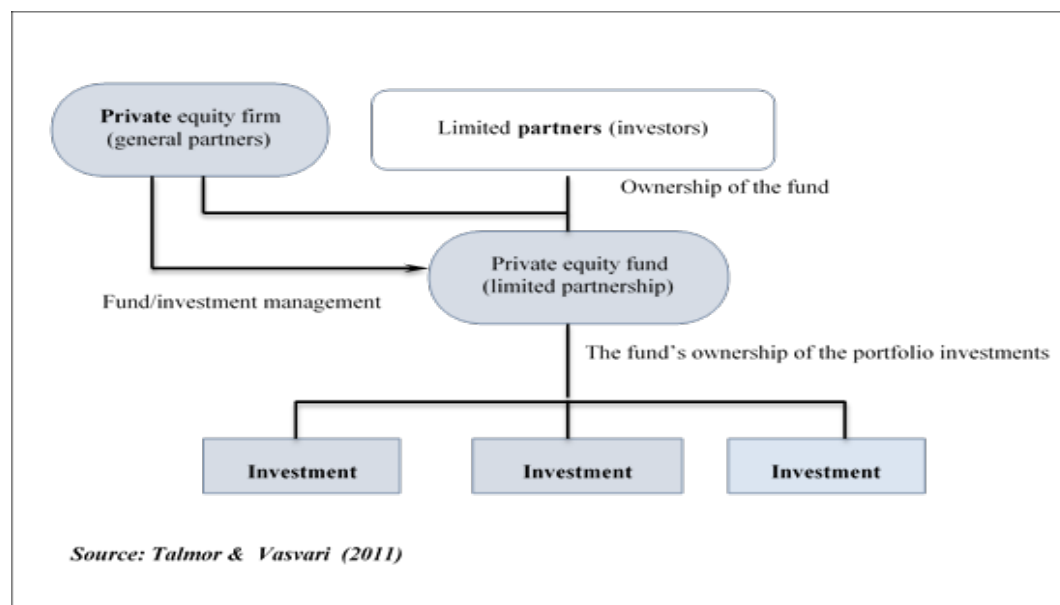


company raises debt or issues other securities to pay the shareholders (the private equity owners).

## 2.2.2 The Legal Structure

The private equity fund is usually set up in the form of a limited/closed company with a limited life (a Special Purpose Company), where the company is not required to have a board of directors or to hold yearly meetings (Cendrowski et al. 2008). Usually the private equity firm is referred to as the General Partner (GP) and the investors are referred to as Limited Partners (LP). They are referred to as Limited Partners as their liability is limited to their capital investment. The LP and GP come together through an agreement/contract that is signed between them.

Figure 2.1 - Structure of a Private Equity Investment Vehicle



The terms of the contract between the GP and the LP usually cover: the terms of the partnership; the management fee; the performance incentive; the hurdle rate of return; the transfer interest of the fund; investment commitments made by the LP; and the investment restrictions set on the GP.

The term of the partnership is usually between 8 to 12 years. It may be less, around 3 to 5 years, depending on the selected investment and the exit strategy. The management fee is in the range of 1.25% to 3% of the collected capital. In addition to the management fee the GP receives an

incentive fee, which is also referred to as carried interest, as it is a fee used to carry/hold the GP interest on the investment. This carried interest usually ranges between 15% and 25% of the gain made on the capital. The remaining 75% to 85% is distributed between the LPs on the basis of their contributions. The hurdle rate is the benchmark rate set based on the percentage gain made above the capital invested, and once reached, the incentive/performance fee is triggered. The hurdle rate is usually around 7% to 8% above the capital invested.

The GP manages the funds, and has the day-to-day management of the portfolio companies, or at times it outsources it to expert firms, while having some of its people in management or on the board of the portfolio companies. They are restricted to the type of investments as per the requests made by the investors at the time of the agreement. However, the LPs are more passive and have limited involvement in the daily management of the portfolio companies. The agreement usually sets the schedule (time and amount) for when the LPs would need to provide the funds.

Investment in private equity is illiquid. Once in the investment, the LPs cannot sell and usually cannot transfer their share of the equity. Some private equity investments allow transfers, but with restrictions. Thus, the LPs can usually only realise their investment through the exit strategy taken up by the private equity firm.

### **2.2.3 The Relationship between the Limited and General Partners**

As mentioned earlier, the LPs usually hand over the management of the investment to the GP. In order for the LPs to do so, the LPs need to see that the GP's interests are in alignment with their interests. This is usually achieved through the following (Talmor and Vasvari 2011).

- **Reputation:** The LPs look into the experience and skills of the investment team of the GP. The track record (performance and diversity) of the GP is very important. Today most of the PEF have around 200 professional employees, from various fields of the private equity industry, ranging from Financial Experts, Accountants, to Investment Strategy Consultants.
- **Equity Interest:** The GP needs to show some form of commitment and that is usually done by the GP investing in the portfolio companies. "The LPs prefer that any

commitment and investment is made in real cash and not from the recycling of management fees” (Talmor and Vasvari 2011).

- Incentive scheme: It is important that the various forms of payments that the GP receives are transparent to the LGs. Usually, the GP receives a management fee, and a carried interest fee (as mentioned earlier above), which is set based on performance above a set hurdle rate. With all the fees set and determined at the outset, the LPs have certain comfort when making and selecting investment decisions.
- Direct control mechanisms: LPs seek partnerships where they are able to place protective mechanisms that affect the incentives of the GP, and can place a cap on the risk/returns performance of the GP’s decisions. LPs seek to set covenants that have restrictions on the investment decisions, beyond a certain threshold, so as to limit the risk the GP might take in the investment.

In addition to the LPs and the GPs there are other market participants involved, that the partners seek, that help to bring the investment together. There are advisors and agents that act as intermediaries. Some of which are: Investment Banks offering advice on matters such as the structure, pricing, and timing of the investment to both parties (LGs and GP); Placement Agents, who help in the fund raising process, in return for a fee (0.5%-2% of the funds raised); and other advisors, such as Legal Advisors that provide advice on the contracts of the transaction.

#### **2.2.4 Collective Investment Schemes**

Collective Investment Schemes (CIS), also known as mutual funds, are schemes or financial intermediary funds whereby investment companies (acting as a financial intermediary) offer investors an opportunity to pool their funds for investments, in return for a portion of the fund’s performance, proportionate to their share of pooled funds, in return for a fee. Investments are made in various schemes such as real estate, hedge funds and private equity, rather than the straightforward (mutual fund) stocks and bonds type instruments that are traded in a financial market. Investments are made in various sectors of the industry (Real Estate, Technology), with various investment purposes (growth (capital appreciation), income (dividend), balanced (growth and income)), the specifics of which are disclosed in an offer document, prepared by the investment company.

A CIS is set up as a legal entity, either as a trust or a corporation, with a board of directors (BOD), who are mainly independent, and have a fiduciary duty/obligation to the entity. The BOD contracts with a management company (the creators/sponsors of the fund) to set up and manage the shareholders' pooled funds, who are also known as the Investment Advisors (IA) of the fund. The IA receives an annual fee in return for his services, based on a percentage of the average net assets of the fund. There are other parties involved in the operation of CISs that form part of the requirements placed by the Regulators of such a market. The CIS does not have employees of its own; they contract with independent parties to perform the roles required for the organisation and operation of the CIS. In addition to the BOD and the IA, CISs are required to have an Administrator, a Custodian, and a Transfer Agent. The Administrator oversees the performance of the services provided to the fund (accounting services, payments, meeting regulatory filing requirements and providing reports to shareholders). The Custodian's role is to protect the assets, and is usually a qualified bank. While the Transfer Agent performs the role of record keeping of the shareholders' accounts. They maintain the shareholders' ownership balances, and calculate and distribute dividends (Pozen 2000).

For a CIS to be offered a prospectus (offering document) is required, with detailed disclosure, which is registered with the regulatory authority and where a no objection to use the documents is obtained. Shareholders are entitled to receive regular (semi and annual) reports on the performance of the fund. Shareholders have the right to vote on major decisions to be made by the fund, such as changes in the terms of the Investment Advisor's contract, and changes to the investment objectives/policies/purpose. CISs can be set up as a result of funds pooled from public investors or funds from institutional and high net worth investors.

There are two types of funds: open-ended or closed-ended. With the closed-ended funds, once the funds have been pooled, and the investment has been made, the fund issues shares/units that are then traded on an exchange for the life of the fund. The price of the fund is determined as the market value in the secondary market. While with the open-ended fund, the fund remains open to pooled funds and the redemption life of the fund is open. It is not traded in the secondary market, and the investor (share/unit holder) can redeem his portion of ownership at the net asset value (NAV) with the investment company.

The investment companies that manage the pooled funds receive fund management fees. Under the closed-ended fund, the fee is taken once, for their efforts in setting up the fund; and after

that the fund is traded in the secondary market. However, under the open-ended fund, two management fees are taken. One at the time of setting up the fund (known as front-end load), and the other at the redemption/exiting of the fund (known as back-end load). The redemption fee reduces over time, so as to discourage early exiting from the fund. These fees are considered sales incentives rather than management performance incentives. The investment company charges an annual management charge for administrating the fund (Solnik and McLeavey 2003).

Private equity is considered an alternative form of collective investment scheme, with the similar concept of pooling investors' funds. As such, the CIS (similar to private equity) faces a potential conflict of interest arising from the fiduciary relationship between the parties involved in the organisation and operation of the CIS. However, the CIS are more regulated in that they have regulatory obligations to meet in setting up and running the CIS than in private equity. The regulations related to private equity will be reviewed later in Chapter 4 of the Literature Review.

### **2.3 THEORIES ABOUT THE PRINCIPAL-AGENT RELATIONSHIPS**

This section looks into the various theories that arise due to the fiduciary relationship between the parties investing in private equity. It first examines the agency theory and the asymmetry in the agency relationship, since the parties in private equity investment take up arrangements similar to those of the principle-agent relationship. Subsequently, the formal and real authority theory is discussed, reflecting on the matter of power and control that arises in the private equity relationship. Furthermore, following on from the asymmetry in the relationship, both in terms of information and power, leads to how such a conflict of interest in decision making can be handled. As such, the study of the knowledge and procedural justice theory was looked into. Moreover, with the private equity investment relationship, it is not purely a question of structure and governance but also involves social interaction; hence, theories related to interactionism matters on how individuals act, react and communicated with one another are studied. The chapter ends by looking into the contractual theory, since the private equity relationship is based on a contractual agreement between parties.

In the private equity investment, several issues arise that are related to the fiduciary relationship between the parties. The parties in the private equity investment take up an arrangement similar to that of the principal agent relationship. This relationship is based on a contractual agreement between the parties, where one party (the agent/GP) undertakes some actions/activities on

behalf of the other party (principal/LP). In such relationships, the main issue is the alignment of the self-interest, risk levels, and goals of the parties involved. This alignment is characterised by information asymmetry, which gives rise to moral hazard and adverse selection. Thus, to gain a better understanding of the principal-agent relationship, their related theories will be discussed in this section.

### **2.3.1 Agency Theory**

The agency theory is based on the assumption that both of the parties are utility maximisers seeking their own interests, where the principals are considered risk neutral, in that they are able to diversify their investments into other investments, and the agents are considered risk averse, since the agent's services and income are tied in the current investment (X.-B. Zhang, Zhang, and Chen 2007).

Fama and Jensen (1983) examined the agency problem through a study of their concerns on “the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions” (Fama and Jensen 1983b). This problem or cost, according to them, arises due to the attempt at separation between ownership and control.

“These [Agency] problems arise because contracts are not costlessly written and enforced. Agency costs include the cost of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests, plus the residual loss incurred because the cost of full enforcement of contracts exceed the benefits” (Fama & Jensen, 1983a: 327).

These contracts specify the rights, performance criteria, risks, payoffs and benefits between the agents (parties involved). Usually the risk borne within these contracts is by those “who contract for the rights to net cash flows”, the investors. Fama and Jensen (1983b:302) refer to this risk as “Residual Risk” and the residual risk bearers as “Residual Claimants”. According to their view, for the residual claimants to control the residual risk there needs to be separation between ownership and control, in order to minimise the conflict of interest that might arise with the managing agent.

They consider that there needs to be separation between the “decision management” and the “decision control”. They look at the decision process as being: initiation, ratification, implementation, and monitoring. According to Fama and Jensen (1983b), initiation (the proposal and the structure of the contract) and implementation (the execution of the decisions

made) are considered as part of the decision management; whereas ratification (the choice of decisions made) and monitoring (the performance measurements and the linked rewards) are considered as part of the decision control. However, Baker, Gibbons, & Murphy (1999) maintain that the management decision process only has two steps: initiation and ratification. Their view is more simplistic in that the subordinate initiates the exploration for project proposals, and the superior ratifies the selected project.

According to Fama and Jensen (1983b), one of the ways to reduce the agency problem is by restricting residual claimants to decision makers. However, by doing so the benefits of specialisation and efficiency are lost. Also, it means that the decision makers need not only possess wealth but must also be specialised and familiar in the area of investment, to be able to make proper decisions. This is fine (restricting residual claimants to decision makers) when the “technology involved does not involve important economies of scale that lead to large demand for specialised decision skills” (Fama & Jensen, 1983a: 333), as in such instances the savings from the agency cost outweigh the benefit that would have been obtained from separating (and specialising) decision and risk bearing functions.

However, in more complex technical/specialised organizations specific knowledge is essential in decision making. In such instances, according to Fama & Jensen (1983a), the Residual Claimants are better off delegating the decision functions to various agents and the decision making can be diffused among the various levels of the organisation, with an independent multi-member board of directors/trustees at the top of the hierarchy/control system. That is possible with proper internal controls and when various agents are independent; along with having an incentive mechanism that rewards agents for “initiating and implementing decisions and for ratifying and monitoring the decision management of other agents” (Fama & Jensen, 1983b:322). In such a way, by making use of the experts at various steps in the decision process, the conflict of interest aspect in the decision being made by the agent (management) is reduced, in that the decision is not made by the individual but by opinions given by independent experts. This expertise might be costly, yet it outweighs the benefit gained from allowing “valuable knowledge to be used at the points in the decision process” (Fama and Jensen 1983b). Baker et al. (1999), on the other hand, argue that rather than delegating formal authority within the organisation as suggested by Fama and Jensen (1983b), it should be in between. They believe that in order for the subordinate to have formal delegation rather than just managing the asset, the subordinate should be allowed to have ownership of the asset.

Band (1992:457), in line with the above thinking, believes that the “Board of directors is one of the governance mechanisms that limit the agency’s self serving behavior”. Citing Pearce and Zahra (1991), he identifies four types of boards of directors by looking at them from the perspective of the board’s relationship with its executive management. These are: Statutory board, caretaker board, proactive board, and participative board. Whereby the types ranging from full decision making and control (statutory) lie with the board which is similar to Fama and Jensen's (1983b) thinking, to equal decision making and control with the executives (participative) and so spreading of ownership which is in line with Baker et al. (1999).

While the separation of control and decision making proposed by Fama and Jensen (1983b) introduces agency costs, it also produces risk sharing benefits. This separation, according to Klein (1983), is not necessarily positively correlated (as claimed by Fama and Jensen 1983b) to the size of the organization: “small organizations are more likely to exhibit no separation of residual claimants from decision makers” (Klein, 1983:371). Whereas in large organizations “the cost of obtaining [risk-sharing] benefits is essentially zero because nothing is forgone” (Klein, 1983:373). The structure of private equity investment, where the project-specific information required for decision making rests on a few people, is considered a non-complex organisational setup in which “the costs of separating decision management from decision control are high” (Fama & Jensen, 1983a:346). Moreover, in investments of private equity, not only would separation appear to be costly, but also since it is not a public investment, the Board Members are generally chosen/selected by the internal managers (GP) and the independence factor is diluted.

### **2.3.1.1 Asymmetry in the Agency Relationship**

Agency problems mainly arise due to the agent having private information that the principal does not have or is not aware of. This gives rise to adverse selection, whereby the principal cannot differentiate between a good or bad agent, and to moral hazard where the agent uses the information to maximise his utility and interest. Zhang & Zhang (2009:388) highlighted that Muller (2008), like Kut and Smolarski (2006), believe that the “principal and agent are different interest groups in private equity investment” and that the “information asymmetric is the root of the agent’s problem in private equity investment”. Thus, with the specific features of private equity investment, where independence is limited and asymmetry subsists, information communication becomes a critical factor and one of the main issues of this relationship.



Sapienza & Korsgaard (1996) explains that this relationship is controlled by the GP (the agent) and is limited due to the personal and professional reasons of the GP. From a personal perspective, the GP being the owner of the investment idea desires the freedom to determine one's decision and seeks to enjoy the power of "information advantage" over the LPs. In addition, if a regular exchange of information does not exist, the GP is not forced to relay a negative or delay in performance of the investment project to the LPs. While from a professional perspective the GP sees the act of maintaining a regular flow of information as costly and time consuming.

Saam (2007), on the other hand, considers there to be three main asymmetries in the principal/agent relationship. The first being information asymmetry, which following on from the agency problem is the sharing of information problem. The flow of information within the relationship between the agent (GP) and the principal (LP) is usually limited, due to the similar explanation given by Sapienza & Korsgaard (1996) above. He then goes on to add a second asymmetry in that both the GP and LP have different risk preferences as they have different attitudes to risk. The GP's (agent) attitude is more outcome based, whereas the LP's (principal) attitude is behaviour based. As a result of their attitudes their goals are different. The agent seeks to maximise income, whereas the principal seeks to maximise returns, leading to asymmetry in goals, which is the third inequality in the agency relationship.

The normative agency problems that arise from the agency relationship are moral hazard and adverse selection. The moral hazard problem is basically due to the conflict of interest, different risk and goals (intentions) between the parties to which it is not disclosed and the adverse selection is mainly to the agent holding back private/personal information from the principal. Spremann (1990, cited in Zhang & Zhang, 2009) adds another type of agent risk, "holdup", to the two known in the normative agent set of risks. Holdup is where the agent uses the "gaps or deficiencies in incomplete contracts, where not every future state is predicted in his favor" (Zhang & Zhang, 2009). Moreover, Kaplan & Stromberg (2004, cited in Zhang & Zhang, 2009) consider "control risk" in addition to holdup, where agents and principles do not agree on the "operating decision-making", as a fourth agent risk.

Further studies have shown that the simple normative agency that starts with mainly two problems (moral hazard and adverse selection) and considers additional issues (holdup and control problems) has developed into what is known as the positive agency theory (Saam 2007)

with four agency problems: hidden action, hidden intention, hidden knowledge/information, and hidden characteristics. By studying them, various mechanisms such as incentive systems and monitoring systems can be considered, and precautionary steps such as signalling, bonding, and screening solutions can be taken, depending on the situation.

Waterman & Meier (1998) add a new perspective to the asymmetry features of the principle-agent relationship. They consider the principal-agent model as a “more dynamic” model and that information asymmetry and goal conflicts are not constants, but variables. Numerous types of the principle-agent relationship exist, along with there also being multiple principals and agents, and as such these components, information asymmetry and goal conflicts change as the relationship progresses. As Crémer (2010:380) states, “at the outset, neither the principal nor the agent know anything about either of the quality of the agent or his cost parameter”, and so keeps an “arm’s length” relationship, however, over time the principal learns and gains information, and develops and expands his resources, through his interaction in the relationship. They suggest a model with eight scenarios (cells) that the principal-agent goes through, not necessary in all cases, as their relationship evolves.

Looking at the agency problems generated by the agency relationship from the above perspective has been criticised as still being narrow. Band (1992) considers the agency theory “ignores the ways in which exploitation can be structurally encouraged by the asymmetric distribution of power”. Both Perrow (1986) and Saam (2007) look at the asymmetry of power when looking at the agency problem and solution mechanisms. According to them, power is the “intervening variable” and it depends on which party (principal/agent) has the greater power to influence/action and change the “belief, attitude or behaviour” of the other party (principal/agent). Saam (2007:836), however, considers that “the Principal possesses quantitatively more power bases than the agent”, which is not the case in the private equity relationship. Power is of importance, but in the private equity set-up, it lies more in the hands of the GP (Agent) rather than the LP (Principal). Usually it is the GP of private equity who brings forward the offer, and the contract/agreement is drawn up by the GP, and the LP accordingly subscribes to the offer. The LP “has very little control over what the capital is used for and usually very little right to replace management - or other such remedies - subsequent to poor performance” (Spindler, 2009:329).

### 2.3.2 Formal and Real Authority Theory

Having identified power as an important variable in the agency relationship leads to who has authority in the relationship. There are two forms of authority: formal authority and real authority (P Aghion and Tirole 1997). We would consider those with ownership of the assets to have formal authority and those who have “an effect control over decisions, on its holder” to have real authority. This brings us back to Fama & Jensen (1983b) separating decision and control. The principals (LPs) might have formal control being the owners of the funds, but by delegating the management of the private equity to the agent (GP), the agent has the real control (Aghion & Tirole 1997).

There are benefits to delegating formal authority. Such delegation “increases the agent’s incentives to acquire information” and hence “reduces the principal’s overload” (Aghion & Tirole 1997:3). It also “facilitates the agent’s participation in the contractual relationship”, however, by delegating the principal loses the selection process of “choice project” (Philippe Aghion and Tirole 1997). Moreover, if the objectives of the parties are “sufficiently dissonant” the principal also faces the problem that the agent might not be keen to provide/communicate information to the principal due to his fear of the principal taking ownership of the agent’s (GP’s) investment. Riordan (1990, cited in Aghion & Tirole 1997:4) argues, “information allows principals to expropriate the agents’ specific investment”. Further, Aghion & Tirole (1997:3) assert that:

“The communication of information is then strategic and depends on the authority relationship. In particular, less communication may take place if the principal has formal authority because the agent is concerned that the principal might abuse [agent’s] authority once [the principal] is well informed.”

The agent will communicate information to the principal if he sees any gain in doing so and on “the degree of congruence between the principal’s and the agent’s objectives” (Aghion & Tirole, 1997:18). The principal by delegating his formal authority to the agent ensures the agent’s participation/effort. Aghion & Tirole (1997) see that the delegation of formal authority to the agent increases the agent’s initiative and participation, which is positively proportionate to the agent’s private incentive/benefits. The agent’s initiative is inversely proportionate to the principal’s interference, as the greater the principal’s interference the less the agent’s participation/effort and as a consequence, there is a fall in the expected returns for the principal. The role of authority interchanges depending on the situation. Under delegation, “the

independent agent”, if informed, picks his preferred project and cannot be overruled by the principal. That is the agent, rather than the principal, who now has formal authority.

On the other hand, while Baker et al. (1999) agree with Fama & Jensen (1983b), in that “formal authority resides at the top”, and on the concept of separation between decision management and decision control, they also agree with Aghion & Tirole (1997) with regards to delegation, yet to them delegation would be informal rather than formal. The view of Baker et al. (1999) is that formal authority is “inherently non-contractible” and that the superior delegates his rights to the subordinate as a form of incentive. The superior gives informal delegation to his subordinate, even after instances where bad decisions were made, and the superior had had the ability to override such a decision, but does not do so. This is because they believe not only as Aghion & Tirole (1997) do, that by doing so would encourage the subordinate to improve on his project selection and such benefits offset the cost of poor projects, but also that the superior behaves in such a manner because he seeks to maintain his “reputation” as a delegator. Their expectation that the subordinate will improve in his selection of projects and is not tempted to shirk or seek self-interest, is based on him wanting to build his reputation with his superior. Thus, they model their delegation authority “as informal, arising from commitments enforced by reputation” (Baker et al., 1999:18).

### **2.3.3 Knowledge Sharing and Procedural Justice Theory**

The information seen above is an important factor and the lack of it, or the asymmetry of information between the parties has an adverse effect on the agency relationships. However, what is also important is the form by which the information is shared, whether it is compulsory, due to formal requirements, or voluntary (by the individual self). Sharing information may be compulsory at times, but if the individual is not voluntarily cooperative and willing, then the quality of the information and the effort by the individual is not as good. Kim & Mauborgne (1998) consider trust and commitment as essential towards voluntary cooperation. If the principal can show the agent that he trusts him, then the principal will most likely gain the agent’s commitment and voluntary cooperation, which is similar to the thinking of Baker et al. (1999) with regards to the reason for continuing to give informal delegation, in the expectation of maintaining commitment.

“Procedural justice [...] is concerned with individuals’ reactions to decisions in which they are personally invested but that they cannot directly or fully control” (Sapienza & Korsgaard, 1996:547). According to Kim & Mauborgne (1998), in most cases, having agreed upon the process for decision-making, then their execution is a form of mechanism that deals with the conflict of interest that may arise between the agent and the principal. The agent by accepting and implanting such procedures gains the principal’s trust and the potential moral hazard, because the possible conflict of interest, is reduced. Sapienza & Korsgaard (1996) also view procedural justice as influencing principal agent behaviour, and that it produces greater commitment and trust, and in some instances there is less monitoring by the principal. They studied it from the angle of the principal and his behaviour and commitment to the investment. They performed a laboratory experiment as well as a field study where they used procedural justice theory to see the investors’ (principals’) reaction to the entrepreneurs’ (agents’) feedback. They looked at it from the aspects of the fairness of procedural justices, the timeliness of feedback, trust and the commitment of the investors. They concluded that “feedback, influence, and procedural justice are important determinants of investor [principal] behaviour and attitudes” (Sapienza & Korsgaard, 1996:571).

To handle the agency problems through either separating decision control from decision management (Fama and Jensen 1983a) or through the delegating of authority (Aghion & Tirole, 1997), with both parties acceptance relies on the procedural justice agreed between them. Kim & Mauborgne (1998) “build a bridge between procedural justice and voluntary cooperation [and trust]”. When the principal and agent are both involved in setting the strategic decision-making process and where the process is clearly understood, the expectation is clearly a sense of belonging and loyalty leading to willingness to “override personal self-interest on behalf of the [relationship]” (Kim & Mauborgne, 1998:327).

Kim & Mauborgne (1998:333) build on the “intellectual and emotional recognition theory of procedural justice”. The theory is built on multiple sources: self-interest concerns, group-value concerns and proper human conduct concerns. Procedural justice is valued because it “recognizes individuals for their intellectual and emotional worth irrespective of their hierarchical level” (Kim & Mauborgne, 1998:332). Therefore, if the agent can be made to feel valued for his intellect and expertise this could lead to voluntary cooperation of information sharing and commitment by the agent. By having fair procedures (procedural justice), it “can serve as a key feature of a new social contract” (Kim & Mauborgne, 1998:336) between the agent and principal that goes beyond self-benefits. Leventhal (1976) agrees with Kim &

Mauborgne (1998) on the participation in the decision-making, however, where Kim & Mauborgne (1998) look at it from the intellectual and emotion aspects, Leventhal (1976) “conceptualizes” procedure fairness in seven elements. He believes that there should be procedures for all steps in the chain of the relationship, with the ability, at the end of the chain, to alter the procedures based on experience. The seven sets of procedures are: selecting of agent procedures, setting ground rules procedures, gathering information procedures, decision structure procedures, appeals procedures, safeguards procedures (measures set to ensure “the decision-making body does not abuse its power” (Folger & Greenberg, 1985:146), and change mechanisms procedures (measures set to ensure “the possibility of correcting unfair situations” (Leventhal, 1976:21).

Having fair procedures also demonstrates some form of communication between the parties concerned (principal and agent). With procedural justice, as per Leventhal (1976), there are six rules that could be used to test the fairness of the procedures. These rules are: “consistence”, “bias suppression”, “accuracy”, “correctability”, “representatives” and “ethicality”. This means the procedures need to be fair to all; applicable to all; and to be consistent with moral and ethical values.

Rawls (2005), on the other hand, while in line with the concept of accepting the outcome “provided procedures has been properly followed” (Feinberg, 1972:1026), talks of three forms of procedural justice. They range from perfect procedural justice to imperfect procedural justice to pure procedural justice. The perfect form is based on their being an independent criterion to what constitutes a fair and just outcome and where having procedures guarantees fair achievable outcomes. With the imperfect form it is also based on the independent criterion, yet no procedures guarantees a fair achievable outcome. However, in the pure form of procedural justice there is “no criterion to what constitutes a just outcome other than the procedure itself”. In the principal-agent relationship, we would consider the imperfect form. Since there is no guarantee that the outcome will always be favourable to both parties, the fairness of the process makes it acceptable to both parties to enter into the relationship and to accept the risks involved.

As can be seen, it all depends on the fairness of the procedures. So the question arises: what determines fairness? Following on from Leventhal (1976) above, where he has given six rules to test fairness, Rawls (2005) proposed three models upon which the fairness of the procedures is determined. The first is the outcome model in which fairness is based on outcome. The

principle of this model is that the fairness of the process depends on the procedure generating the right result. However, there are limitations to this model, in that it is not always the case that equivalent outcomes are always generated/arrived at by following the fair procedures.

The second model is the balancing model. This is where fairness is achieved by balancing between cost, procedures and the benefits of the procedures among the parties involved. Even by attempting to balance the costs and benefits, there are times when some procedures/fairness are compromised. The third model is the participation model in which fairness is achieved by allowing those involved/affected to take part in decision-making, and creating and agreeing on the process to be used to make decisions. In the case of the principal–agent relationship, this is the management agreements.

There are various theories with regards to procedural justice, and some of them believe that fair procedures lead to a fair outcome. Looking at it from this context, this can also be applied to the principal-agent relationship in that if an agreed process of decision-making with regards to operating the company/project is in place and if it is followed by the agent, then whatever the outcome (good or bad) it will be accepted by the principal. The principal would not suspect that the agent might have made conflicting decisions. There would be some form of trust.

### **2.3.4 Interactionism Theory**

The interactionism theory looks at the behaviour of individuals, how they act, react and communicate, as a result of their interaction with one another or within a group (Turner 1988). Thus, it needs to be looked at with relevance to the issues pertaining to the agent-principal relationship and can be discussed under the different headings given below.

#### **2.3.4.1 Moral Hazard and Ethical Considerations**

Following on from the agency problem, a way in which the GP can maintain the LP's trust and continuous financial support is by maintaining the information and feedback flow with the LPs. This is based on the fact the GP, by reducing the lack of information (information asymmetry) barriers, gains the trust of the LPs (Sapienza and Korsgaard 1996).

According to the agency theory, self-interest behaviour (adverse selection) is affected by the quality and quantity of information shared between the parties in the relationship (organization). Moral hazard comes in when one of the party's reactions is based on self-interest or when he decides to shirk while hiding his actions by holding back information from the other party. The agency theory is based on the general belief that one will always act in his self-interest, as this is part of human nature. However, that is not always the case. On the contrary, when looking into human nature there is also the aspect of ethical behaviour to consider. "Ethical considerations are good predictors of [agent's] behaviour when moral hazard exists" (Tuttle, Harrell, & Harrison, 1997:20).

Having looked into the concept of trust and fairness (procedural justice), it is expected that some form of loyalty starts to form and the parties involved (more specifically the agent) develop a sense of belonging, an obligation to act in the interest of their company (project). The agents with whom the moral hazard behaviour is feared becomes "socialized into the organizational role" (Tuttle et al., 1997:12). As such, this brings another variable to the basic equation of the principal-agent theory. Ethical consideration is a dimension in the process that needs to be considered when decisions are implemented in a relationship (organization).

According to Tuttle, Harrell, & Harrison (1997), ethical decisions vary according to the individual's understanding, to the individual's community's (society) acceptability, to its legality and to its morality. Studies were conducted to see an individual's behaviour. Classifications of the study were based on two categories: normative and contextual. Whereas normative is based on how individuals are expected to behave under "normative standards and justifications of morality" (Tuttle et al., 1997:12), contextual is how individuals actually behave given the circumstances. Tuttle et al. (1997) introduced the "factor dimension" to measure ethical aspects. The measuring factor had three dimensions: moral-equity, relativism, and contractual dimension. Under the moral-equity dimension the individual looks at it based on whether his behaviour is acceptable, fair and moral with one's self. With relativism, the individual looks at his actions relative to the guidelines of his society's system, relative to his culture. And in the third dimension the individual compares his actions to his contractual obligations. Thus, basically, it is a process that starts within one's inner self, the nucleus (own values) and moves outwards to the immediately outer circle (his community), and then further out to what is on paper (the agreement). It was found that "individuals rely on patterns of criteria in evaluating situations that are similar to their pattern of criteria in estimating their own



behaviour” (Tuttle et al., 1997:13) and the individual would “use more than one rationale in making ethical judgments” (Reidenbach & Robin, 1990:639).

There were other findings where agents would place their self-interest first, but that was with agents of low levels of “moral developments”. This means at least two things. The first is that “the agency theory assumption that behavior is motivated solely by self-interest may be invalid” (Chang & Yen, 2007:356) and “integrity” plays an important role. This is because it is only related to a certain category and not across the board. While at the same time, being “agents of [...] moral development” suggests that there is room for development of one’s agent, possibly through socialising him within the organisation (relationship). This leads to the need to “incorporate an ethical perspective in [agent] compensation” (Chang & Yen, 2007:357) when drawing up the agreement.

#### **2.3.4.2 Trust and social culture**

A social relationship works on reducing the gap between the principal and the agent. It works on building a form of understanding between the parties in the relationship. This understanding is arrived at through considering: individual differences, social economics perceptions, and ethical values. It is what is known as trust, and what is also known as “soft moral bonds” (Sztompka 2003). Although in the literature there are various definitions of trust, in general, it is where some risk exists in entering the relationship and there is “mutual confidence that no party to the exchange will exploit the other’s vulnerability” (Sabel, 1993:1133). The idea of mutual confidence relates to the culture, the belief in one another, the lack of need for some form of precautions and the belief in the word agreement/handshake. “Trust culture accumulates and codifies into rules those prevailing, lasting experiences with various type of trust” (Sztompka, 2003:99). Different societies with different cultures have different levels of trust. There are cultures that are considered high trust societies, such as the Far East, and cultures of low trust societies such as the West (Sztompka, 2003:81).

According to Beccerra and Gupta (1999), there are two bases of trust that we need to consider: “differences in attitude” which is the equivalent to moral hazard in the agency theory; and “subject evaluation of the other person in the relationship” (Beccerra and Gupta, 1999:182), which is adverse selection when considering the agent in the agent/principal relationship. They group trust into three properties: “attitude-focused trust, behaviour-focused trust, and

competence”. This is similar to Saam’s (2007) three asymmetries stated earlier: information asymmetry (competence), different risk preference (attitude), and conflicting goals (behaviour). These differences can be reduced through the process of trust building, which we can also consider as the basis for the sources of trust. On the other hand, Sztompka (1997) believes that the basis of trust is three-dimensional rather than two-dimensional. His model comprises “reflected trustworthiness” (characteristic of the individual), “basic trustfulness” (accumulated personal experience in relationships) and “culturally generated trust” (“human collectivities) which is pooled cultural capital from which individuals can draw in their actions (Sztompka, 1997:8). The first two are similar to Beccerra and Gupta’s two dimensions, and then he goes on to add a third, which is related to culture. In that the individual will react/ behave based on the pooled “social facts [believes]” of his surroundings.

Das and Teng (1998:503) offer four trust building techniques, which are “risk taking, equity preservation, communication and inter-firm adaptation”. They see that by the investor (principal) taking the risk and investing with the partner (agent), this exhibits to the partner that he has trust in him. They propose that profit distribution needs to be “kept on an equitable basis”. In that the partner “contributing the most resources (both tangible and intangible) to the alliance should get the most from it” (Das and Teng, 1998: 504), so as not to feel that he is being taken advantage of. Furthermore, communication is essential towards trust building, since it is from “continued interaction, from which partners further develop common values and norms” (Leifer & Mills, 1996, cited in Das & Teng 1998:505). And with “bilateral adaptation”, whereby demonstrating “flexibility and willingness to accommodate deviations from the contract” (Das and Teng, 1998:505), the trust building process can develop as it shows that partners are “acting for mutual interests rather than self-interests” (Das and Teng, 1998:505).

On the other hand, Doney, Cannon, and Mullen (1998) offer five steps to the trust building process. The first step of the process is considered “calculative” and profits sharing. By doing so, one can satisfy self-interest without the need to deviate from the common goal. The second is “prediction” where one bases his trust on reputation/track record, and expects the past actions (that created this record) will be “mirrored” in “future behaviour”; the principal undergoes the prediction process. The third is “intentionality” in which the intentions of the other party are assessed and when both parties share similar values it is easy for the other to understand his partner. The fourth is “capability” relating to the competence factor. By having the appropriate expertise, it is easier to believe/trust that the competent partner would fulfil his word and goal

as agreed. The fifth is “transference” whereby the individual seeking to enter into a relationship does so through networking and friends. “Trust is transferred from a trusted ‘proof source’” (Doney et al., 1998:606). Their steps are similar to Das and Teng (1998) in one way or another when analysed and aligned (risk taking—prediction, equity preservation-calculating and profit sharing, communication-transferee, inter-firm adaptation-intentionality). However, they also consider proficiency and experience (competency) as an addition factor. They also consider that the spread/depth of each step depends on the parties’ culture and values, whereby similarities would widen the spread and differences would shrink the particular step/process.

Different cultures have different meanings of trust and control. For example, in the Far East (China) any claiming of legal rights or placement of some form of control mechanism may be translated as a lack of trust in the partner (Child et al., 1997, cited in Inkpen & Currall, 2004:597). Looking at the trust building process, while Beccerra and Gupta (1999) agree with Das and Teng (1998) on the following concepts: profit sharing, the risk taking and the bilateral adaptations, they also take in cultural values as another step in the equation of the trust building process. However, Das and Teng (1998) do not ignore the cultural aspect, as to them “cultural blending” is a form of control mechanism of the trust level, which leads to confidence in the partnership cooperation, rather than being part of the building process. They regard trust as “expectations about positive motives” and confidence as “certainty about cooperative behaviours” (Das and Teng, 1998: 494). They view trust and control as contributing factors to confidence, and with an adequate level of control mechanisms, a high level of confidence can be achieved, even with low levels of trust. Trust and controls “supplement each other as a key source of partner cooperation” (Das and Teng, 1998:493). And as an outcome of a study undertaken by Das and Teng (1998), partnerships take place through confidence development and “trust and control are two distinct sources of confidence” (Das and Teng, 1998: 508).

Sztompka (1997) is a great believer in the role of culture in trust. It acts as a “social resource” and has many benefits: it “liberates and mobilises human agency” (Sztompka, 1997:9), “encourages sociability ... and enriches the network”, “encourages tolerance”, “strengthens the bond of an individual with the community” (Sztompka, 1997:10), and finally reduces “transactional cost”. He believes that trust is built through culture. To him there are seven circumstantial conditions necessary to harvest the culture of trust, which is developed and embedded with time and changes according to the events that the social group/society goes through. The conditions are circumstantial in that he looks at the structure of the collective individuals’ surrounding mechanics of order. He starts with the “normative certainty”, then

“transparency of social organisation”, followed by “stability of the social order”, then “accountability of power”, to “enhancement of rights and obligations”, to “enforcement of duties and responsibilities” and ends with “safeguarding of dignity, integrity and autonomy of each societal member” (Sztompka, 1997:14). His beliefs are similar to those mentioned above, yet his view is more from a comparatively macro level. As stated earlier, his model is three-dimensional.

Manigart, Korsgaard, Folger, & Sapienza (2002) in accordance with Das and Teng (1998) see trust (“psychological contracts”) and control (“formal legal contractual agreements”) as having “different roles in a partner relationship”, whereby control is triggered when the trust level is not sufficient enough. Although they share their views that trust and control are supplementary but only for “parties faced with a potentially large agency problem [principal]”. Whereas, for “parties faced with smaller agency problems [Agent]” they see trust to be a “substitute for control” (Manigart et al., 2002:13) in that agents are prepared to give up control over principals when trust is high in the relationship. However, the principal needs to bear in mind that such initial “sacrifices” will need to be compensated with time. In the event it is not, then most likely agents would “retaliate by withholding effort or information” (Manigart et al., 2002:13) and as suggested by Sitkin and Roth (1993, cited in Das & Teng 1998:501), the “effectiveness of the legalistic remedies [...] for building trust” form a “negative relationship”.

Granovetter (1985) and Shapiro (1987) consider the sources of trust to also act as opportunities to abuse trust. They work as a double-edged sword. This is based on the principal’s deficiencies, as he enters either into a “contentful agency” (Mitnick, 1984, cited in Shapiro 1987:628) relationship due to his lack of experience or into a “practical/structural agency” relationship, where he has the capabilities but prefers to delegate and “enjoy the economies of scale and spread risk” (Mitnick, 1984, cited in Shapiro 1987). This brings us back to the agency problems that we mentioned earlier. As such, it is these sources that also “provide the opportunity and means for its abuse” (Shapiro, 1987:625) since they are the main reasons for the principal to delegate the agent once he has entered into the trust relationship.

Principals attempt to reduce the abuse of trust by attempting to take precautionary steps by “risk spreading and making insurance-like arrangements” (Shapiro, 1987:643) that imitate “personal social control” and “often entrust a second tier of agents [...] to be the gatekeepers to and watchmen” (Shapiro, 1987:639), which could actually “escalate problems of abuse”. These

steps increase the “physical and social distance” and although they may “foster the development of vigorous and effective intra-agency control” (Shapiro, 1987:644), they could also lead the agent to slack and be careless. Furthermore, the agent as a “repeated player”, in comparison to the principal, who is usually a “one shotter”, has real authority over the agenda of the relationship (Shapiro, 1987).

Moreover, the principle can place performance controls, but the question is whether the principal is capable of monitoring and measuring the agent’s performance. Is he capable/competent enough to enforce proper governance? Hence, there rises a need for a contractual agreement for the “impersonal [outside the social ties] trust” (Shapiro, 1987), which is based on “procedural regulations”. These norms/standards, “structural arrangements” set thresholds on the agent to abide by to maintain the “goal in congruence” and to avoid “performance ambiguity”. Das and Teng (1998) agree with Parkhe (1993, cited in Das & Teng 1998) who suggests having “ex-ante deterrents” and “ex-post deterrents”. Ex-ante deterrents are arrangements that should discourage opportunistic behaviour such as the division of “equity ownership” arrangements. The ex-post deterrents are to have arrangements such as “checking devices”, “accounting examination, cost control, arbitration clauses, and lawsuit provisions” (Das and Teng, 1998: 507). However, most importantly for such arrangements to work it is necessary to avoid any “cultural clashes” and to build on “cultural blending” and how “members process information and react to the environment” (Das and Teng, 1998:507). The procedural arrangements and the cultural clashes are similar to Sztompka's (1997) thinking, as mentioned above, but he looks at the setup on a larger scale, the “social organisation”, i.e., the relationships between the individuals in the society.

These procedural impersonal trust arrangements are looked at, and as long as the basic specific procedures are taken, any undesirable outcomes due to errors or bad decisions are acceptable. They are “reputable” (Zuckerman, 1977 cited in Shapiro 1987) errors versus “disreputable” errors, which are negative outcomes when procedures were not followed in the first place; and then the intentions were not good in the first place. As Granovetter (1985) stated, these institutional arrangements “do not produce trust but are a functional substitute for it”.

The positive aspect of having procedural regulations is that they do not need to be set/agreed on by the principal-agent, but can be put in place by the industry regulators, to be practiced/implemented by the participants (principals and agents). If government regulations

are considered structural, a way of facilitating compliance to procedural norms, then procedural norms could be looked at as an acceptable industry practice.

However, as Das and Teng (1998) have suggested, there is a cost element involved, which needs to be weighed up in order to reach an “optimal combination of trust building and control mechanisms” (Das and Teng, 1998:508). We need to take care of these procedural norms while attempting to reduce conflict of interest and to protect the principal so he does not constrain the agent’s ability and limit his performance. Such a complex situation is described well by Shapiro (1987:651):

“The paradox of trust is akin to the choice between Type I and Type II errors. Should the procedural constraints of trust be set so narrowly that desirable agency behaviour is deterred or so flexible that inappropriate behavior is tolerated?”

Sztompka (1997) agrees with Das and Teng (1998) in that these structural procedural arrangements need to be weighed up; however, unlike them he does not look at cost and constraints to be variables to be weighed, but his variables are application and enforceability. The enforcement of these arrangements needs to be consistent in its application, yet prudently enforced, in order to build trust and avoid the development of distrust, by giving the benefit of the doubt. All in all, despite all this, the “engine of social complexity” (Shapiro, 1987: 652), impersonal trust continues.

### **2.3.4.3 Social Capital and Social Network Embeddedness**

The culture and values among societies influence their economic actions. They are embedded in their social relations and engender an acceptable standard of behaviour. The level of confidence among the various types of relationship varies depending on the level of embeddedness and the “connectedness”, the social network between the parties. These closely embedded relationships form a valuable intangible asset of social capital that is not exhausted by use. On the contrary, its value/power grows the greater the social connections (Johnson and Droege 2004). Their value is in that by analysing the social structure is a “key to understanding how existing institutions arrived at their present state” (Granovetter 1985:505). Social relationships within societies form an important part in their economic life, through bonding within the same group and bridging within mixed groups.

Moran (2005) views social capital to have two dimensions: one being “structural”, the “network configuration” of the relationship, while the second is “relational”, the quality of the relationship. To him the relational embeddedness is a more important dimension. Contrary to what one would expect, he sees that the more “unacquainted” one’s contacts are the more one will benefit from such a relationship, as one is likely to gain “access to different and thereby non-redundant sources of information and resources” (Moran, 2005:1131). This form of relationship is formed from “interpersonal trust” and having common characteristics such as “integrity”, “competence” and “predictability” (Moran, 2005:1140). According to Moran (2005), it is the “relational” dimension that needs to be measured when seeking a substitute for trust.

Das and Teng (1998) believe that “informal” “social”/“clan control” stimulates appropriate behaviour. These “soft measures” of goals and norms-sharing generate interpersonal respect and increase the level of trust. Moreover, Granovetter (1985) agrees with the concept of embeddedness and the important role of social capital. However, he looks at it from the perspective of “under or over socialized” human actions. When analysing embeddedness, he looks at the “institutional arrangements” which have developed over time as acceptable procedural norms; the “general morality” and the reputation that one seeks to maintain; and the “networks of relationships” one generates. Procedural norms are important, yet they are “undersocialized” in that they still do not “discourage malfeasance”, while reputation is considered “oversocialized” in that it is also over estimated at times as it still does not dissuade “malfeasance”, if the opportunity benefit for doing so is greater than the cost. This embeddedness “do not produce trust but instead is a functional substitute for it” (Granovetter, 1985: 489). Together, they meet the purpose of maintaining order. Although Granovetter considers “institutional arrangements” as “undersocialized”, Williamson (1975, cited in Granovetter 1985) and Arrow (1974, cited in Granovetter 1985) on the other hand, believe that societies over time have established certain arrangements (contracts/agreements) that are “essential to the survival of the society or at least contribute greatly to the efficiency of its working” and that “some degree of trust must be assumed to operate” (Granovetter, 1985:489).

Johnson and Droege (2004) believe, as do Alder & Kwon (2002, cited in Johnson & Droege, 2004), that although the principal-agent relationship is a chain of contracts, there are also three relationships that exist among the parties. These are: “market, authority [hierarchical] and social”. They believe that “social reciprocity [social relations], rather than direct compensation [market relations], forms the basis of exchange”. Johnson and Droege (2004:327) then go on

to say that “social capital differs from market relations [authority]”, and that the social relationship is viewed in relation to the “national cultural characteristics” (2004:332). It is seen that national cultural characteristics reduce the self-interest notion in certain cultural environments (non-Western societies). This is similar to what Perrow (1986) meant when he criticised the agency theory for ignoring power, social power.

Wright, Mukherji, & Kroll (2001) also criticise this relationship as being too narrow as it “discount[s] contingencies that may be more reflective of realities in economic relationships” (Wright et al., 2001:414). In other words, the theory assumes a certain set of behaviours (moral hazard and adverse selection) of the parties involved, and does not take into consideration the possible of the parties’ unified cooperation. In that behaviour could vary in various settings and societies with different values and beliefs.

### **2.3.5 Contract Theory**

The contract theory is a combination of the incentives, information, reputation and economic institutions (the laws and customs) (Bolton and Dewatripont 2010). The principal agent relationship is a chain of contracts, and as seen above, there are three relationships that exist among the parties: market, authority and social. The social relationship has been looked at in the previous section, where the contract between them is one based on trust, culture and customs. The relationship with the authority is related to the laws, rules, regulations and their enforceability (the legal system). This is an important issue when looking into a contract and which is assumed to be well-functioning. However, the main relationship that is of concern and pertains to the principal-agent relationship is between the market participants (in this case the LP and GP). That is trying to reach an efficient optimal combination, ensuring allocation efficiency and trade off of the incentives, hidden private information (adverse selection) and hidden action (moral hazard) (Bolton and Dewatripont 2010).

Risk is also a factor to consider, since it differs between the parties: the principal (LP) is considered risk neutral (to a certain extent), while the agent (GP) is considered risk averse. In addition to having different risk appetites, their objectives also differ: the agent seeks to maximise income, whereas the principal seeks to maximise continuous wealth. Guang-ming (2011:187-189) explains that in the contractual relationship between the principal and agent, the principal’s aim is to design a contract that will provide an incentive to the agent to behave/act on his own accord, in a way that will be to the benefit and interest of the principal,



and “reflect the risk sharing requirement” of both parties. The incentive contract is to consist of two portions. One is fixed, while the other portion is to be based on the output and the sharing of profits. The aim is to reach an optimal combination that will provide an incentive, yet maintain the level of risk to be taken by the agent; since high returns could mean high risks (Guang-ming, 2011:187-189). Sung's (2001) formula, which is not too different from Guang-ming's, to obtain “optimal efficiency” when designing a contract, is to consider the information asymmetry problem before and after contracting and moral hazard that could arise after contracting simultaneously.

According to Sung (2001), for the agreement to be attractive to the agent, it should be designed in a way that it provides the agent with some control over the project and the output, yet at the same time allows the agent to be risk averse. He sees that the optimal contract can vary. This is due to reasoning that an “efficient manager [agent] tends to prefer safer projects than an inefficient manager [agent]” (Sung, 2001:33). As such, to induce some form of risk taking by the efficient agent, the incentive should be more sensitive to the expected compensation portion rather than the fixed portion. He considers that the “optimal contract depend not only on the final output but on the managerial forecast of the firm's future profits” (Sung, 2001: 33). Whereas, Kaplan & Stromberg (2004) advise that in looking into the contract design and the risk factors, it is more important to study the internal risk factors, such as the quality of the management, the management's track record and monitoring cost, rather than external risk factors (“market size”, “competition”, “exit condition”), or the risk sharing requirements. In a sense they advise looking into those risk factors that are within the control of the management than those that are not, since they consider them to be more related to moral hazard and information asymmetry.

Moreover, although Harris & Raviv (1979) also look at incentives when seeking an optimal contract, they however, link incentives to “the possibilities for acquiring information” rather than risk attitudes (Harris & Raviv, 1979:231). The “Pareto-optimal [incentive] contract” depends on the “monitoring technology” (Harris & Raviv, 1979:232), and thus purposes a contract of two parts. The first part is to be constructed on monitoring the agent's behaviour and the second part is to be constructed on payoffs to the agent based on the outcome of the monitoring. This is based on that at the initial stage, the information on the agent's actions is limited, and thus it is difficult to determine a payoff and so by adding monitoring into the equation, it acts as a motivation variable towards determining the agent's payoff.

Ross (1973) agrees with the concept that “the principal ... is dependent on the desire to motivate the agent” (Ross 1973). He also believes that the agent is at a comparative informational advantage over the principal, and that the actions of the agent cannot be taken for granted, and some form of monitoring is required. However, he questions the economic viability of monitoring, and as such sees the use of fees as a form of “communicating mechanism”, especially when dealing with multiple agents (Ross 1973). Therefore, he looks at the Pareto-optimal possibilities to motivate, however it might not necessarily be Pareto-efficient. Thus, not necessarily offering a first best contract, “one that results in the realization of an efficient outcome” (Sappington, 1983:4), which is in line with the thinking of Dybvig, Farnsworth, and Carpenter (2010) to go for a second best or third best contract, which are basically more inclined to offer the agent greater portions of the excess returns to incentivise greater effort from the agent. This is required since prior “communication information” (Dybvig, Farnsworth, and Carpenter 2010) is not always available, restricting the likelihood of obtaining optimal output from the first best contract.

Hirshleifer & Suh (1992) maintain that the type of contract to draw up to obtain an optimal contract, without “controlling the project perfectly” (Hirshleifer & Suh, 1992:310), depends on whether the project is observable or unobservable. They segregate between projects that have “monitoring institutions” (Hirshleifer & Suh, 1992:330) (such as shareholders, independent directors) and those that do not. Accordingly, the contract is designed in a way that would provide the appropriate balance between motivating work and motivating project choice: If no monitoring institutions are available “it becomes more important to motivate the choice of risky projects” (Hirshleifer & Suh, 1992:333), and so greater option-based compensation is proposed. Whereas, if monitoring institutions, which act as proxies to the investor, are available, then less option based compensation is proposed, as the concern about project selection is lower. They term their contracts as concave or convex contracts, and the concavity or convexity varies according to whether the project is observable or unobservable. If the project is unobservable then they recommend a convex contract (a contract where the manager’s compensation scheme is set to induce and motivate the manager to select a risky project over a safe project. Alternatively, when the project is observable they recommend a concave contract (a contract that will induce and motivate the manager to select a less risky project). Concave and convex terms are derived from the form of functional relationship between returns and fees, and the marginal utility of such a relationship. However, Fehr, Hart, & Zehnder (2008) prefer to go for “rigid contracts” where payoffs are fixed/limited than the “flexible contract” with variable payoffs perused by agents, so as not to distort or promote less than the best effort by the agent and to avoid “inefficient shading activities” (Fehr, Hart, & Zehnder, 2008:25).

Grossman & Hart (1986), on the other hand, believe that in order for one party (agent) to spread/reduce his risk in an investment project and to encourage risk sharing, he would need to offer the second party (investor/principal) some “ownership rights over the assets [project]” (Grossman & Hart, 1986:717). This view is also taken up by Cestone (2001), who along with Dewatripont and Titole (1994, cited in Cestone, 2001) looks at the capital structure and control rights, “when monetary incentives are not sufficient to discipline manager [agents]” (Cestone, 2001:4). However, he warns that care is needed while providing/designing the control rights, and that the LP interference is limited. Formal control and real control needs to be handled delicately, and the “overall formal control enjoyed by the investor [LP] and the riskiness of her claim should be negatively correlated” (Cestone, 2001:15). According to him when designing an optimal contract the “cash-flow rights and control rights are [to be] allocated independently, and yet [...] follow a joint pattern” (Cestone, 2001:24). Controlling the LP interference while giving him control rights can be achieved by offering the LP convertible preferred stock<sup>6</sup> (limiting his involvement rights, so as not to jeopardise the GP’s plans during implementation of the project) that is converted into common stock as each target is realised.

Conversely, Aghion & Hermalin (1990) look at restrictions to enhance efficiency. Their belief, in line with Ross (1973), is that there is usually one party that is better informed than the other, and he uses this to his advantage by giving signals to the other party that could have a negative effect on the other party’s decision process: “...one way to signal a good project is to promise a large payment to the investor if the project fails” (Aghion & Hermalin, 1990:382). The interpretation of such a signal is that the investor will be tempted to go with such a project, thinking that the entrepreneur will not be making such a risky statement if the project is not that good, and thus, the investor is misled by such a statement. Aghion and Hermalin believe in imposing certain legal restrictions in the regulations on the terms of the contract, such as “prohibiting signalling...prohibiting the [agent] from exposing [himself] to excessive risk, may enhance welfare” (Aghion & Hermalin, 1990:382). The intention of such a restriction is to increase the efficiency of the terms of the contract. However, care needs to be taken so as not to have laws that are rigid. The reason being is that not all relationships are the same, and so in the writing up of these regulations some form of flexibility needs to be incorporated to allow for the various types of relationships. Nonetheless, this is not to be confused with the density

---

<sup>6</sup>“Unlike in public settings, in private equity preferred stock refers to a security that awards liquidation rights to the investor if the company does not achieve a threshold performance level...we refer to the group of securities as convertible preferred stock to avoid confusion with preferred that only has preferential voting rights” (Lerner and Schoar, 2005:226).

of a contractual contract, upon which it is usually used to recognise a suitable agreement. While examining the relationship between the terms of the contract and returns, a study by Caselli, Garcia-Appendini, & Ippolito (2012) found that companies with better returns were those that had “covenant-heavy contracts” (Caselli, Garcia-Appendini, & Ippolito, 2012:2). The reason being that GPs of projects with positive prospects are prepared to take on covenants because “they are less likely to be constrained by them”. Their study also revealed that there is “a negative association between the appointment of insiders and the target firm’s [project] profitability” (Caselli, Garcia-Appendini, & Ippolito, 2012:3). Whereby as a mechanism to reinforce weak agreements and to maintain close monitoring, some form of board governance (related to the LP, such as directors) is placed on the target company.

Gompers & Lerner (1996) seek to regulate the GP behaviour through the use of covenants and restrictions to be imposed in the contract. The LP, once he has entered into the relationship, due to his limited liability, his participation in the day-to-day management is restricted. He is also restricted in the event he wanted to sell and exit the project, thus the major solution is “legal actions triggered by a violation of the covenants” (Gompers & Lerner, 1996:746). The number and kind of covenants are determined by the availability of capital inflow in the market (the “supply and demand conditions”) and “the need for oversight” (Gompers & Lerner, 1996:493). In addition, explicit covenants are only inserted in the contract when the benefits of inhibiting such actions outweigh the cost of negotiating and enforcing them. Gompers and Lerner divided the covenants “into three broad families: those relating to overall management of the ... [project], the activities of GPs, and the permissible types of investments” (Gompers & Lerner, 1996:480). Gompers & Lerner (1996) also, in a similar way to Kaplan & Stromberg (2004) who suggested looking into the internal risk factors and the characteristics of management, view reputation as an important characteristic to consider. They rationalise that the GP is seeking a long-term relationship with the LP (for reinvestment in other future projects) and so will endeavour to maintain his reputation. Thus, they perceive an inverse relationship between reputation and the need for covenants.

Likewise, Black & Gilson (1998) have a similar line of thinking, and view reputation as an “implicit contract” term (Black & Gilson, 1998:263). They also propose to consider exit strategy covenants. They view it as another form of incentive, since the type of exit strategy affects the gains obtained by the GP. In an IPO exit, the GP gets a “call option on control” (Black & Gilson, 1998:261) upon the success of the company/project; he receives cash along with tradable securities, versus receiving only cash through an exit strategy of a sale to another

private company. Furthermore, the LP can obtain some form of control, while providing a form of incentive, by committing to provide the required capital in instalments/stages. That way the GP, in order to maintain the inflow of investments will be performing with the LP's interests in mind, and the LP will be able to gain some form of monitoring over the project.

With all the above views and the various ways of drawing up contracts to arrive at an acceptable optimal contract, they are still considered incomplete. This is because it is not possible to consider all the possible scenarios/factors that could affect the project, so as to tie them to the performance and payoffs. It is also considered costly and time consuming (which is also a form of expense) to be able, in advance, at the *ex-ante* stage of a contract to think of all the possibilities/contingencies that could occur in the *ex-post* contractual relationship before signing the contract, let alone the cost of writing them all up. Moreover, there are also *ex-ante* (drafting and negotiating) and *ex-post* (set-up, maintaining alignment of the task, and enforcement) transaction costs that need to be considered simultaneously when planning a contract. Chung (1991) suggests that this incompleteness in the terms of the contract can be diminished by having at the *ex-ante* stage initial simple contracts with terms that provide for renegotiation, so that the parties can revisit them *ex-post*.

Both Hermalin & Katz (1991), in agreement with Chung, encourage having renegotiation in contracts. They consider renegotiation in a contract to “serve as a natural mechanism for incorporating an unverifiable signal into an agent's compensation scheme [...] allows the parties to use this unverifiable signal to improve risk sharing” (Hermalin & Katz, 1991:1752). They also consider renegotiation as providing a “second instrument” to achieve the desired goals. They see that “the initial contract creates incentives, while the renegotiation contract provides insurance” (Hermalin & Katz, 1991:1738). Maskin & Tirole (1999) however, although they agree on the point of having short-term contracts that are then open to renegotiation, also believe in the irrelevance theorem. Whereby, the parties involved need only look at the payoff contingencies, rather than the physical contingencies, since that is what matters. Nevertheless, there is still some concern with regards to “incentive-compatibility: will it be in each agent's interest to specify these details truthfully?” (Maskin & Tirole, 1999:84).

As such, the idea of an incomplete contract theory has emerged, in that many “contracts are vague or silent on a number of key features” (Tirole, 1999:741). This incompleteness, while being a solution, also “entails the loss of contractual flexibility” (Al-Najjar, 1995:435). Al-

Najjar offers two solutions to regain flexibility. One is to have ambiguous terms that are wide in meaning, such as “every reasonable effort” (Al-Najjar, 1995:435), and the other is to supplement the contract with other forms of governance, such as “reputation, conventions, property rights over physical assets, or the legal system” (Al-Najjar, 1995:435), as do Hart & Moore (1999).

Tirole (1999) sees that it is not a matter of “debate between incomplete and complete contracting” or simple or complex contracts, but more the need to design a “balance decision process” (Tirole, 1999:771), to have a form of structure. Incentives might vary depending on the agent, “but would not change the basic point”. Principals must consider, design and agree on the decision process of the matters that they are more likely to disagree on with the agent. This point is important as it sets the ground for a more efficient enforcement. The parties may be able to settle disputes between them based on the agreed decision process, and avoid situations where the judge “may not enforce the letter of the contract” (Tirole, 1999:761). Moral hazard and adverse selection can also exist among judges: moral hazard in that they may not take the initiative to understand the details of the case; and adverse selection in that they might not have the appropriate training/education, in addition to them having their own preferences based on previous “legal precedents and principals, [...] regardless of what the contract says or what the parties want” (Tirole, 1999:761).

Lerner & Schoar (2005) in quoting Grossman & Hart (1986) and Hart & Moore (1990), state that the allocation of control rights is important in drawing up contracts, so in the event the “courts were unable to enforce [...] the parties will be able to reach a second-best arrangement” (Lerner & Schoar, 2005:226). Grossman & Hart (1986:717) believe that by providing for the distribution of property rights and that of residual control rights earlier on, the parties will be protecting the surplus and the distributions of ex-post contracts, should any obstacles be encountered at the time of renegotiation. On the other hand, Hart's (1988:133) views combine those of Harris & Raviv (1979) with the concept of the need to establish incentives and allocate “return schemes” and those of Lerner & Schoar (2005). Also, those of Grossman & Hart (1986) on the need to allocate ownership and the residual control rights (which are not necessarily the absolute right of the owner of the property/asset), as if they are not classified this can cause a hold-up at the time of renegotiation.

On the other hand, Aghion & Bolton (1992) explain the use of ownership and control in a different way. They recommend reviewing the governance structure of the relationship, and in seeking to protect the investor's claims, they offer three governance structures. They advise starting with providing the agent full "Entrepreneur Control". However, if this does not work well then they recommend moving across some of the control to the investor "contingent control", and if such partial control is not satisfactory, then the investor is to have full "investor control". These controls are provided for via the financing structure to be adopted by the company to be set-up. So as in the event of entrepreneur control, the appropriate financial contract would be non-voting equity, where under contingent control it would be partial voting and/or debt, and for full investor control it would follow the full voting equity structure.

According to Lerner & Schoar (2005), what affects the structure of a private equity deal is not the "contracting constraints" in the country of transaction, but rather how acquainted the private equity participants are with the "contracts in its domestic market" (Lerner & Schoar, 2005:234). They observe that the financial structure of a private equity deal depends on the level of enforcement and the type of law. Nations under common law and high enforcement usually use "convertible preferred stock with covenants" (Lerner & Schoar, 2005:223), whereas nations with civil law and low enforcement usually use "common stock and debt, and rely on valuation and returns" (Lerner & Schoar, 2005:223). Djankov et al. (2003, cited in Lerner & Schoar (2005)), in agreement with Lerner & Schoar (2005), view that countries with long time frames to resolve contract disputes usually use debt, versus those countries with short time frames that usually use preferred stocks. This is derived from the concept that if the investor is comfortable with the legal system of that country, he is willing to forgo controlling interest (common stock), since he can attain minority shareholder protection through other contractual means.

In the agent-principal relationship of private equity, the principal has sufficient wealth vis-à-vis the agent whose financial wealth is limited and is seeking an investor (the principal). In such a relationship, where moral hazard and limited liability exists, one would expect that the bargaining power would lay in the hands of the principal as is the understanding of Pitchford (1998) and many others. Yet in the practical relationship of the private equity industry, it is the agent who is the GP and the principal is the LP. It is the agent who has the bargaining power and makes a take it or leave it offer to the principal. Whereby the agent prepares a Private Placement Memorandum (PPM), enclosing the details of a proposed private equity partnership to potential investors. It is the PPM that forms the contract and the agreement terms of the

partnership. It is a unique PMM (does not vary from one investor to the other for the same project) that is offered to all potential investors with little or no room for negotiation.

## **2.4 CONCLUDING REMARKS**

This chapter has previewed the relevant literature on private equity in general and in particular within the conventional system, which is essentially a form of investment contract/agreement entered into by two parties: the agent (GP) and the principal (LP). In such a relationship two main problems arise: moral hazard and adverse selection, and the aim is to arrive at the most efficient contractual agreement that would govern this relationship, and to minimise these problems. There are various variables involved that are either behavioural based or outcome based, which affects the agenda of the relationship between the parties. With the explicit variables ranging from: risk attitude, goal conflict, availability of information, outcome, outcome measurability, payouts, and type of governance structure. While the implicit variables range from social expectation, to social connectedness, culture, reputation and trust.

The literature also indicates that the private equity relationship is fairly complex. Whereby the management and running of this investment lies in the hands of the one with real authority, rather than the one with formal authority. It lies in the hands of the agent (GP), due to his position and involvement in the market, and as such he has greater power (real authority) to control and direct the handling and running of the deal over the principal (LP), the owner of the funds and formal authority, who permits such control based on reputation and trust. As such, in examining the relationship between the investor and the financial institution, and in seeking to answer the research questions, the study will be based on the multiple theories discussed in this chapter. However, even though Islamic private equity is based on the conventional, indicating that the theories with regards to the relationship are similar, yet, it is to be noted that being an Islamic form of financing, there is an Islamic aspect involved. “Islamic economics brings a social dimension of living into focus” (Siddiqi, 2004:5). Whereby, certain behaviours are not acceptable and could make the relationship non-compliant or void. There is an emphasis on morality and its role in steering behaviour away from “individualism”/“self-interest” (Siddiqi, 2004:5). Matters related to *Shari’ah* principles and the expected behaviour are examined in the next chapter.



## Chapter Three:

### PRIVATE EQUITY IN ISLAMIC FINANCE: PRINCIPLES AND FEATURES

#### 3.1 INTRODUCTION

This chapter examines the literature on private equity in Islamic finance. The chapter first provides an overview of the *Sharia'h* (Islamic law) concepts and reviews the Islamic system, before moving on to the private equity and Islamic finance. Discussions on Islamic law start with *Maqasid Al Shari'ah*, the *Shari'ah* principles/objectives. *Maqasid* (*maqasid* - plural) means the end goal that one should be seeking, which mainly revolves around the realisation of human well-being as an individual within his society/community/economy. Hence, the *maqasid* represents the overall infrastructure of the system, upon which the Islamic economic system functions. The chapter discusses the basic principles of an Islamic economic system to provide a broader perspective of Islamic finance in general and private equity in particular. The literature write-up of this chapter will be an explanation, elaboration and informative rather than a discussion of theories.

#### 3.1 MAQASID AL SHARI'AH AND FINANCIAL PRINCIPLES: A BRIEF OVERVIEW

This section starts with the introduction of *Shari'ah* and outlines *maqasid al Shari'ah* and their nexus within the Islamic law and then examines some basic *Shari'ah* principles governing financial transactions.

##### 3.1.1 *Maqasid Al Shari'ah*

In simple terms *Shari'ah* (being derived from the word *Tashri'a*, which means to promulgate/legislate) is a “code of law...that regulates the conduct of human beings in their individual and collective lives” (Ayub, 2008:21). *Maqasid*, which are the principles upon which if applied and adapted, the Islamic code of law can be maintained, and the benefits and welfare of the society/economy as a whole can be preserved (Chapra, 2008, Laldin, 2008a). *Shari'ah* and its objectives are “the rules of life for Muslims economically, socially and religiously” (El-ashker & Wilson, 2006:35) that are derived from four basic sources. The two primary sources being the Quran (the holy writings of Islam revealed by God to the prophet Mohammed (pbuh)

and the Sunnah/Hadith (sayings and activities of the prophet Mohammed) (Ahmed, 2011a:19). Rulings from these sources are mainly to do with *'ibadah*, the religious rituals, and “cannot be changed according to the change of time and place or circumstances” (Laldin, 2008a:7). The other two sources are based on scholars’ reasoning (*ijtihad*) of the Quran and Sunnah. *Ijtihad* is used when there is no direct reference to an issue in the primary sources. The injunction is arrived at based on the use of an analogy (*qiyas*) to a similar matter/issue in the primary sources and consensus (*ijma*). The rulings derived through *ijtihad* are more flexible to keep pace with time and circumstances and are known as *fiqh*. They are established whilst bearing in mind enhancing public interest (*maslaha*) and preventing public harm (*mafsada*).

The Islamic view does not separate between obedience (religion) and welfare (*almaslahah*), as they are considered to be complementary and to balance one another. As such, fulfilling the *Maqasid* is considered a way of life (Atia, 2011:119). However, hitherto looking into the different classifications of *maqasid*, it needs to be made clear that for one to accept, understand and implement the *maqasid* at the individual level, there are certain characteristics that need to exist, as without which *maqasid* have no meaning and are difficult to realise. These characteristics are sound human instincts (*alfitri*) and the ability to reason/rationalise (*al-ta'leel*) that compels the individual to be attracted to the good and to ward off the bad (AlHassni, 2005:323).

An individual with human instincts that are unblemished has the basic prerequisite to accept all aspects of religion and faith. If these instincts are enriched by the ability to reason and rationalise, then he/she is able to accept the set of boundaries/values (natural/personal, religious, authoritative) to be bestowed upon him/her, setting the grounds for preserving the *Shari'ah* principles/*maqasid*. After this, co-operation with one another, in its spiritual and real form for the benefit of all, is required to maintain its existence throughout the community/society within which humans live, without which these codes of law have no meaning nor serve their purpose (AlHassni, 2005:323, Atia, 2011:28).

The classification of *maqasid al Shari'ah* is based on the principal objective of the “realisation of benefit to the people, concerning their affairs both in this world and the hereafter” (Laldin, 2008a:14). *Shari'ah* is divided into three basic ordinances: principles on beliefs (*Al-ahkam al-i'tiqadiyya*), principles on behaviour (*Al-ahkham al-akhlaqiyya*), and principles on transacting (*Al-ahkham al-'amaliyya*), also known as *fiqh*. These principles are established on: mutual consultation (*shura*), equality, justice, and preventing harm (Laldin, 2008a:44-46). The

fundamental intention is to enhance social welfare. These sanctions and principles of Islamic law are similar to “today’s notions of human rights, development, and civility” (Auda, 2008:1, Atia, 2011:119).

The basic traditional classifications of *maqasid al-Shari’ah* are based on the various levels of need, and they are: “necessities (*dururiat*), needs (*hajiyyat*), and luxuries (*tahsiniyyat*)” (Auda, 2008:3), which can be said to be an analogy to Maslow’s hierarchy of human objectives (Auda, 2008:4). The necessities, according to some (such as Al-Ghazali), revolve around the protection and development ‘*hifz*’ and to some (such as Al-Shatibi) observance ‘*ri’ayah*’ of human well-being with regards to: faith (*din*), intellect (‘*aql*), posterity (*nasl*), wealth (*mal*), and the human self (*nafs*) (Malik, 2015). The necessities (*dururiat*) are based on the preservation of these five basic elements of human development. Neglecting these “will lead to total disruption and disorder” (Laldin, 2008a:18). The needs (*hajiyyat*) are enhancements of the five basic elements of the human development, that if ignored does not lead to total disruption and disorder, but “leads to hardship” (Laldin, 2008a:29). The luxuries (*tahsiniyyat*) are embellishments that if overlooked cause discomfort. Over time, Ibn al-Qayyim expanded the range of categories further, from serving the individual to capturing the entire society/community and covered freedom, justice and equality, “ensuring welfare, as the utmost *maslahah* to be preserved through *shari’ah*” (Malik, 2015).

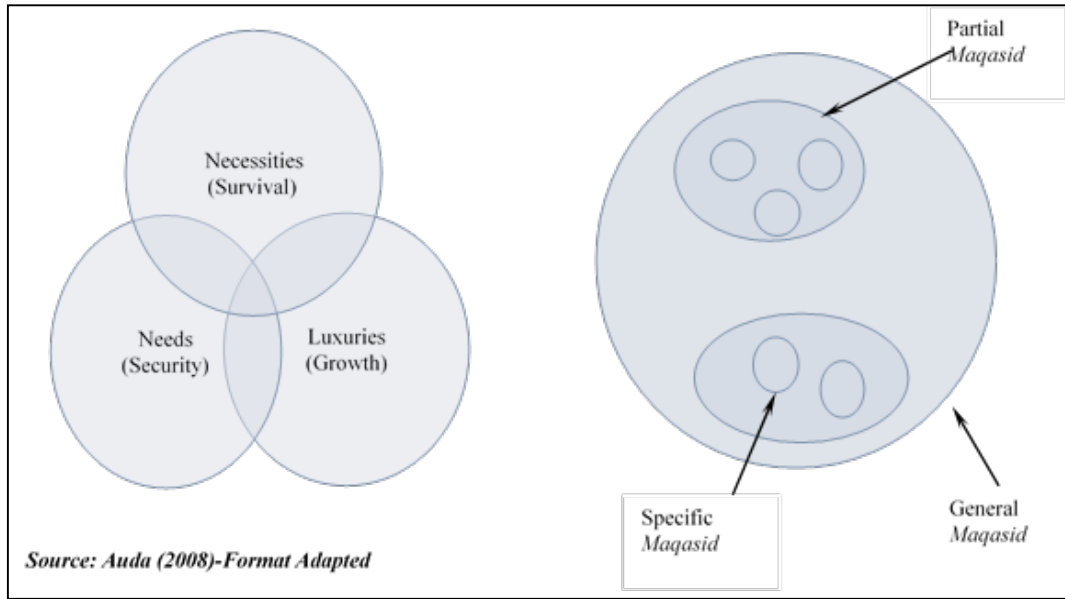
The contemporary view of *maqasid* classifies the elements/needs into three classes: general, partial and specific. For example, the element need of faith (*din*), since it is a wide spectrum is classed as general *maqasid*, and each of the five pillars<sup>7</sup> of faith are classed as partial *maqasid* and the details for within each of the pillars are classed as specific (Auda, 2008:5, Atia, 2011:49). Although the developments of faith, intellect, prosperity, wealth and human self are essential, they are not always at the same level of need nor are they of the same degree of importance. On the contrary, there are times when they diverge and times when they are complementary. It depends on the circumstances (the *maslaha*) and objectives (the *maqasid*); some might have precedence over the other, and in other instances they can be complementary. As such, the needs can take an interrelated, “over-lapping” (Auda, 2008:4) form to that of a hierarchy<sup>8</sup>, as it encloses the whole economy and society, and becomes part of a whole.

---

<sup>7</sup> The five pillars of Islam are: the Islamic Oath (*alshahadtain*), prayer (*al-salah*), fasting (*al-sawm*), alms giving to the poor/needy (*Zakat*) and pilgrimage (*haj*). For a discussion on the five pillars of Islam see (Abuznaid 2006) and (Keller 2002).

<sup>8</sup> An example of the needs being interrelated is if one looks at *Salah* (prayer). It is one of the pillars of Islam and is considered an essential element/necessity (*dururiate*) of faith (*din*). And in performing prayers, there are certain procedures that must be maintained, for the prayer to be accepted and considered correct. However, there are times

Figure 3.1 - Structure of *Maqasid AlShari'ah*: Interrelated (Left) & Contemporary (Right)



Islam is not an “ascetic religion” and “allows a person to satisfy all his needs (both necessities and comforts) to increase his efficiency and well-being” (Chapra, 2008: 21). As such, as technology develops and living standards change, needs are also expected to change. They are mainly related to *mu’amalat* (transactions) that are related to political, economic (banking and financial), and social activities, especially since these activities have greatly developed since the times of the Prophet (pbuh).

### 3.1.2 Transactions as per *Shari’ah* Principles

Upon the development of the area of *mu’amalat*, the doing of business and financial activities, there are certain *Shari’ah* principles that need to be preserved. The first three are more universal, while the remaining three are more related to the dealings with one another. The first is the “continuation of wealth” (Laldin, 2008b:78) and trying to enlarge the circle of those involved or those that can benefit, so as not to “concentrate the wealth in a few hands” (Laldin, 2008b:78). The second principle is “continuity of the investment wealth” (Laldin, 2008b:79) whereby the

---

when certain procedures can be eased, to remove hardship, such as reducing the number of *rakat* or being able to sit rather than stand. Thus, this easing could be considered as *hajiyyat*/needs that can be undertaken without *tabtil*/voiding the *duriyat* of performing prayers. Another is the element/need of posterity (*nasl*), where marriage is an important need for the continuation of posterity (*nasl*). Furthermore, in order to preserve the marriage (*nikah*) adultery is forbidden and is considered a *dururi*/necessity. Moreover, the way women dress whereby they are to avoid revealing parts of their body (so as not to attract the attention of men other than their husbands) is considered as a *hajiya*/need). In addition, it is preferred that women do not over beautify themselves (which is considered *tahsiniyyant*/luxury) to outsiders, to prevent jealousy and jeopardise the marriage. Thus, this makes the need and luxury important issues complementary and they form part of the necessity/*dururi* (Al-Shatibi, 2007:5-19; Baza, 2008:205). In other words, they are interrelating rather than “strict hierarchy” levels (Auda, 2008:4).

wealth that is available should be invested for the economy to continue to develop and expand along with maintaining the first principle of reaching out to as many as possible within a society. These two principles lead to the third of “achieving comprehensive communal prosperity” (Laldin, 2008b:79) with the aim of spreading social harmony. The fourth is “financial transparency” (Laldin, 2008b:80) and maintaining disclosure to prevent any ambiguity, misunderstanding and exploitation while dealing or doing business with one another (Gait & Worthington, 2007:7). The fifth is “validation of ownership” (Laldin, 2008b:80), whereby one cannot sell something without owning it in the first place, and a transaction needs to be directly or indirectly asset based (Gait & Worthington, 2007:7) (with the exception of services). The final principle is that profits and revenues that are earned need to be generated based on work performed, thereby making the “pursuing of work obligatory” (Laldin, 2008b:87).

Based on the above principles the following are prohibited in an Islamic economy. Hoarding and the storing away of wealth is prohibited, as it goes against the principle of the continuity of investment and the availability of capital liquidity that an economy needs in order to grow and develop. “Squandering, extravagance and stinginess” are also banned (Laldin, 2008b:86). In living their lives humans need to be moderate in spending to safeguard capital and economic growth. Competition is encouraged and monopoly is down casted, as it “diminishes economic freedom” (Laldin, 2008b:88). Irresponsible activities that have a negative impact on the individual and society, such as “gambling, casinos, production of alcohol” (Gait & Worthington, 2007:24) are considered haram and dealing in them is forbidden.

*Riba* (usury) is prohibited in *Shari'ah*. There are two basic forms of *Riba* that have been referred to in the *Qur'an* and *Sunnah*: *riba al-nasi'ah* and *riba al-fadl*. *Riba al-nasi'ah* is taking interest (extra money) on the money that is borrowed. It is prohibited because it places constraints and hardship on the borrower. *Riba al-fadl* relates to the unequal exchange of goods. It would include exchanging an inferior good for one of a greater quality, when dealing on the spot with a homogeneous good (Laldin, 2008b:84). This form is forbidden as it goes against the principles of transparency, continuation of wealth and earning a return without any effort. *Maysir* (gambling/speculating) is also prohibited by Islamic law. Islam does not discourage taking risks; on the contrary, it is against accumulating gains based on taking chances rather than work performed. Such dealing and contracts are also prohibited as they “result in a zero sum effect, where at least one party will end up as a loser by mere chance” (Sultan, 2009:29) and no new wealth is created; it is only transferred from one to the other.

Islam is also against *gharar* which relates to ambiguity in contracts whereby in transactions “consequences are concealed” (Gait & Worthington, 2007:10). It is against the uncertainties in contracts, as it leads to conflict and moral hazard issues, and provokes members to have dishonest behaviour, with “the risk of litigation and disputes as a result of ambiguity to the contract” (Sultan, 2009:27). Consequently, in order to avoid nullification, a contract has to “encompass[...] the full disclosure of information and removal of any asymmetrical information” (Gait & Worthington, 2007:7).

Having preserved the principles and avoided the prohibitions, transactions in an Islamic system can be completed by taking into consideration: the redistribution of income (*Zakat*) and having a supporting legal framework. *Zakat* is to be considered because it is a form of “a social self-help system” (Durrani & Boocock, 2006:152). It is the giving from one’s income to another, without the intention of “depleting the resources of the rich” but in order to improve on the living standards of the poor within the society to create “social and economic equity” (Gait & Worthington, 2007:13). While a proper legal and supervisory framework must be considered in order to maintain compliance with *Shari’ah*. Rules and regulations are required to protect those within the Islamic system from “haram and hardship” (Ayub, 2008:25), and to prevent “selfish atomistic behaviour” and to preserve “God-given freedom... to ensure freedom to all” (Naqvi, 1981:69).

### **3.2 THE ISLAMIC ECONOMY**

Economics is defined as “the study of how societies use scarce resources to produce valuable commodities and distribute them among people” (Samuelson & Nordhaus, 2005:4). In the conventional economy, the understanding is that man’s wants are unlimited and cannot be met by the limited resources. While the Islamic economy is based on the belief that resources are *amanah*/trust from God and man is accountable for the proper use of these resources: “on the production side he should seek efficiency, and on the distribution side he should strive for social justice” (El-ashker & Wilson, 2006:35).

The Islamic economy works on the basis of combining ethics and economics. Thus, utility-maximisation, consumption, production and distribution need to be balanced to achieve “total welfare and not just (Pareto-optimal) marginal welfare” (Naqvi, 1981:65). Those in the conventional economy prefer markets with minimal government intervention based on the

assumption that market forces by themselves are expected to “create harmony, and lead to efficiency and equity” (Ayub, 2008:37). Their efficiency concept is based on assumptions that are not easily achievable. Their assumptions are based on that a perfect market exists and that individual preferences and social interests are aligned. They also assume that the “rest of society ...deal with the problems of externalities, inequalities, and instability, without the aid of [corporation and authorities]” (Dusuki, 2008:105). The conventional system encourages the “*laissez faire*” form of market, with little government intervention and the “unbridled profit motive” concept (Ayub, 2008:37). However, such a system cannot withstand time because “profit motive in the absence of any ethical norms finds loopholes for misdeeds, injustice and corruption” (Ayub, 2008:37). Whereas, in the Islamic system the state, as a “social authority” is expected to take measures for the proper “functioning of market forces”, the “prevention of exploitation”, and the ensuring of “social justice”, whereby the “Holy Qur’an gives the Islamic State the necessary legal authority to do so” (Ayub, 2008:39). Islam has *Shari’ah* principles/rules that are “religion-based, valuation-orientated, morality-judged and spiritually-bound” (Ayub, 2008:37). These principles/rules set limits/boundaries on the individual’s behaviour to sustain the welfare of society, and to “protect economic freedom without harming either buyers or sellers” (Presley & Sessions, 1994:585) in working towards the ideal Islamic state of social welfare through its guidance on the proper use and allocation of resources (Gait & Worthington, 2007:5, Naqvi, 1981:66).

The Islamic economy seeks social welfare as well as economic welfare. All members of society are to be given equal opportunities to access resources, disregarding their income state, as it hinders “resource allocation opportunity and efficiency” (Yusof, Kashoogie & Kamal, 2009: 7). It is the efforts made and the different abilities of the individual that distinguish the outcome. Cooperation and risk sharing is fostered because it unites the members of society. It helps “blunt the impact of economic shocks, disappointments and suffering for individuals by dispersing their effects among a large number of people” (Iqbal & Mirakhor, 2013: 198). To cater for risk sharing, contracts are drawn up, whereby the obligations of the parties and breaches of the terms are identified. Contracts are to be exchange based and not interest based, both sharing the ex-ante and ex-post risk of the transaction, as per their share in the deal and property entitlements are identified. Returns are based on the economic activity of the capital. No trade/exchange is to take place without the parties having ownership of the goods and services to be exchanged. As such, the activities of the financial sector are reflected in the real economy.

Money in the Islamic economy is a tool and is not considered as capital that can earn profit in itself. Profit needs to be generated/earned in return for some effort being inputted or risk and responsibility being taken by those involved. A capital owner is not entitled to earn profit on his capital, just for owning the capital; he needs to take on some form of economic activity (either investing and producing himself, or to partner with someone who manages, and as such is taking on some risk), for him to be Islamically entitled to the profits when they are generated. The *Shari'ah* principle for the Islamic economy is based on productivity, and wealth is a combination of “property (*mal*) and the effort together” (Ayub, 2008:33). Islamic financial transactions in investing activities are mainly partnership based, and over time are expected to have positive rippling effects on the economy.<sup>9</sup>

### 3.2.1 The Islamic Economy and the Individual

The Islamic economy, however, does not work independently of faith. For an economy to grow and sustain growth, faith along with wealth is required. Wealth provides the resources, capital and productivity that is needed, and faith acts as the disciplinary hand that maintains the human consciousness for proper conduct. “Moral growth and economic growth go hand in hand, reinforcing each other” (Chapra, 2008:34). Although income growth and wealth contribute to the development and the meeting of the human needs (the needs mentioned above), it does not satisfactorily complete the Islamic concept without the inclusion of the moral principles, the *maqasid al-Shari'ah* (mentioned above). Thus, the authorities in an Islamic economy, while planning and designing for the development of their economy, also need to consider the financial aspects, the development of the individuals within the economy.

Based on the fact that individuals “are the end as well as the means of development” (Chapra, 2008:27), then those running the economy (governments/authorities) need to direct the individuals within their economy on to the proper paths that fit with the times therein. Areas such as education, health care, safety, and basic infrastructure need to be developed within an economy for the successful development of the individual’s basic needs. The basic pillars upon which economic planning is to be based are: faith, intellect, self, posterity, and wealth. Faith needs to be at the forefront because it acts as a “moral filter” (Chapra, 1995:7) and wealth at the end as “it is a means ... for realizing human well-being” (Chapra, 1995:8). The aim is to

---

<sup>9</sup> Those that are equity based and on the asset side of operations (*Musharaka* and *Mudarabaha*), with no form of debt effect (such as *Tawarruq*).



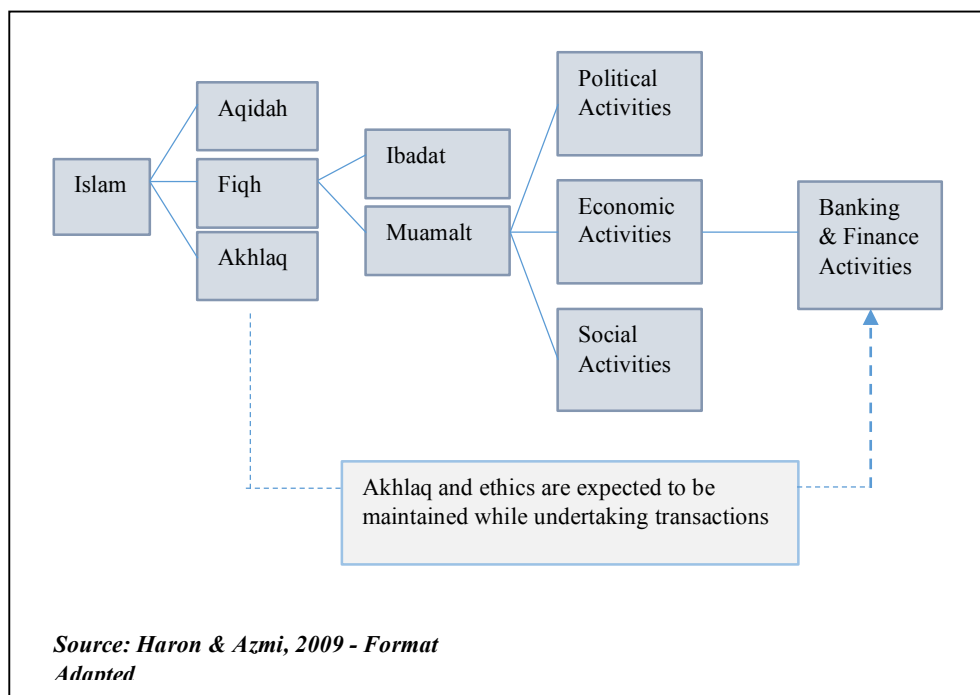
change the individual’s “behaviour, life-style, tastes, preferences, attitude towards the creator, other human beings, resources at their disposal, and the environment” (Chapra, 2008:27) through educating, guiding, and regulating.

Those responsible for development need to work on strengthening faith, values and rules of conduct, so as to develop the individual’s moral obligation with one another and within a society, to arrive at a lifestyle where the rules that govern it are “unconditionally accepted and observed by everyone” (Chapra, 2008:29). Through working on the development of the individual’s intellect, self, wealth, and posterity in conjunction with faith and the concept of equal opportunity of wealth, individuals can be enriched and social harmony can be maintained, which is the goal of the Islamic world.

### 3.3. ISLAMIC FINANCE

Continuing from the basic rules of Islam (*Ahkami-tiqadiyya [aqidah]*, *akhlaqiyya [akhlaq]* and *‘amliyya [fiqh]*) discussed under section 3.1.1 above, and the belief that *Shari’ah* principles offer a way of life, the relationship between the banking and financial system and Islam can be seen in Figure 3.2 below.

**Figure 3.2-Relationship Between Islamic Banking & Finance System in *Shari’ah***



As can be seen above, the Islamic finance activities are a sub-part of the Islamic economic activities. This is because the “economic man” seeks a source of income (working/producing) and seeks to increase his income and wealth, as finance helps to mobilise and channel the various resources (such as capital, skills, services, etc.) available in the economy among the participants, while adhering to the boundaries of *Shari’ah*.

The main *Shari’ah* principles that are related to Islamic finance are the prohibition of *riba*, *gharar* and *maysir* (Gait & Worthington, 2007:7). Though these prohibitions have been mentioned earlier, the researcher would like to elaborate a little further on *gharar* before proceeding to the next section. The reason being is that *gharar*, an analogy to excessive risk (not the speculative trading type of risk) and uncertainty of the conventional system, is a state that is difficult to determine and at times difficult to avoid.

*Gharar* “is a kind of uncertainty... it means, deception or misrepresentation, which includes exposing oneself or others or his property or others to jeopardy” (Al-Saati, 2003:6) and can lead to dispute. There are three basic classifications of *gharar* (Al-Dhareer, 1997:12): the first being “doubtfulness”/uncertainty of the probability of something happening; the second being “ignorance” and the third combines the first two meanings of “unknown and doubtful”. In an economic system there are usually exogenous and endogenous variables/uncertainties. *Gharar* in contracts/transactions, like uncertainty cannot be completely prevented from occurring, and it is also affected by endogenous variables. While the exogenous variables occur due to changes of elements from outside of the economic system and cannot be avoided (e.g., taste, habits, technology and external events such as floods, earthquakes, etc.), the endogenous variables are related to contracts/transactions (such as appropriateness of the parties, the quality of the goods) that occur due to changes in the factors from within the economic system that can be reduced through performing proper due diligence (Al-Saati, 2003:4).

Thus, since *gharar* cannot be completely shunned, and some *gharar* is to be tolerated, the jurists have classified the “degree of permissibility of *gharar*” (Al-Saati, 2003:9) as: “prohibited *gharar*”, “permissible *gharar*”, “acceptable *gharar*”, and “mandatory uncertainty”. The prohibited *gharar* are transactions with excessive *gharar* (uncertainties), that “include the idea of voluntary and deliberate *gharar* taking” and those “with no value added or created from the transaction” (Al-Saati, 2003:10). While “permissible *gharar*” is the existence of some uncertainties such as “selling what is hidden in the ground”; where such transactions are for the benefit ‘*maslaha*’ of the general public. There is also the “acceptable *gharar*”, where

uncertainties arise due to exogenous and endogenous variables, such as changes in technology and in consumers' taste. Finally, the "mandatory uncertainty" is the uncertainty that is based on the concept of "revenue goes with liability", which is the main prerequisite to a valid contract (Al-Saati, 2003:9-14).

In meeting the systemic and dynamics of an Islamic financial system, stability, growth and economic welfare are to be considered (Yusof, Kashoogie & Kamal, 2009). As such, risk is to be spread rather than concentrated. Just as resources are to be allocated efficiently and equitably, so are economic risk and gains (Maghrebi & Mirakhor, 2015). In promoting stability and equitable growth, equity/risk sharing financing is considered the ideal form of financing over debt/interest financing. Whereby the burden is not placed on one party and where both parties can benefit: no claiming of fixed returns when losses are incurred, and no losing out when large profits are made (Yusof, Kashoogie & Kamal, 2009). By following the sharing mode of financing, not only is stability achieved, but it also encourages greater involvement of members of society and entrepreneurship is incentivised, than in a system that fosters the interest based mode of financing (Yusof, Kashoogie & Kamal, 2009).

Islamic finance/investment can be classified into three basic forms. The first being a profit/risk sharing partnership (such as in *musharakha* and *mudarabah*), and the second is based on sales contracts with an anticipated/fixed return (such as in *murabaha*, *istisna*, and *salam*), while the third is based on the assigning of usufruct rights (such as *ijara*) (Kahf & Khan, 1992:32, Atai, 2010:3).

Furthermore, in dealing in Islamic finance, understanding of the ownership rights needs to be clear. The owner of the rights is entitled to the proceeds that are generated from the rights, in addition to the owner being the "sole bearer of all responsibilities and risk" (Kahf & Khan, 1992:32) of such rights.

### **3.3.1. Islamic Financial Contracts**

Under Islam, the main business concept is to "share rather than transfer the risk" (Durrani & Boocock, 2006:157), and therefore, the mechanism of sharing in profits of business/investment involves a form of agreement/contract, in order to avoid any ambiguity. Contracts are the basis of Islamic financial activities and there are four main components that dictate an Islamic contract. The first is the Intention (Al-niyya) to enter into a legal binding relationship. This

involves the “meeting of both minds based on mutual satisfaction...and goodwill” (Hassan, Kayed & Oseni, 2013:58-59). The second is the Form (*Sighah*) of the contract. For there to be a contract/an agreement there needs to be an offer and acceptance in return, which forms the relationship. The third is the Parties of the Contract (*Al-Aqidan*). Those making the offer and acceptance need to be competent and have the capacity to enter into such an agreement. The fourth component is the Subject Matter (*Al-Ma'qud Alaih*), which needs to be in line with *Shari'ah*, and the essential details of the subject and related rights and benefits of the parties are to be clearly stated. The parties then conclude the terms and conditions of the agreement in a concluding meeting, which is referred to as *majlis al-aqd* (Hassan, Kayed & Oseni, 2013:58-59).

In Islam, productivity is an important feature of the infrastructure it is aiming to achieve, and as such when interpreting this feature in the Islamic finance activities, the transactions that are based on profit/loss sharing principles are the most applicable. These principles are based on the following. If all parties are participating in the capital then the profits are shared according to agreed terms but loss is borne in proportion to their injected capital (Musharakah). However, where not all members are participating in the capital, in that the others are handling/managing the business/project only, then they share the profits between them based on a pre-agreed percentage, while the loss is only borne by the capital provider on a pro-rata basis (Mudarabah). This is because the managing member's loss is his/her time and effort spent (Gait & Worthington, 2007:12). Both are forms of partnership. The capital provider in both forms has similar obligations (in providing the capital agreed on), but it differs to the manager (*mudarib*). The *mudarib* in the role of managing the investment has obligations towards the other partners/capital providers, in achieving mandates and reporting. The obligations on the *mudarib* are covered under section 3.4.1 below.

Parties are expected to enter into investments together, not through speculation, but after forming proper due diligence on the type of investment for the proper allocation of their funds and resources (Zaher & Hassan, 2001:159). Islamic contracts are considered as economic relationships and have a moral/ethical as well as a value effect. This is similar to the concept of outcome-based agreements (rewarding the principle) and behaviour-based (alignment of interest) agreements, discussed under Chapter 2 (section 2.3.1.1). The Islamic finance contract is considered a combination of both (behaviour/ethical and outcome/value) (Aljifiri & Khandelwal, 2013: 85). Moreover, under *Shari'ah*, all types of transactions between parties require there to be a written contract between the parties, so as to preserve the rights of all

parties involved.<sup>10</sup> Thus, “an economic relationship without a formal contract can be considered null and void in Islamic Finance” (Aljifiri & Khandelwal, 2013: 81). As per Ul Haque & Mirakhor (1986:4), “The core notion of contract is understood in Islamic Law as meaning that the rights and duties between the two parties are specifically determined and fixed by their own voluntary and actual agreement”. This in turn designates the importance to having a transparent, well-defined contract which covers the allocation of responsibilities, monitoring and reporting mechanisms, so as to avoid exploitation and injustice to any party.

Islamic financing contracts are entered into in order to meet an individual’s or a party’s specific requirements. The following are the commonly used basic Islamic financial contracts that act as the basis for other elaborate transactions.

### **Debt Based Fixed Income Instruments**

#### ***Murabaha***

*Murabaha* is considered a “price-deferred sale” (Ahmed, 2012:381) contract. This transaction is based on assisting individuals/institutions (customers) with finance for the purchase of a good/tangible asset. In simple form such a transaction is conducted, whereby the Islamic Financial Institution (IFI) purchases from the supplier the asset that the customer is interested in and then sells it to the customer. The customer pays for the asset through instalment payments, where the overall cost would consist of the original cost plus a mark-up, and the components of the cost are clear and transparent to both parties involved. The mark-up is what the IFI is entitled to, for its efforts in the purchase and sale, and for bearing the risk of temporary ownership of the asset being purchased, which needs to be within reason, and does not change throughout the payment period.

#### ***Tawarruq (An application of Murabaha)***

It is a form of providing liquidity to the client (*mustawarriq*-client/the seeker of funds). There are three types of *tawarruq*: Classical, contemporary and reverse (Hassan, Kayed & Oseri, 2013, 96-97). The classical definition is that the *mustawarriq* buys a commodity on deferred payment and sells the commodity for cash at a lower price to a third party, with the intention of getting access to cash. While, in the contemporary definition, which is also known as organised

---

<sup>10</sup> Holy Quran Surat Al Baqarah (2:282).

*tawarruq*, the *mustawarriq* buys a commodity on deferred payment from the IFI, and sells the commodity via the IFI (acts as an agent) for cash at a lower price to a third party, usually performed simultaneously on the spot market. There are three contracts involved, two of which are considered *murabaha* contracts: the one for cash, between the IFI and the seller and the other for deferred payment between the IFI and the *mustawarriq*. The third contract is the agency contract between the *mustawarriq* and the IFI to sell the commodity on his behalf. Whereas, reverse *tawarruq* is the same as the organised *tawarruq*, but the roles are reversed: the IFI acts as the buyer of the commodity (*mustawarriq*).

The organised form of application has faced some controversy in recent years, due to the fact that it moves the transaction from the equity to the debt market, and creates greater debt than the cash it generates. This debt effect leads to “inefficiency” and “inequity” (Siddiqi, 2007:2) within society. “Therefore, the financing facilitated by *tawarruq*, like its counterpart, leading in the conventional system, is free and unhinged from the real sector of the economy” (Siddiqi, 2007:3). Thus it is not in-line with the understanding of the Islamic economy and Islamic finance. Consequently, in 2009 the International Council of Fiqh Academy ruled (OIC Resolution 179 (19/5))<sup>11</sup> organised and reversed *tawarruq* as “impermissible”.

### ***Istisna***

*Istisna* is considered an “object-deferred sale” (Ahmed, 2012:381) contract. It is used in construction and manufacturing, whereby the funds are pre-provided to the customer by the IFI for the construction of a building/project, in return for providing the material and building/work (Atai, 2010:6). The IFI either owns the property at the end, or leases, or sells it thereafter to the customer on a deferred cost plus markup basis as in *Murabaha*. *Istisna* is a form of long-term working capital financing, and is exempted from the two *Shari’ah* principles where the asset under consideration needs to be in existence and to be owned prior to entering into a transaction (due to the ‘*maslaha*’, and the benefit of the general public - an example of ‘permissible *gharar*’).

---

<sup>11</sup> OIC Resolution 179(19/5) in relation to *Tawarruq*: “...the classical *tawarruq*, which is permissible, provided that it complies with the Shari’ah requirements on sale (bay). ... It is not permissible to execute both *tawarruq* (organised and reversed) because simultaneous transactions occur between the financier and the *mutawarriq*, whether it is done explicitly or implicitly or is based on common practice, in exchange for a financial obligation. This is considered a deception, i.e. in order to get the additional quick cash from the contract. Hence, the transaction is considered as containing the element of *riba*” (Organisation of Islamic Cooperation 2009).

## ***Salam***

*Salam* is used to provide finance for the purchase of a good which is delivered at a later date and is considered an “object-deferred sale” (Ahmed, 2012:381) contract. It is a form of financing used mainly in agriculture. It is also a form of working capital financing, but is considered short-term rather than long-term, and is thus also exempted from the two *Shari'ah* principles of existence and ownership due to permissible *gharar*.

## **Asset Backed Instrument**

### ***Ijara and Ijara wa-Iqtina***

These are forms of Islamic leasing. In *ijara* the IFI leases to the customer the desired asset for a pre-agreed upon lease payments, for a certain period of time, after which the asset is returned to the IFI. This is similar to operational leasing in the conventional system. However, with *ijara wa-iqtina*, the customer has the right to own the asset, if he so seeks, at the end of the lease period. This is similar to the capital lease of the conventional system. The IFI needs to ensure that the assets that are being leased have the productive life of the leased period, and the customer needs to ensure that the asset is not mishandled. The profit that the lessor earns is in the form of rent.

## **Partnership Based Instruments**

### ***Musharakah***

This is a joint-venture/partnership agreement between two or more parties who enter into a business activity/project with the purpose of making profit. The parties provide the capital, not necessarily in equal portions, and management/labour is agreed between them, where not all need to actively participate. The profits are distributed as pre-agreed ratios and the losses are borne by all, in proportion to their capital contribution.

### ***Mudaraba***

It is also a form of partnership agreement, but more private equity (capital growth). Whereby capital is provided by one or more members (capital owners: *rab al-mal*), and management is entrusted to another (non-capital provider) party who acts as a manager (*mudarib*) with the purpose of making profit. Profits are based on a pre-agreed percentage, and losses are borne only by the capital providers.

There are various contracts in Islamic law, and a summary of those related to banking and finance are stated in Figure 3.3 below.

**Figure 3.3 - Contracts of Islamic Law (Selection)**

Contracts of Exchange	<ul style="list-style-type: none"> <li>• Lease-based, i.e. <i>ijarah</i></li> <li>• Sale-based, i.e. <i>Murabahah, Salam, Istisna</i></li> </ul>
Contracts of Partnership	<ul style="list-style-type: none"> <li>• <i>Musharakah</i></li> <li>• <i>Mudarabah</i></li> </ul>
Contracts of Gratuity	<ul style="list-style-type: none"> <li>• <i>Hiba</i> (gift)</li> <li>• <i>Waqf</i> (endowment)</li> <li>• <i>Qard al-hasan</i> (benevolent loan)</li> <li>-</li> </ul>
Contracts of Security	<ul style="list-style-type: none"> <li>• <i>Rahan</i> (pledge)</li> <li>• <i>Kafalah</i> (guarantee)</li> <li>• <i>Hiwalah</i> (transfer of debt)</li> </ul>
Other types of Contracts	<ul style="list-style-type: none"> <li>• <i>Wasi'ah</i> (safe custody)</li> <li>• <i>Wakalah</i> (agency)</li> </ul>

*Source: Sultan, 2009:37-Format Adapted*

The Islamic financial contracts that are considered “strongly Islamic” are those that are based on principles that “conform to Islamic objectives in both form and substance” (Haron & Azmi, 2009:145). Of those financial contracts stated earlier, *musharakah* and *mudarabah* are the two that are considered strongly Islamic, since they meet the Islamic objectives of “permit[ting] risk sharing between providers and users of funds” (Haron & Azmi, 2009:145). Hence, it is encouraged to use the profit/loss sharing (PLS) and profit sharing (PS) forms when investing/financing and to use the other forms of financial contracts when “risk-return sharing cannot be implemented” (Haron & Azmi, 2009:145).

### 3.4. PRIVATE EQUITY AND ISLAMIC FINANCE

The two forms that are considered as partnership venture investments in Islamic finance are the *musharakah* (*Sharika al-aqd*, contractual partnership) and the *mudaraba* forms of financial contracts. For a financial contract to be Islamically valid, certain “essential elements and necessary conditions” (Sultan, 2009:43), in addition to the general *Shari'ah* principles mentioned in the earlier section above, must be fulfilled. Therefore, in the next section the



essential elements and necessary conditions for those partnership venture types of contracts are covered before proceeding to the setup of Islamic private equity.

### **3.4.1. *Mudarabah* Contracts**

As mentioned earlier, the *mudarabah* contract is a partnership agreement that follows the PS principle. The essential elements/components and necessary conditions/criteria of the contract are outlined next.

The main components/features that shape the *mudarabah* agreement need to be clearly stated and known. The involved parties' role (the capital provider and the manager) both need to be identified. The type of project to be entered into along with the amount of capital to be used needs to be stated. The profit ratio needs to be determined, and for it to be an agreement there needs to be an exchange of an offer and acceptance. These are the essential elements of a *mudarabah* contract (Sultan, 2009:43).

The necessary conditions revolve around the elements of the contract and in clearing any possibility of any ambiguity that may arise. The amount and form of capital needs to be clear. Capital cannot be in the form of debt, and if tangible assets are used, they need to be valued and the monetary value needs to be stated. Furthermore, since the profits are shared and losses are only borne by the capital provider, then the expenses that will form part of the agreement need to be clearly defined, in addition to clearly defining the profit distribution ratio. The profit ratio cannot be of a fixed amount or tied to capital. The *mudarib* does not receive a service fee, but his percentage of profit may be higher than the other partners, if agreed by all parties, to act as an incentive. Furthermore, the parties may agree to vary the percentage ratio beyond a certain threshold of profits generated. Additionally, profits that are generated should first be used to offset any losses that are being incurred in any part of the business, prior to being distributed (Sultan, 2009:55-56, Usmani, 2008:50-51).

The *mudarib* is obliged to work towards achieving the mandates of the contract, and to handle the funds in the best way possible (within the agreed boundaries), using his expertise and skills, and not to misuse the funds for his own interests and expenses. He is to use *Shari'ah* compliant transactions while realising the business/project. The *mudarib* has an obligation to the *rab al-*

*mal* (capital provider) to provide him with information, and to update him with the activities and developments of the business. The *mudarib* is permitted to create a reserve fund, which he is able to use to even out the revenues, and accordingly use to pay dividends to the investors across reporting periods. However, if losses are incurred, the losses have to be offset using the reserve fund, prior to paying out to the parties as per the agreed ratios.

### **3.4.2. Musharakah Contracts**

The *musharakah* contract, as mentioned above is a partnership agreement that follows the PLS principle, and the essential elements and necessary conditions are as follows.

The essential elements of *musharakah* are similar to those of the *mudarabah* agreement, with the exception that the parties involved are all involved in the capital as partners or shareholders. Hence, in addition to identifying the parties, the capital, the project to be ventured into, and the profit ratios all need to be stated in the agreement; in addition to there also being an exchange of an offer and acceptance between the parties venturing into the business together (Sultan, 2009:48).

The necessary conditions of a *musharakah* contract require that the capital cannot be in debt form, but can be in tangible assets, where they have to be valued and their monetary values need to be stated. No partner can provide a capital guarantee to another partner, and the capital contribution among the parties need not be equal. Furthermore, there might be some partners that are also contributing to the managing of the business, and in such a case, their role needs to be clearly identified; they will act as *mudaribs*, and the conditions and duties of the *mudarib* will apply, along with them being partners. The profit distribution ratio needs to be determined by the parties before entering into the agreement, bearing in mind that the profit entitlement cannot be a fix amount, and the percentage rate cannot be tied to the capital invested, with the exception of the sleeping partners. For them their percentage portion of the profit cannot exceed their ratio of the invested capital (Sultan, 2009:55-56, Usmani, 2008:50-51). Conversely, one of the partners can be appointed to manage and can be paid a fix fee, provided that it is based on an independent contract to that of the *musharakah* contract. The parties may also appoint an outside party (rather than from among them) to manage under a *Wakala* (agency) contract, based on set terms and conditions. In such a case he is paid a fixed fee that is paid out of the

*musharakah* expenses. Furthermore, the parties have the liberty to adjust the contractual provisions in line with the business conditions.

### **3.4.3. Musharakah and Mudarabah intermingled**

This is a situation where the manager (*mudarib*) is interested in investing some of his funds into the invested project. In such instances the *musharakah*'s necessary elements and conditions apply, with the addition of the following conditions. The *mudarib* needs to obtain the permission of the *rab-almal* (capital provider) before mingling his funds with those of the *rab-almal*. The profit generated is divided in proportion to the two funds, and the *mudarib* will receive all the portion of profit generated from his fund along with his agreed portion of the contractual fund.

### **3.4.4. Islamic Private Equity**

Following on from the two basic forms of partnership that are used in Islamic finance, the following are the basis of the Islamic private equity process (Yunis, 2006:67-68):

- A special purpose vehicle is established, whereby the Articles of Association of the vehicle cannot allow for any prohibited/haram or speculative activities, which is based on tangible *Shari'ah* acceptable assets;
- The common form of legal structure is a limited partnership. Where the investors will act as Limited Partners (LP) and the fund raisers will be the General Partners (GP), whose role is to invest, monitor, and exit the investment;
- A prospectus covering the terms and details of the investment is prepared. The memorandum should cover as a minimum: the objectives, the investment approach (in line with *Shari'ah* principles), the exit strategy, the opportunities and risks, the management and the board, the legal and tax matters, and terms of investment/subscription;
- Using the prospectus offers are made to the investors;
- The investors' funds/assets are pooled into the vehicle, that has been set up for such purpose;
- The funds are invested based on partnership structures, such as *mudarabah* and *musharakah*.

Figure 3.4 - Simple *Mudarabah* Structure

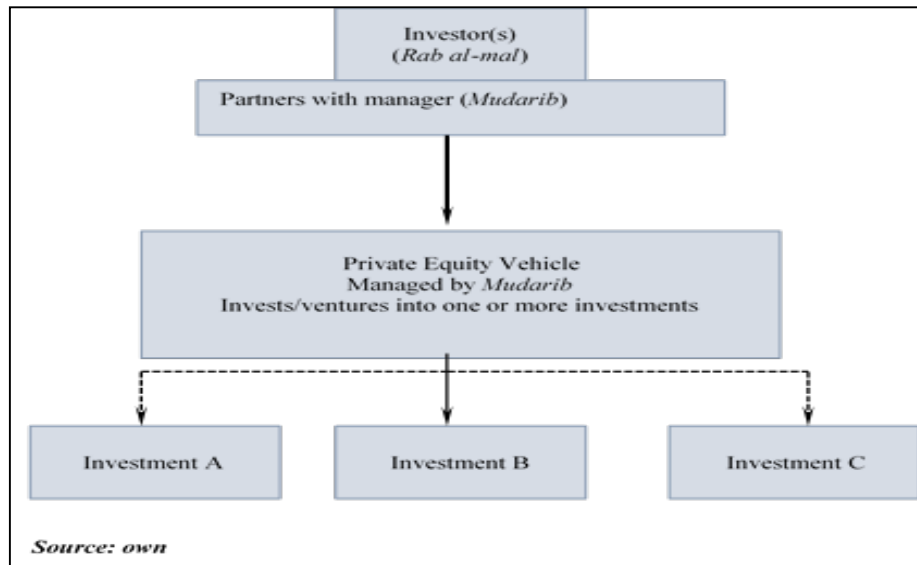
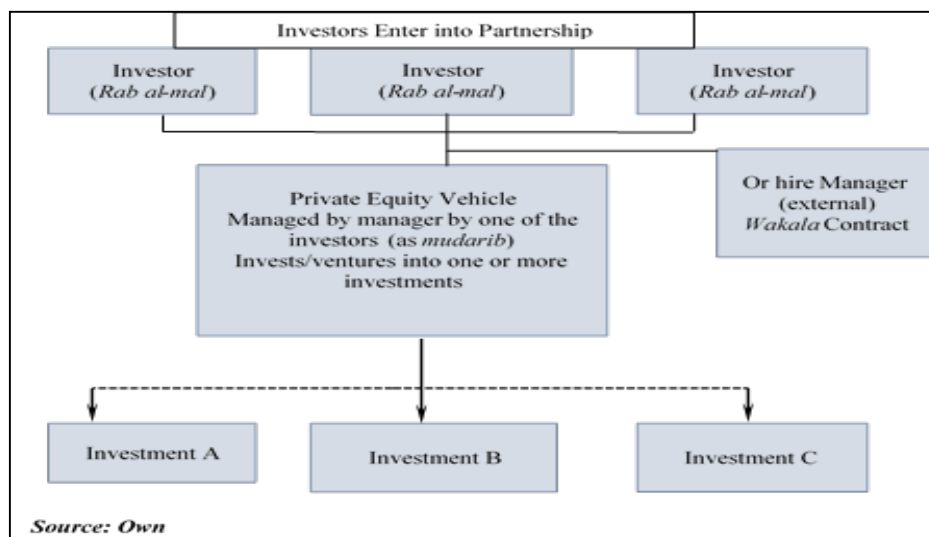


Figure 3.5 - Simple *Musharakah* Structure



### 3.5. Contrasting the Islamic and Conventional Private Equity

Although today's Islamic private equity (IPE) has been established based on the conventional private equity (CPE) model, there are some similarities and some differences between the two approaches of private equity investments. The following section will attempt to provide an insight into the most prominent ones.

### **3.5.1 Similarities of Islamic and Conventional Private Equity**

Both the Islamic and conventional private equity are set up in the form of a partnership, normally similar to limited and general partners. The capital committing providers take up the role of financiers as well as investors, and they are usually institutional investors as well as high net worth individuals. Furthermore, since the funds will be locked up for a reasonably long period, that could run to 8 years or more, then for the investment to be attractive to both approaches it needs to demonstrate that it has the ability to generate some cash-flow during the investment period, in addition to having a persuasive exit strategy, where and when the investors will be able to generate a return on their investment (Yousfi, 2012:7-8). The “technical operational” aspects of administration and monitoring the project are similar in both methods (Ahmed, 2004:3).

Both approaches function on the basis of a partnership and accordingly follow the principal agent relationship. Thus, they both face moral hazard, adverse selection, and asymmetry of information problems that are associated with such a relationship.

### **3.5.2 Differences between Islamic and Conventional Private Equity**

The differences arise from the aspect of the need for IPE to be Islamic. By this, the partnership needs to be in line with the *Shari'ah* principles and its related Islamic business ethics. Even though characteristics such as truthfulness, trust and competence are desired and sought in CPE, yet in the IPE it is a pre-requisite for it to be Islamically accepted (Durrani & Boocock, 2006:151). First and foremost, the target investment/project needs to be *halal* (not in prohibited sectors) and it needs to serve some form social and economic benefits. The IPE is financed following the PLS principles (mentioned above, section 3.1.1). The *mudarabah* method is similar to the conventional venture capital financing, whereas the *musharakah* method is more similar to the conventional private capital growth financing.

Furthermore, they face operating differences, in that as per *Shari'ah* requirements, they are not permitted to take interest-based leverage; unlike its CPE counterparts, where their working capital can be through interest-based debt (Yousfi, 2012:19). Although in some instances IPE is allowed to take on board some debt (when investing in conventional stocks), and if the debt is in the form of interest-based loans, the debt to equity ratio cannot exceed 33% (Yousfi,

2012:19). Both approaches face various risks, such as market and liquidity risks, and the IPE is restricted in the way that it cannot overcome them by hedging against these risks. For instance, the CPE is able to go down the road of options, futures and diversify, while the IPE is not permitted to do so. In entering the trusted contractual agreement, the IPE is obliged to stay in the investment until maturity, even if it is making a loss. As such, the IPE face higher risks than their CPE counterparts, and so there is a greater need for them to be selective in their investments. Moreover, the CPE and the IPE contracts are similar in that they both have an outcome element but they differ in that with the IPE the ethical element should be paramount, unlike in CPE where it is an expected behaviour (Dusuki, 2006).

Due to the importance of compliance with *Shari'ah*, IPE in their structural set up are required to have a *Shari'ah* Supervisory Board. Their role is to make sure that the investment/project is in line with *Shari'ah* right from the selection of the investment to its exit. Such a board is not required in CPE. When coming to the supervisory issue, the regulations are not clear for both parties, but more so for IPE, and they vary from one country to another. At least with the CPE, although disclosure might be an issue, there is some form of harmonisation and standardisation in certain areas of regulations/supervision (Yousfi, 2012:12-20).

### **3.6. CHALLENGES FACING ISLAMIC PRIVATE EQUITY**

Although IPE is an encouraged form of doing business since risk is shared rather than transferred, it still faces many challenges. This section identifies some of the challenges that such a method of financing faces.

#### **3.6.1. Arrangement Structure of IPE**

Under IPE it is either the structure of *mudarabah* or *musharakah* that is used, and in both modes issues relating to the principal agent relationship of moral hazard and asymmetry of information arise, but more so in the former than the latter. The *mudarib*, which acts as an agent in the *mudarabah* and in the *musharakah* (when the management is allocated to certain partners), may act in his self-interest once the financing has taken place. The *mudarib* usually seeks to run the venture with minimal or no interference from their partners, and monitoring becomes uneconomical for some, more so with the high net worth individual investors than the institutional investors. It is more risky with *mudarabah* than *musharakah*, due to the fact that

*mudarabah* is a non-binding contract. That is, the capital provider trusts the *mudarib* with his funds, who acts as an agent and with his consent. As such, any loss is to be borne by the capital provider (AAOIFI, 2008:245).

As an incentive to the *mudarib*, the *Shari'ah* standards allow for the *mudarib* partner of the *musharakah* to receive remuneration provided it is in a separate contract to the *musharakah* contract. This is so if anything should happen to terminate the managerial agreement it would not affect the partnership agreement. However, this is not the case with the *mudarib* in a *mudarabah* contract as the *mudarib* entered the agreement with this being his role and responsibility and his contribution to the venture. Nonetheless, the *mudarib's* expenses (within reason) can be covered by the *mudarabah's* funds (AAOIFI, 2008:240).

In the CPE, the above agency problem does exist, and it is overcome by introducing preference<sup>12</sup> and convertible shares in the financing as an incentive. Although preference shares (of different classes and rights) are not permitted in *Shari'ah*, convertible shares are permissible.<sup>13</sup> Moreover, to overcome the agency problem IPE permits different profit entitlement (that is greater than the percentage of the injected capital), upon exceeding a certain threshold, to act as an incentive (provided all parties agree).

In *musharakah* there is a form of buy-back known as diminishing *musharakah*, whereby the entrepreneur of the venture buys back the other partners'/investors' equity portion, as profits are generated. The exit strategy is another challenge, since the investors' return on investment

---

<sup>12</sup> Reference to preference shares in CPE: "Unlike in public settings, in private equity preferred stock refers to a security that awards liquidation rights to the investor if the company does not achieve a threshold performance level...we refer to the group of securities as convertible preferred stock to avoid confusion with preferred that only has preferential voting rights" (Lerner and Schoar, 2005:226).

<sup>13</sup> Convertible shares are permissible in *Shari'ah*, however, they are not structured in the same way as the conventional, as it involves *bay al-'inah* and discounted *bay al-dayn* and is considered to lead to *riba*. Islamic convertible bonds are structured using three contracts: *Al-wadiah* contract, *Kafala* contract, and *al-qirad* contract. "Since *Al-Wadiah* is not a loan (*al-Qirad*), it is likely that some contractual return can be guaranteed based on mutual consent (*ta'awun*) if and only if the investment is profitable...the distributive scheme of *Al-Wadiah* can help provide an incentive to asset-owners cum investors to take minimal risk but to be assured of some returns when some profits are indeed realized" (Rosly and Omar 1999). An agreed upon profit ratio is contracted between the owner (investor) and the Custodian (issuer) in an *Al-Wadiah* contract. And in order to offer an *Islamically* acceptable call option (i.e. a price free conversion option which acts as a sweetener in the conventional), a separate contract from *Al-Wadiah* is entered into: a *Kafala* contract. This is where a third party on the concept of *ta'awn* (for a service fee from the issuer) enters into a *Kafala* contract with the owner/investor, where he guarantees the conversion of the *Al-Wadiah* contract into stocks. The third party will warrant selling the *Al-Wadiah* at the conversion price (which is below the market price). Then the owner/investor purchases stocks with the cash proceeds at the conversion price, through an *Al-Qirad* contract. In the *Al-Qirad* contract the distribution of profits is not assured and it is based on performance (Rosly and Omar 1999).

is heavily dependent on being able to exit from the investment/venture. The form of exit needs to be stated in the contract. Other than diminishing *musharakah*, there are a few permissible ways, such as initial public offering (IPO), acquisition, and secondary sale that may reflect positively on the returns, if the venture exists through such methods, yet this requires a well-developed and operating financial market (both private and public).

### **3.6.2. Legal Structure of the IPE**

The usual legal set-up in such an approach is that of limited liability whereby claims can only be made to the company and cannot reach out to the personal assets of the parties involved. This introduces a challenge especially when a few partners, who are mainly sleeping partners, provide the funds and the business is run by the activities of a single/few partner(s). Claims can arise due to the managing partner's behaviour that the venture is unable to settle.

Furthermore, this legal set-up (of a vehicle where the funds are pooled, in order to form a single entity for the purpose of making it easier to manage and administer the venture), is usually established in another jurisdiction, other than where the managers, parties or the investment/project are located, which makes it even more difficult to monitor and oversee. The laws of the jurisdiction where the entity is established/registered govern the legal structure, which might not be in alignment with the laws of the jurisdiction that the parties are from, making it even less effective to control or regulate such an entity.

There is also the matter of investors'/shareholders' protection and entitlements such as investors' rights and "upholding property rights, respecting the consistency of entitlement with the rights of ownership, linking transactions to real life activity, [and] transfer of property rights in sales". In addition to the contract, the "documents, processes and operations" are the legal axioms that need to be endorsed, not in the "form and words" but in the "object and meaning" of the Islamic law (Ahmed, 2011:150-151). Under the current Islamic laws and regulation environment, there are two main challenges. The first is the familiarity (not only knowledge, skills and expertise, but cultural and language) of those transacting and involved with the *Shari'ah* principles and the Islamic law. The other is the endorsement of such investor's rights issues in the national laws which are also of concern to the parties and participants involved in the transaction, especially as there is little experience in endorsing such cases pertaining to the Islamic law. The concern and fear of the participants arises from the aspect that "there is no



explicit mention [in the Islamic laws and regulations] of shareholder's rights as stated in the contemporary corporate law framework" (Ahmed, 2012:387).

In *mudarabah* once the covenants are agreed upon and the agreement is signed, any subsequent changes cannot be made without the agreement of both parties. So if the venture does not go as planned the *mudarib* cannot easily persuade his partner to make any changes. While in *musharakah* the terms and covenants of the contract can be agreed on to be adjusted in phases, as the venture progresses. This constraint on the flexibility of the covenants of the *mudarabah* is to protect the capital provider from being at the mercy of the *mudarib*.

### **3.6.3. Transparency of the IPE**

As seen above, the asymmetry of information is of concern in financial transactions. The concern arises in that in both *mudarabah* and *musharakah* not all parties are aware or have the same level of information. In *mudarabah*, the *mudarib* manages the business without any interference from the capital provider/financier (*rab-almal*/investor), and so the main channel of information to the investor is from the *mudarib*. Also in *musharakah*, although all parties are involved, and the non-managing parties can be on the advisory board, the information they receive is also from the managing partner. Furthermore, in practice, upon subscription the investors sign a proxy to the managing partner. As such, the restriction in authority places the need for more disclosure (Aljifri, 2013:83). There is an essential need for transparency and detailed specific disclosure clauses to be covered in both the covenants of the contract, and in the regulations that will enforce such requirements to be part of the contract, let alone monitoring its compliance.

Furthermore, the documentations involved in such transactions are few. And in order to avoid any misunderstanding, ambiguity, loss of rights and to prevent any disputes, proficient due diligence is required in drawing up the related contracts. There is also the issue of these documents meeting the *Shari'ah* scholars' approval and the regulations of various jurisdictions. This can turn out to be very costly and time consuming, and can be reduced by having acceptable standardised documents that could be made available for use, which can be tweaked to suit specific arrangements (Khan 2011).

### **3.6.4. *Shari'ah* Knowledge and Understanding**

The *Shari'ah* principles are not understood by all market participants. There is a lack of those who are knowledgeable about *Shari'ah* and finance at the same time (Jaffer, 2010:19). Scholars and jurists who are experienced in *fiqh al-muamalat* and Islamic commercial jurisprudence are in short supply. Furthermore, this deficiency in transacting the Islamic way is also applicable to market practitioners. The practitioners that are involved in dealing in Islamic transactions are not professionally qualified. They lack the correct awareness and in depth understanding of the basic *Shari'ah* principles and lack an appreciation towards the *Shari'ah* requirements (Abdull Mutalip, n.d.). Most of the professionals handling the deals, in such an industry, are from the conventional system, and their knowledge of the *Shari'ah* way of transacting is more experience rather than in-depth study/academic.

On the supply side, the high net worth investors whose knowledge on the *Shari'ah* way of transacting is shallow, in that it lacks an in depth understanding of the basic Islamic principles, and the spiritual social reasoning behind the prohibitions. There is a lack of “cultural acceptance of Islamic products” (Bose & Mcgee, 2008:14). Their understanding is gained from networking more than anything else, which gives rise to certain misunderstandings about certain *Shari'ah* concepts (such as with there not being a difference between interest and mark-up and the social harm it can have). Furthermore, the deficiencies in some of the transactions (with regards to them being fully *Shari'ah* compliant) that the industry has been experiencing (such as *tawarruq*, and certain *sukuk* issuance (Bose & Mcgee, 2008:10; Jaffer, 2010:4-5), along with being more familiar with the conventional system, has given rise to confusion and doubts in investors, resulting in less trust when investing in such Islamic investments.

The *Shari'ah* compliant way of financing is a culture that needs to be developed from a top-down approach, embracing all members, not just those of the industry, but also society, as is understood from the literature review of the earlier sections of this chapter.

### **3.6.5. *Shari'ah* Perspective**

The *maqasid al-shari'ah* imposes both legal and social obligations on those practicing Islamic methods. The “legal requirements can be deliberated in terms of form and substance and the

social aspects can be recognised in the role played by the [financial institutions]” in meeting the market needs of different segments of the society (Ahmed, 2011:155).

Having the proper documentation in place can allow them to conform to *Shari’ah*. However, the challenge lies in meeting the substance and social aspects of the obligation, which is usually not easily reached or seen. With regards to the substance, this feature is related to legal characteristics that need to be maintained during implementation, and since it is not tangible, it can easily be distorted in application. With regards to the social aspect, it is the ability to service all segments of the market and fulfil the needs of all group classes (rich, middle and poor). Due to these concerns and doubts, the terms “*Shari’ah* compliant”, “*Shari’ah* based” and “pseudo-Islamic” (Ahmed, 2011a:150) have arisen. The table below gives a summary of the various positions and their corresponding requirements.

**Figure 3.6 - *Shari’ah* Requirements and Product Categories**

Product Type	Legal		Social	
	Form	Substance	Market Segment	Needs
<b>Pseudo-Islamic</b>	✓	?	?	?
<b><i>Shari’ah</i> Compliant</b>	✓	✓	?	?
<b><i>Shari’ah</i> Based</b>	✓	✓	✓	✓

Source: Ahmed, 2011:156

Therefore, an IPE can be pseudo-Islamic if it only meets the legal form and it can be considered *Shari’ah* compliant if it meets both the legal form and substance, yet ignores the market segments and does not offer assistance to those in need in the market, and it could be considered *Shari’ah* based when it realises all goals; the legal and the social.

### 3.7. CONCLUDING REMARKS

This chapter reviewed Islamic private equity in the context of the Islamic financial system and *Shari’ah*. Everything revolves around the *Shari’ah* principles that are not there to preserve and punish, but to serve as a set of values and systems to be followed. As the Islamic system is

considered a code of life, religion and management of daily life are not to be considered as unrelated but rather to act as complements. By succeeding in one's daily life in this world a person correspondingly works for success in the world hereafter.

The individual is not to work in isolation, but to work within the society; working for the benefit of oneself through benefiting others in the society. The thinking should be to maximise welfare/social outcomes rather than to maximise profits. The aim is to create a system that would remove/reduce hardship and protect the rights of all, including the minority.

Islamic finance is a faith based blending of economics, ethics, and Islamic law and also must comply with national laws/regulations. Whereby the dealings have to be real and based on transparency, equality, and risk sharing. As such, equity is the favoured form of transacting, as debt in the long-term can only lead to imbalance and harmful outcomes. Actions are observed both externally (what can be seen) and internally (what cannot be seen); and intention, of which substance is an analogy, forms a vital component in *Shari'ah*.

Islamic private equity might be similar to the form of the conventional private equity, yet it has to preserve the above-mentioned *Shari'ah* parameters. Hence, meeting the structural and legal format is not sufficient for the structure/venture to be fully acceptable by *Shari'ah*. The whole cycle of the venture needs to be followed and monitored. There needs to be an on-going process of checking and monitoring to make sure that transparency, disclosure and investors' rights are being preserved, so as to maintain the legal requirements, both form and substance, and the social *Shari'ah* requirements, so that it can be considered fully Islamic, i.e. *Sharai'ah* based.

As participants progress further down the road of IPE, several deficiencies relating to corporate governance principles have come to float lately. Some of which are difficult to resolve (such as risk management, hedging strategies and innovative instruments), due to the *Shari'ah* features involved and demanded, while others can easily be seen to by the supervisory and regulatory institutes. Standards and regulations regarding legal rights, investor protection, transparency, and disclosure (those that protect the society and the individuals, reduce agency problems, and uncertainty (*gharar*), and also form part of the pre-requisites to being Islamic) are but some that need to be available, enhanced and enforced even when dealings are related to the private

market. There is the matter of exit strategies that can also be developed, so as to encourage this form of investment/financing.

Even though the conventional approach has similar deficiencies towards investor protection, (such as: moral hazard, adverse selection, asymmetry of information - as discussed in the previous chapter), there lies a greater need to develop the rules and regulations of the Islamic approach. The reason being, such shortfalls in the conventional approach do not affect the legal status of being non-compliant, considering that no such dealing takes place in the public market. However, as discussed above, these deficiencies cannot be ignored with the Islamic approach, and need to be resolved for the legal status of the transactions not to fall short of being Shari'ah compliant.

## Chapter Four:

### PRIVATE EQUITY REGULATIONS: PRINCIPLES AND STATUS IN THE GCC

#### 4.1 INTRODUCTION

Carrying on from the previous chapter, several deficiencies relating to corporate governance principles can be identified. Matters that protect the society and individuals, reduce agency conflict and uncertainty such as investor protection, transparency, and disclosure are of concern and cannot be ignored in Islamic private equity for it to be *Shari'ah* compliant. Thus, there may be a need to introduce some form of discipline in the conduct of the parties involved in private equity.

However, as private equity, unlike the public equity market, is considered a private market and does not deal with public investors, it is not expected to affect systemic risk. As a result, it may be argued that it does not require much regulating. Nevertheless, following on from the financial crises this view is starting to change, and regulators, as well as some industry participants, are starting to see the need for more transparency in the private market, especially private equity. This is because private equity firms are different from conventional privately owned businesses (Morris & Phalippou, 2012:79). Contemporary private equity firms manage funds on behalf of pension schemes, financial institutions, endowments, and high net-worth individuals, which all fall under the definition of sophisticated/qualified/accredited investors.

Before proceeding with the chapter and the regulatory environment for private equity, to give an indication of the size and nature of the private equity in the region, the following is a brief synopsis of the private equity market in the MENA<sup>14</sup> region.<sup>15</sup> According to the MENA Private Equity Association report<sup>16</sup>, the private equity growth slowed for 2015/2016, after having experienced some growth in 2013/2014, following the drop post the previous peak in 2008 (US\$7.113bn). Recovery from the effects of the financial crisis was short lived, due to the recent

---

<sup>14</sup> MENA - Middle East and North Africa.

<sup>15</sup> The researcher was unable to obtain data specifically for the GCC market on the Private Equity market. Furthermore, the researcher was unable to obtain data specifically on Islamic private equity. The data obtained (stated above) includes both conventional and Islamic private equity.

<sup>16</sup> As per the MENA Private Equity 2015 Report: "Investment information is necessarily not fully comprehensive as it is estimated that up to 30% of PE and VC transactions in the MENA region are not announced, and not all announced transactions include details regarding the size of the investment".

drop in oil prices, the economic slowdown and the regional instability in the region. Although the number of investments reached 244 (175 in 2015), the total value of investments had dropped by 25% (US\$1.1134bn-2016, US\$1.487bn-2015). As per the MENA report<sup>17</sup>, of the GCC countries UAE (62%) had experienced the greatest private equity investment activity during 2016, while KSA experienced the greatest drop in value of investments of 38% (21%-2015, 9%-2016). Most of the other countries took a slower approach with “a wait and see” attitude. The number of divestments during the year was 14 (21-2015) with an estimated<sup>18</sup> value of US\$462m (US\$1,379m-2015). Consumer driven sectors, such as retail, healthcare, transportation, food & beverage and education were the popular investment sectors. Investors’ preferences were towards the deal by deal transactions (specific investment) method of raising funds, as opposed to the pooling of funds method. As per a survey conducted by the MENA Association on the GP sentiments going forward for the PE market, 33% of the GP see the main impediments to doing PE deals in the region as the capital market regulations and foreign ownership restriction. This was followed by a need for more effective enforcement of agreements and minority shareholders’ protection (20%) (MENA Private Equity Association, 2016).

In this chapter, regulation on private equity will be examined. The chapter will first start to look at the framework and types of regulations, followed by the overall regulations on private equity. After which, the *Shari’ah* regulations on private equity will be viewed. The chapter will then view the GCC market regulations on private equity in general and Islamic private equity in particular.

## **4.2 FRAMEWORK AND TYPES OF REGULATIONS**

Regulations are usually a set of orders or directives that are set in place to control operations and conduct in the market economy. Black (2002:26) defines regulation as “the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes, which may involve mechanisms of standard-setting, information-gathering and behaviour-modification”. The regulatory framework is based on three levels (pillars) (section 4.2.3), and together they are “complementary and mutually reinforcing” (McCahery & Vemeulen, 2008:15) in stipulating

---

<sup>17</sup> As per the MENA Private Equity Association 2016 Report: “Private equity is defined to include houses that have a General Partner/Limited Partner structure, investment companies and quasi-governmental entities that are run by, and operate in the same way as, a private equity house”.

<sup>18</sup> Estimated, due to lack of information in the market on exit value.

order into the market. Moreover, there are different ways of how the market participants deal in the market (relationship versus rule based), depending on the development of their market economy, as can be seen below. The discussion below is in relation to the private market and private equity in particular.

#### **4.2.1 Relationship Regulation versus Rule Based Regulation**

The level of enforcement depends on the types of regulations/enforcement mechanism that exist in that particular market. Depending on whether it is an emerging/“catching-up” (Li, 2003:669) or developed economy, the form of enforcement mechanism will vary. Economies, where the “information structure” (Li, 2003:656) is well developed is considered to rely on market based governance, while those economies where the information structure is not as advanced rely on relation based governance. Market efficiency relies on how effectively “noise” (caused by the irregularly and uncertainty of information) can be reduced in a market; where noise can only be reduced by having a developed informational structure, that is “universal ... shar[ed]” (Li, 2003:656). “The information infrastructure includes accounting, auditing, notary, and rating agencies, and legal cases and codes, which develop and accumulate slowly” (Li, 2003:655-656).

Most economies start with relation-based governance and move towards rule-based governance as economies develop. In relationship-based governance, transactions are based on a personal basis with implied contracts and are enforced-based on personal relationships and sanctions. The checks and balances of the state in the form of rules are not sufficiently available, or if they exist, are not implemented effectively due to lack of clear and commonly understood rules to offer the protection and comfort required, and are “only ink on paper” (Li, 2003:667). On the other hand, a rule-based market is where information is widely available, rules are well established and an effective monitoring and enforceable legal system exists. Market (rule)-based governance might appear costly, however, as the market grows and transactions become more numerous and complex, the marginal cost of transactions on a personal basis increases and outweighs the benefits gained from such a personal relationship transaction. As the market evolves, market-based governance benefits from the economies of scale can be gained from having a reliable monitoring and enforceable mechanism (Li, 2003:655-656).

Parties involved in private equity (especially venture capital) face a great deal of risk. Consequently, they have decision factors to consider, prior to deciding on their investment.



These decision factors are based on a network of commercial organisations known as “economic institutions” (Zacharakis, McMullen, & Shepherd, 2007:691). Economic institutions represent “the ‘rule of the game’ that provide incentives and reduce uncertainties in assessing the cost of transacting” (Zacharakis et al., 2007:691). These rules of the game (decision factors) include a long spectrum that varies from human capital to arm’s length (impersonal)-based transactions. The information used in the decision factors might be the same but it is weighed differently, depending on which point of the spectrum their market is at (Zacharakis et al., 2007:692). At one extreme, in relation-based markets, where the enforcement of contract and property rights is weak and relies on “national culture” (Zhou & Peng, 2009:2) more weight is given to the information available on human capital and trust (“informal rules”) when making decisions (Zhou & Peng, 2009:1). For example, “trust in the entrepreneur is necessary to compensate for the lack of a strong rule of law” (Zacharakis et al., 2007:695).

At the other end of the spectrum, in markets with an effective legal mechanism and strong enforceable property rights, decisions are made on the basis of the information available in the market itself, such as size, growth, technology and rules (Zacharakis et al., 2007:695). There are also economies where venture capital decisions are made based on both human capital and market information; this is still under the transformation stage from one form to the other. The progress from one end of the spectrum to the other takes place over an extensive period of time, where the length of time depends mainly on three variables. The first variable is the availability of the necessary rules to govern all transactions; while the second is the strength of enforcement of those rules, and the third is the resistance and acceptance of adapting the rules (Peng, 2003:282).

#### **4.2.2 Principle-based Regulation Verses Market-based Regulation**

Principle-based regulations are based on international standard setting organisations that provide the general outline of the rule or matters to be regulated and leave the details to the regulators to develop their own systems and internal control to meet such principles. Although this might give the regulator the freedom to form its own system and structure of regulations it also works as a ‘double edged sword’. On the one hand it provides the regulator with the principle/value of concern, yet on the other hand, it does not provide sufficient details that can help him to deal with the matter, and which in turn affects effective enforcement. Transforming these principles into functional rules requires “the exercise of a good deal of judgment, and the

various actors in the regime may have quite distinctive and divergent approaches to making such judgment” (Baldwin, Cave, & Martin, 2013:304). The various actors coming from different backgrounds, with different assumptions and various values, can affect communication and interpretation and thus the final formation and implementation of the rules. It also requires expertise and resources, which not all regulators (being at different stages of development) might have (Baldwin et al., 2013:305).

Moreover, principle-based rules set by international organisations, such as the ones set by the International Organization of Securities Commission (IOSCO) and the Islamic Financial Service Board (IFSB) for the securities and financial market, are not considered “freestanding”<sup>19</sup> (Pistor, 2002:115) rules in that they usually rely on another set of rules for their implementation and enforceability. They are considered “dependent rules” (115) in that they depend on other rules, where additional amendments are required to already established rules to make them compatible: “further reference to other rules, legal concepts, or entire bodies of law needs to be made” (Pistor, 2002:115). With regards to the IOSCO principles, “the efficacy proposed by the rules will depend on the scope and quality of the general framework for commercial law” (IOSCO, 2003:5). Furthermore, they are set based on the concept of the “lower common denominator” ((Pistor, 2002):109). These principles are set by international organisations, with members from various countries with backgrounds of different legal systems and rules. Consequently, when arriving at an outcome, the selection/outcome will be based on those most compatible to their pre-existing legal models and rules. They might not necessarily be the most efficient to all members.

Market-based rules are based on set rules and standard templates arrived at from the supply and demand side of the market needs. Specific rules and standard templates are easier to implement and more cost effective. Even though it overcomes the deficiencies of the principle-based rules, it has its weaknesses as they are formed by the market/industry participants taking into consideration their interests which might not take into consideration the interests of other stakeholders. For the stakeholders to benefit effectively, an “independent evaluation and accountability” (Andenas & Chiu, 2014:93) is required. Market-based rules lead to standardisation, and although they might provide some form of certainty and efficiency, they can lead to issues, if ignored, which could lead to systematic risk (even if non-prudential). One of which is that changes can occur in the economy/market over time and the market participants

---

<sup>19</sup> As opposed to the accounting rules, the International Accounting Standards (IAS) are considered ‘freestanding’ because they “can be derived from reading the IAS alone, and no further reference to other rules, or entire bodies of law needs to be made” (Pistor, 2002:115).

might act selfishly and adapt to the changes in such a way to “protect themselves, but not the system as a whole”(Andenas & Chiu, 2014:93). These types of behaviour could lead to lack of “regulatory capture” (Carpenter and Moss 2013) and to market failure. The other issue arises when implementing the set standard rule, whereby it loses its spirit and becomes more of a ‘box-ticking’ form of implementation. Hence, regulatory supervision is required to overcome such behaviour.

### **4.2.3 Framework of Regulation**

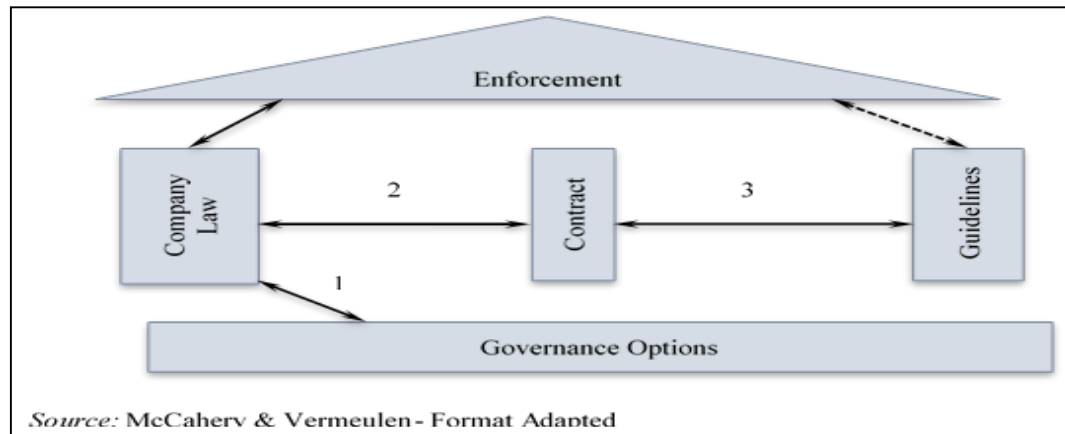
Governance of the private equity market is based on three main pillars: “company law”, “contractual mechanism”, and “best practices”/“soft regulations”(McCahery & Vemeulen, 2008). The company law regulates “registration and formation, organisation and operation, distribution of powers and decision-making, exit and dissolution, information and disclosure, fiduciary duties and liability protection” (McCahery & Vemeulen, 2008:5). Contractual mechanisms such as “joint venture agreements and shareholder agreements” are used by businesses to curtail the deficiency in the regulations in the company law, with regards to the specific requirements of certain forms of business structures (private equity/venture capital) (McCahery & Vemeulen, 2008:55,12). Best practices provide the business with a “well-tailored framework of legal mechanisms and norms”, filling the gap that has not been covered in the other pillars (McCahery & Vemeulen, 2008:5,11).

The company or corporate law is a “standard set of rules that represent different points on the continuum of types of firms” (McCahery & Vemeulen, 2008:23). These range from organisations in which the owners retain significant control over organisations where control is given fully to outsiders (shareholders). As we move along the spectrum, and more parties are involved and interact with one another, the need for contractual agreements become important. These agreements work as a way of aligning the interests and rights of the parties involved. And as markets expand and globalise, norms/standards/best practices (codes/guidelines) are promoted to reflect professionalism.

Usually codes and guidelines, known as “soft regulations”, are more effective. At times they are informative and assist industry players in performing their role more effectively; they provide more detail on certain conduct, which assists enforcement players (Smith, 2012: 378, 399). They are also more flexible than legislation. They can easily be updated, and new ones introduced, to reflect the social and economic changes that occur in the market, while legislation

cannot easily be changed (McCahery & Vermeulen, 2008:198) (Morth, 2004:194-195) (Smith, 2012:387). Furthermore, it is “closely related to socialisation, identity-building” (Morth, 2004:195) that they can act as a form of a disciplinary mechanism within the industry, from the aspect of maintaining integrity and reputation by abiding to these codes.

**Figure 4.1 - The Legal Governance Framework**



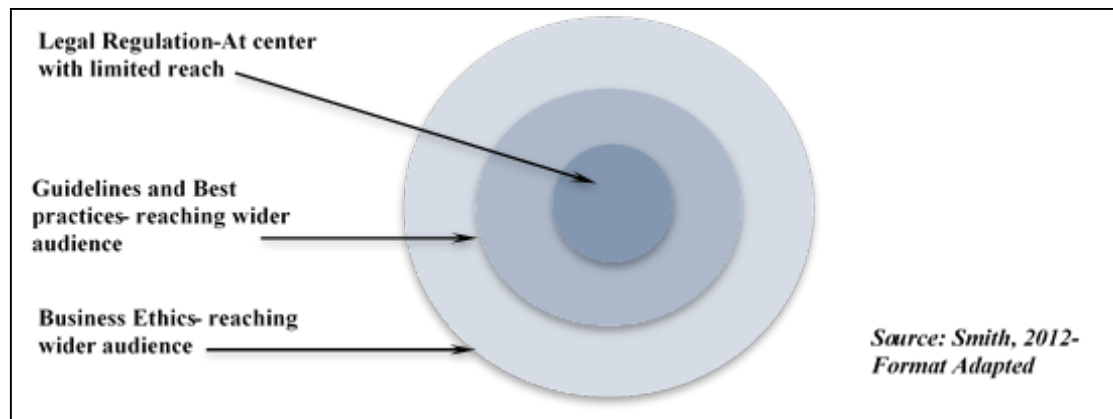
#### 4.2.3.1 Industry-based versus National Oriented Regulations

The private market is a different market to the public/listed companies market, with different forms of relationships between the owners, investors and managers. The partnership contracts involve control and benefit rights, which at some time during the relationship will require effective governance and enforcement. It is the “governance mechanisms” that are of great importance. These are the mechanisms that are “triggered by stakeholders, those internal and those external to the [business]” (Smith, 2012:382). It is not enough to have legal accountability, as provided by the company law, but there needs to be accountability in terms of self-regulation, and the norms of so-called ‘best practice’ (Smith, 2012:382).

Along the “formal... system of control” (Smith, 2012:381), “informal” systems are required. The spectrum of formal to informal ranges from: the state/company law (legal regulation) at one end, to business ethics at the other end, where codes of conduct and best practices lie in between. With the legal regulation being at the centre, its dispersion is centralised to that particular state/sector; while business ethics and best practices are decentralised, and are more dispersed. Business ethics is mainly behaviour based on culture, society, the individual and his integrity. While best practices are codes/standards/norms (also known as soft regulation) put in

place by the industry, or in liaison with the industry, and they cross: boards, societies, and cultures. Thus, they have a wider range of reach than the legal regulation.

**Figure 4.2 - The Spectrum of Governance: From Formal to Informal**



Since the guidelines and best practices (set by/with the industry) have wider ranges of reach, they are a more appropriate form of regulation for the private market. The desired flexibility (in lieu of the law that cannot easily be changed) is retained through them, yet the essentiality of transparency and disclosure for the growth of this market, especially private equity, is promoted. However, since they are not obligatory, they are not necessarily followed/complied with by all participants. “The challenge is to locate the right mix of soft law and government measures that encourage [a company] to effectively disclose” (McCahery & Vermeulen, 2012:223). Therefore, it would appear that some form of co-regulation between the industry and the regulator (National) cooperation is inline, to be able to reach an acceptable level of compliance. Whereby, a “periodic review of the company compliance is conducted by government sponsored monitoring committees which publish the industry-wide compliance level yearly” ( McCahery & Vermeulen, 2012:224).

#### **4.2.3.2 Compliance and Regulation**

It is not sufficient to have standards, rules and regulations that are widely accepted without the effective enforcement. Compliance with them is essential, even if it is the implementation of rule-based regulations. Being rule-based and “formalistic” (Pistor, 2002:113) does not necessarily mean that all those related will oblige. There needs to be supervision and monitoring to ensure its implementation. Compliance without some form of enforcement or monitoring can

lead to “formal” compliance, rather than “real compliance” (i.e. in form rather than in spirit) (Pistor, 2002:125).

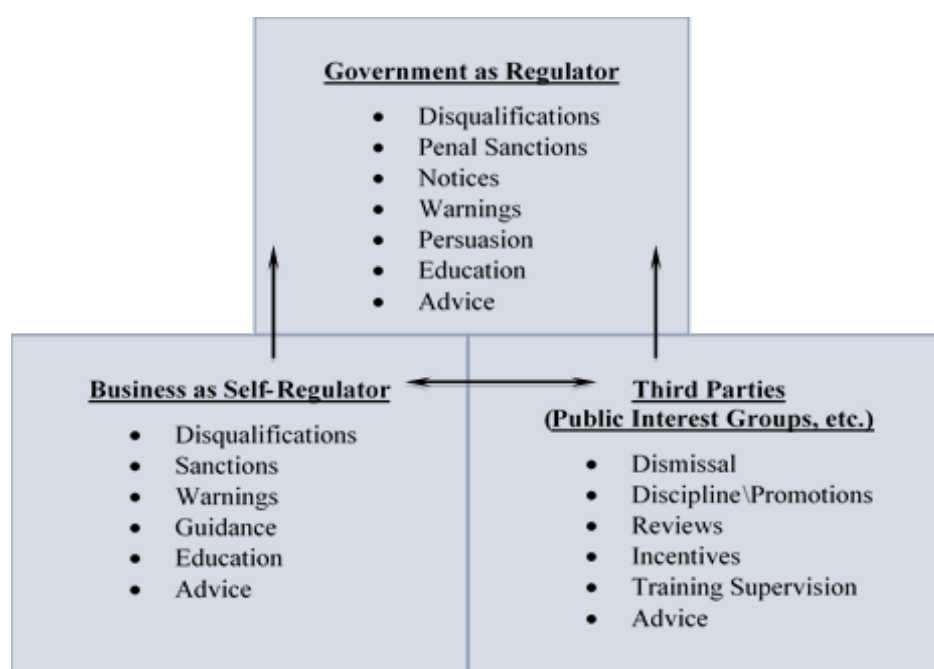
Effective enforcement systems are also required with soft laws, even if created by the industry; it does not mean that compliance would be of a high level or of high value. Many of the soft regulations are ‘voluntary’, and on the basis of ‘comply or explain’. Although they are flexible and act as a self-regulating mechanism, there are drawbacks to soft regulation. “[T]here is often no clear duty to comply and no clear beneficiary of the duty” (Smith, 2012:380), since they are not legally obligatory and so will not necessarily be practiced by all nor will they all be implemented. In such circumstances, who checks the soundness of the basis of whether to comply or not? And how effective is the monitoring? So as to be able to deal with “creative compliance” (Pistor, 2002:113) created as a result of different explanations and interpretations by the implementers.

In the private contract/agreement, the investor is not involved in the day-to-day management, and does not have many governance powers. As such, they “must rely on regulatory enforcement to ensure compliance” (Andenas & Chiu, 2014:181). Hence, operative legal systems that are receptive to improper behaviour, and where accordingly rules are enforced, will increase investor confidence and market growth.

#### **4.2.3.3. Smart Regulation**

Smart regulation, a contemporary form of regulation, follows on from the above concept of regulators collaborating with other parties to realise compliance and enhance the regulatory enforcement strategy. In such regulation the regulator empowers second (quasi-regulators) and third parties (public interest groups) to act as “surrogate regulations” (Gunningham & Sinclair, 1998:2) and (Andenas & Chiu, 2014:86). The “three-sided” (Baldwin et al., 2013:266) form of regulation works on the basis of mixing strategies and instruments implemented by the parties participating in the enforcement. Enforcement starts at the parties’ level, with the least interfering policy measures and is escalated upwards within the parties and to the regulator, when response to the lower level fails. Such a form of flexibility in the enforcement serves to fill the sanctioning gaps. At times when it might not be possible to escalate the matter upwards, due to certain legal issues, alternative options are available, by traversing sideways.

Figure 4.3 - The Three Aspects of Smart Regulation



*Source: Baldwin, Cave & Lodge-Format Adapted*

However, for such a form of regulation to be effective in its compliance and enforcement requires that the regulators take up certain measures to act as warning signals, if compliance/enforcement effectiveness is weakening. Regulators must take into consideration certain matters for the “regulatory pluralism” (Parker, Kuuttiniem, Klaasen, Hill, & Jacobs, 2000:67) to work. In order for the non-government regulating parties to perform their task effectively, regulators must bear in mind that these parties could seek their self-interest above that of the industry/society (Andenas & Chiu, 2014:86,467), and regulators would need to keep regulatory capture, caused by those seeking their self-interest above those of the industry, at a minimum. As such, a form of monitoring (firm reporting, inspecting, independent auditing, etc.) is required. To assist in the “trigger[ing]” (Gunningham & Sinclair, 1998:8) and to act as a warning sign, once a certain level is reached, taking into consideration allowing for a “buffer zone” (Gunningham & Sinclair, 1998:8), upon which the regulator can react, before any negative effect spills over. There are also times when regulators would need to introduce temporary measures that act as “circuit breakers”, especially when new regulations that are unfavoured by the industry are being introduced and implemented. They are required in order “to achieve real progress in areas where regulatory resistance is high and external monitoring is difficult” (Gunningham & Sinclair, 1998:9).

For such a form of compliance/enforcement to be acceptable and adaptable by those enforcing (the regulatory pluralism) and by those that it is enforced upon (the regulatees), trust in the effective implementation of such a system is imperative. Trust that the regulator will act as a “fair umpire who administers and enforces laws or regulations that have important substantive objectives” (Parker et al., 2000:72); and trust that the law would be implemented effectively and that non-compliance is not an acceptable culture. Furthermore, those assisting parties require adequate information in order to be able to perform the duties effectively and to make fair decisions. Therefore, industry information is mandatory at the lower levels of the pyramid. However, upon enforcement for the provision of information, those that are compliant should not be put at a comparative disadvantage by those that are non-compliant, especially under voluntary compliance regimes, and disciplinary sanctions to overcome and prevent such exploitation are required.

### **4.3 REGULATIONS ON PRIVATE EQUITY**

Although private equity investment has been around for a long time, interests with regards to governance and transparency have only surfaced in the last couple of years, after the financial crisis. Upon reviewing the international (in this study: USA, UK and Europe) market regulations on the matter, it appears that the form of direct investment in private equity is considered private placement when dealing with “accredited investors”<sup>20</sup> and is considered “Exempt”<sup>21</sup>, and only in some jurisdictions registration with the securities regulator/commission is required. Moreover, the major forms of private equity that have been of concern and gained some attention from the international market and regulators is the “private equity tainted by the perception of asset stripping, excessive leverage and disregard for the interest of employees” (buyouts) (Goddard, 2009:3). Accordingly, guidelines directed to the portfolio companies of private equity firms (such as the David Walker Guidelines, by the BVCA<sup>22</sup>, that became mandatory in 2007), and Directives on hedged funds (such as European Alternative Investment Fund Managers - AIFM<sup>23</sup>, enforced in November 2010) have been put

---

<sup>20</sup> Most definitions are similar and accredited investors under US regulations include “banks, investment and insurance companies and certain tax-exempt organizations and individuals whose net worth exceeds \$1million (or meet certain income thresholds)” (Ref. US. Private equity Funds: selected regulatory and Tax issues-Filippo M. Cinotti, Esq.)

<sup>21</sup> The offering and sale of securities are considered exempt from registration with the securities regulator, provided that they are not offered to the public (only to accredited investors, and are sold to a relatively small number of investors (e.g. in the US only 35 accredited investors).

<sup>22</sup> British Venture Capital Association, the industry body and public policy advocate for private equity and venture capital in the UK.

<sup>23</sup> AIFM “is defined as any entity managing alternative investment funds ... as a regular business. An alternative investment fund is considered any “collective undertaking” which raises capital from a number of investors in order to invest it according to a defined investment policy and does not require authorisation pursuant to Article 5 of



forward. In the US, following the Dodd-Frank Act, the SEC adopted rules that placed reporting requirements on advisors of private hedged and private liquidity funds. They only apply to large funds, and in the case of private equity, funds with US\$ 2billion assets, need to report annually on “their fund leverage, bridge financing and certain financial investments”. The reported information will be for internal use (“to monitor systemic risk in the U.S. financial system”) and will not be published (Paraskeva 2011).

Furthermore, international non-government organisations that place best practices and standards on the governance of corporations and issuers of securities, such as the International Organization of Securities Commissions (IOSCO),<sup>24</sup> and the Organization for Economic Cooperation and Development (OECD),<sup>25</sup> have attempted to look at private equity from the aspect of conflict of interest and the managing of the portfolio companies. However, their attempts have concluded that most of the matters are addressed in their existing issued general principles and code.

There are also industry associations that try to monitor the activity of the industry and try to maintain an acceptable professional level in the industry. Such as, with regards to private equity there are: the British Venture Capital Association (BVCA), the European Venture Capital Association (EVCA<sup>26</sup>), the Dutch Private Equity Venture Capital Association (NVP<sup>27</sup>), and the Institutional Limited Partners Associations (ILPA) (based in Canada). They mainly offer guidance on the private equity business in general and on the relationship between the GP and

---

Directive 2009/65/EC (commonly known as UCITS Directives).” AIFM Directives applies to managers of hedged funds, private equity funds, real-estate funds and commodity funds (Seretakakis, 2012).

<sup>24</sup> IOSCO set principles and standards that reflect good conduct, with the aim of protecting investor rights, to increase market efficiency and to reduce risk and market failure. IOSCO initiated a consultation paper in 2006 on “Private Equity Conflict of Interest”, whereby the aim was to outline principles for the industry and the regulators to assess private equity firms for managing conflicts. In May 2008 it issued its final report and the report concluded that most of the issues related to market abuse and conflict of interest are not exclusive to private equity and are covered by their general principles on the securities market. In addition, some issues “could fall under the remit of other international organizations”(IOSCO 2008).

<sup>25</sup> OECD initiated a paper in May 2007 on “The role of private equity of capital in corporate governance” for hedge funds and private equity firms (though it was for those actively engaged in publically held companies). Later on that year, it rejected the proposed code as the related principles are addressed within the existing OECD principles of corporate governance (OECD 2007).

<sup>26</sup> In the EVCA Handbook, it recommends that the fund document should provide for the GPs obligations to the LP on the following matters: “the frequency of reports to be made; the information to be contained in these reports; the form and frequency of responsible investment reporting; the basis of valuation that will be used for such reports; and the manner in which the reports are able to be made (e.g. in writing, by email, via a secure website).” It also recommends that the LP Advisory Committee (LPAC) should advise when it comes to conflict of interest matters and be involved in investment decisions. It also recommends that the GP make suitable arrangements to facilitate in meeting the LP’s inquires and concerns and to have an annual meeting whereby the GP can meet and update the LPs in person (EVCA, 2013:29-30).

<sup>27</sup> Nederlands Vererigging Van Participatiemaatchappijen.

LP, and the GP and the portfolio. Among these associations, the ILPA<sup>28</sup> is the only one that looks at serving the requirements of the limited partner rather than those of the general partner. It places reporting requirements on the general partner, which meet the institutional investor's disclosure requirements. They have produced minimum reporting content to be provided by the GP to the LP on a quarterly basis<sup>29</sup>. Furthermore, it provides templates of the form of reports, with the aim of "increase standardization in the private equity industry...to create greater efficiencies, improve the level of disclosure, and reduce the expense of administrating and monitoring private equity investments" (Ilpa 2016b:4). In addition, as a best practice, under the "Private Equity Principles", they suggest that a committee with members from the LPs should be established (Limited Partner Advisory Committee - LPAC). Whereby its role "is not to directly govern, nor to audit, but to provide a sounding board for guidance to the GP and a voice for the LPs when appropriate" (Ilpa, 2011b:13). They also have a Due Diligence Questionnaire "that is a comprehensive document that covers ...questions investors should ask GPs..." so as to help the investor with his due diligence process and in making his investment decision.

There are also principles for responsible investment (PRI) in private equity addressed to LPs. These principles/guides are an investor<sup>30</sup> initiative in participation with the United Nation Environment Programme (UNEP) Finance Initiative and United Nations Global Compact. They provide an outline for the investor<sup>31</sup> to consider environmental, social and corporate governance (ESG) issues, while making their investment decision, in order to maintain market sustainability and improve long-term returns. They encourage LPs to act as "stewards" in private equity, similar to investors/shareholders in a public company role, and to perform governance over the fund by introducing/requesting disclosure practices. They refer the LP to the use of the ILPA's private equity fund governance best practice.

Closer to the region, there is the MENA<sup>32</sup> Private Equity Association. They are a non-profit entity that serves to encourage the growth of PE and VC in the region, to enhance transparency and to promote the sharing of information and network communication among the PE and VC and related stakeholders. It was established in 2010, and the partners of the association are:

---

<sup>28</sup> The ILPA have three guiding principles on private equity partnership: Alignment of interest, Governance and Transparency.

<sup>29</sup> The ILPA's Quarterly Reporting Standards were originally released in October 2011 and were revised in September 2016.

<sup>30</sup> "The principles were developed by, and for pension funds and investment managers" (PRI, UNEP, & UN, n.d.:2).

<sup>31</sup> Their "target audience is any LP seeking to ensure that their GPs work with the underlying portfolio companies to consistently and effectively identify and manage material ESG risks and opportunities, with the aim of improving long-term, risk-adjusted returns" (PRI et al., n.d.:3).

<sup>32</sup> Middle East and North Africa – MENA.

Egyptian Private Equity Association (EPEA), KPMG, Hawkama, and Zawya. In addition to providing reports on the private equity growth in the region, they have documents on the content of the legal document<sup>33</sup> and the term sheet that will bind the relationship in the VC parties in the deal. The aim of such documents is to help reduce the high cost of producing such essential documents, which is vital to sustaining the relationship between the VC/PE parties. The documents are addressed to entrepreneurs seeking to raise venture capital. Unlike the other associations outside the region, membership is not mandatory, or “comply or explain” compliance, however, as per their code of conduct<sup>34</sup>, it encourages their members to comply with eleven principles. These principles include: “Members shall be accountable to their investors and keep their investors fully and regularly informed, including the provision of regular financial reports” and “Members who sponsor investment syndications with other parties, whether members of the Association or not, must operate on the basis of full disclosure to such other parties”, and “All full members must supply investment and performance information to the Association or its nominated agent. This information will be treated confidentially and used in the compilation of private equity industry reports where only aggregate information will be published” are three principles related to disclosure and transparency. They have an objective to liaise with regulators to communicate the industry’s participants’ concerns and to work on improving the regulatory regime in private equity industry, so as to encourage investment opportunities in the region.

The guidelines/measures that are recommended by these associations are proposed in consultation with the industry experts. The guidelines are implemented differently among associations. Some such as BVCA are implemented on the basis of “comply or explain”, and others such as the EVCA, Dutch and ILPA, their guidelines/code have become mandatory for all members of the association. The associations’ aim is for the guidelines to work on the basis of the venture capitalist making an effort to uphold reputation through being in line with the norms.

The intention is for the best practices/guidelines to work as supplements to provide greater transparency in the industry. This supplementation has its deficiencies, in that the variety of guidelines across the industry can cause disorientation. Therefore, to have greater effect they need to work towards standardisation of their standards (J. a. McCahery & Vermeulen,

---

<sup>33</sup> “Venture Capital Legal Documentation in the Middle East and North Africa: a guide to help entrepreneurs understand the legal documentation process involved in venture capital deals in MENA” - March 2012 (MENA 2012).

<sup>34</sup> As of January 2012.

2012:220). It is not that it should be a one-size-fits all concept, as much as it is for the guidelines/best practices to have common language, to be standardised, and consistent in the information reported/disclosed, and to act as a benchmark.

Moreover, the effectiveness of such standards is contingent on the level of support they receive from the regulators and industry participants. These industry setters, although they reach a wider range of participants, they need the support of the regulator. While maintaining flexibility in the private market, legislation is to be avoided, yet this does not mean that the regulator has no role in enforceability. For these best practices to be taken up in the national codes by regulators, this would help enhance transparency and “the voluntary guidelines would ... have a mandatory effect” (McCahery & Vemeulen, 2008:216). The regulators can monitor the compliance through sponsoring third parties to monitor and publish the compliance level on an annual basis. Hence, effective implementation of transparency and disclosure is arrived at through “the coordination of public and private resources to manage regulatory risk” (McCahery & Vemeulen, 2008:223). Furthermore, for an effective outcome of transparency and for it to serve its purpose, two other conditions are required: publicity by making information available/accessible and accountability by having to “pay[ ] the price for one’s action” (Naurin, 2007:3). Hence, making information transparent and available increases awareness, yet it does not necessarily produce the desired outcome. Holding back information will not be reduced if the party holding it back is not held accountable for such action/misconduct, nor will it incentivise the counterparty from speaking out (Naurin, 2007; World Development Report (Spotlight 11), 2017:247-251).

#### **4.4 GOVERNANCE IN PRIVATE EQUITY**

The private equity market is different to the family owned or the public/listed companies market. As such, the regulations of a company law, of a “one-size-fits all” type of regulation is not suitable (McCahery & Vemeulen, 2008:2). Although private equity is a form of partnership, most company laws do not cover directly for such form/structure. The partnership set-up/company is only regulated as a corporate body, subject to the requirements of any other regular business (Cumming & Johan, 2007:3219), while private equity is “a hybrid business form between the limited partnership and a corporation, which play[s] the role of the general partner” (McCahery & Vemeulen, 2008:27). With such an arrangement the governance framework, moral hazard, and asymmetry of information problems that could arise from the relationship are vulnerably covered by company law, and are supplemented by getting into a

contractual agreement. Even though the contractual arrangement complements the company law, the contractual agreement in private equity is considered somewhat incomplete (as seen in Chapter 2 earlier) as not all circumstances or outcomes can be foreseen. Furthermore, not only is it incomplete, it also involves significant costs (both monetary and time worth), and the level of enforceability can vary significantly, all depending on the “experience[] of the courts and legal systems” (McCahery & Vemeulen, 2008:48).

Since private equity does not involve the issuing of debt or securities to the public, it is beyond the regulators’ and policymakers’ radar for most jurisdictions. LPs are considered as “large investors” and should be able to handle themselves, and regulators usually limit their regulations to “retailer investors” and preventing systemic risk. However, according to the de Larosière Report<sup>35</sup>, “appropriate regulation must be extended ... to all firms or entities conducting financial activities which may have a systemic impact... even if they have no direct links with the public at large” (de Larosière et al., 2009:26). Private equity (including venture capital) is another form of institutional setup providing finance/liquidity to the market; parallel to the banking system and capital market exchanges. Subsequently, ignoring such relationship can lead to market failure (Andenas & Chiu, 2014:142). Large investors, more commonly known as sophisticated/accredited/qualified investors are assumed to be able to write optimal contracts with their GPs, and sustain conflict of interest to a minimum (Andenas & Chiu, 2014:24-25). This is not always the case, since we are dealing with an industry where information is opaque and contracts are very complex and not easily comprehensible. Therefore, in order for this industry to grow and for more investment/money to be put into private equity (especially venture capital), some form of regulation is required. A form that is expected to sustain market flexibility, by keeping regulatory interference low, yet enhance market efficiency, and assist in “macro-prudential oversight...essential for financial stability” (McCahery & Vermeulen, 2012:199) (de Larosière et al., 2009:24). The “intention is not for anyone, least of all regulators, to dictate specific terms and rules. Instead, the idea is to make important items easier to understand and compare” (Morris & Phalippou, 2012:61,77). The intention is to make information available in the market, and it is suggested that, in order for it

---

<sup>35</sup> In October 2008, after the crisis, Jacques de Larosière was commissioned by the European Union Commission to chair a high-level expert group on EU financial supervision, which was mandated to give advice to the future of the European financial regulation and supervision and to take the European Union “Towards a new regulatory agenda – to reduce risk and improve risk management; to improve systemic shock absorbers; to weaken pro-cyclical amplifiers; to strengthen transparency; and to get the incentives in financial markets right” (de Larosière et al., 2009:4), as one of its objectives.

to function efficiently, “market-wide information has to be monitored and submitted to national regulators, primarily by market providers” (Andenas & Chiu, 2014:423).

Information is required to be in a “convenient and consistent format; comprehensive (but with the emphasis on quality rather than quantity)” (Morris & Phalippou, 2012:61,78). Currently, most of the directives and guidelines look at the relationship between the manager (GP) and the portfolio company, and not much attention is given to looking into the relationship between the LP and the GP. Moreover, not much public information is available (even with the regulators there is not much information) on the private equity market. There is some flow of information between the GP and the LP.<sup>36</sup> However, such information is not of great quality as it is neither consistent nor easily comprehensible. Therefore, in order to address this concern in the private equity industry, agreeing on standardising and harmonising information/reporting/documentation is essential (Andenas & Chiu, 2014:178 and Morris & Phalippou, 2012:61,78). The enhancement of information flow and its availability will not only assist decision-making, but will also increase confidence in the large investors to invest in private equity (especially financial/insurance institutions, and pension funds, who have some form of obligation to their stakeholders) (McCahery & Vermeulen, 2012:224). However, in order that some of the investors do not lose out, care needs to be taken, so that standardisation is not made prior to identifying all the parties involved and allocating and understanding their risk. This is because “the weakest party always suffers from premature standardisation because the big institutional players want to reduce their costs, and have all the leverage”<sup>37</sup> (Alim, 2014:234).

Furthermore, the growth of private equity/private investments positively affects the economy and in turn has positive social benefits. As such, the post-crisis thinking is to treat it as social responsibility with a social good concept, so as to obtain the supervision and monitoring attention it deserves. Being part of the financial stability equation, social accountability is essential, and is expected to form part of the policy of development of financial regulations (Andenas & Chiu, 2014:468-469). Care is needed not to rely completely on the global organisations to develop and enforce the relevant related policies. This is because the reach of such organisations is limited and does not easily penetrate the domestic market, thus falling

---

<sup>36</sup> The ILPA, with one of its principles being transparency, has produced standards for quarterly reporting, so as to: enable the LP to interpret and account for a transaction accurately; reduce LP and GP processing times and ultimately reduce monitoring costs; improve LP-GP communications with regards to an investment’s status and thereby minimising required follow-up questions; and enabling GP compliance with legal terms in documentations” (Ilpa, 2011a:2) as a few of its purposes.

<sup>37</sup> Quoted in an interview by Micheal J.T. McMillen, Lawyer.

short in meeting the domestic market needs. Moreover, the “international organisations are in any case unlikely to be able to do more than produce enabling pieces of soft law” (Andenas & Chiu, 2014:461). As the international surveillance by global organisations is not easily (or always) integrated into the domestic market, then, to resolve such matters, some best practices/soft regulations, with the backing of domestic regulators (for effective compliance and enforcement) relating specifically to meet the deficiencies of such markets are required.

#### **4.5 SHARI’AH REGULATIONS AND GOVERNANCE ON PRIVATE EQUITY**

The main international standard setting bodies for the Islamic finance industry are the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Service Board (IFSB) and the International Islamic Financial Market (IIFM). AAOIFI is an organisation body that sets the accounting, auditing and *Shari’ah* standards for Islamic financial institutions and performs a similar function to the International Accounting Board (IAB) that sets the accounting standards for the conventional industry.<sup>38</sup> The IFSB is an organisation that issues guiding principles for the banking, insurance and capital markets for the Islamic financial industry; similar to the Basel Committee on Banking supervision (BCBS), the International Association of Insurance Supervision (IAIS), and the International Organization of Securities Commission (IOSCO) in the conventional financial industry. While, the IIFM is an organisation with the aim of setting standards for the Islamic capital markets and money market, with its primary aim of standardising the Islamic financial products, documentation and related process.

The aim of these organisations, while remaining in line with the international standards, rules and guidelines, is to address the specifics of the Islamic features and *Shari’ah* principles related to the Islamic industry. The above organisations are relatively new compared to their conventional counterparts, and as such, they have not yet covered all matters pertaining to the Islamic financial industry. It is an on-going process.

---

<sup>38</sup>AAOIFI “identifies the gaps and differences between the IAS/IFRS and the specific needs of Islamic financial institutions and transactions. AAOIFI formulates industry specific standards when the equivalent IAS (or IFRS) are not suitable in whole for Islamic financial institutions or where specific Islamic banking and finance practices (such as *mudaraba* and *musharaka*, two profit and loss sharing modes) are not discussed within IAS/IFRS” stated under the chapter on Dr. Rifaat Ahmed Abdel Karim (the inaugural Secretary-General for AAOIFI and IFSB) in (Alim, 2014:165).

### 4.5.1. *Shari'ah* Regulations

With regards to standards and guidelines on Islamic private equity, like the conventional not much is available. Islamic private equity is based on the concept of *Sharika*<sup>39</sup> and *Mudaraba*<sup>40</sup> and AAOIFI has *Shari'ah* accounting standards related to these forms of partnership and to the principal agent format known as Investment *Wakala*.<sup>41</sup> The standards cover issues such as transparency, in particular to documentation, conflict of interest with regards to incentives (profit sharing ratios, servicing fees) and on restricted/unrestricted contracts/accounts. These standards are related to the mechanisms of treatment and of accounting and presenting when reporting in the financial statements. They are not related to the governance relationship between the investor (LP) and the financial institute/manager/entrepreneur (GP). AAOIFI has also issued governance standards (GS) on “Statement on governance principles for IFI”, where it stipulates matters pertaining to the governance practices the IFI is to follow. Principle 3 of the standards (GS-6/5/3)<sup>42</sup> requires the IFI to treat its fund providers equitably and to provide them with adequate and timely financial and non-financial information<sup>43</sup>, so that the fund providers are able to make suitable investment decisions. As part of principle 3, the IFI is to have the necessary governance mechanism “to safeguard against any inequitable treatment of fund providers” and it proposes to provide “certain rights to those parties to help in their decisions and related measures.”<sup>44</sup>

Moreover, the IFSB’s main concern is the stability of the financial institutions, and as such, their principles and guidelines are more concerned with serving the financial institution itself and its operations. In line with the international organisations’ setting standards (BCSB, OECD, IOSCO) disclosure, transparency, conflict of interest, the discipline in market conduct and ethical behaviour, along with the requirements of a *Shari'ah* board and a compliance officer for monitoring purposes, are addressed, but in relation to the financial institution. The IFSB

---

<sup>39</sup> *Sharika (Musharaka) Shari'ah* Standard No. (12)-AAOIFI (1429H-2008).

<sup>40</sup> *Mudaraba Shari'ah* Standards No. (13)-AAOIFI (1429H-2008).

<sup>41</sup> Investment *Wakala Shari'ah* Standard No. (46)-AAOIFI (1433H-2012).

<sup>42</sup> AAOIFI Governance Standards (6.5.3): “An IFI should ensure equitable and unbiased treatment of fund providers and other significant stakeholders and associated investments as well as in relation to the provision of adequate financial and non-financial information to allow them to take appropriate decisions regarding their dealings with the institution”.

<sup>43</sup> AAOIFI Governance Standards (6.5.3.2): “Fund providers and other significant stakeholders of an IFI should be provided with adequate and timely information about major changes to its business that can have material consequences to their interest in the IFI”.

<sup>44</sup> AAOIFI Governance Standards (6.5.3.1): “Necessary governance mechanisms should be in place to safeguard against the risks of inequitable treatment of fund providers and other stakeholders. Such measures could be the provision of certain rights to those parties to help in their decisions and related measures”.



follows a “principles-based”<sup>45</sup> voluntary approach, whereby the implementation of the principles would enhance the institution’s reputation. They have general governance related principles<sup>46</sup>; however, they are not specific to the private equity industry and are similar to the conventional principles, so the LP/GP relationship is not within the equation. Principle 4<sup>47</sup> of IFSB-3 deals with transparency towards investment account holders (IAH) (restricted and unrestricted) which requires the IFI to make a timely disclosure of information relevant to their accounts. Additionally, even though some references to reporting requirements are made, such as those under IFSB-3, standardisation of the form of reporting (which helps in the investment analysis and comparison purposes) is lacking. Furthermore, Islamic private equity LP/GP investment is considered, as per the AAOIFI standards, as a restricted investment that is off-balance sheet<sup>48</sup>, and IIFM have not yet issued any standards related to such restricted investments.<sup>49</sup>

IFSB have recently issued IFSB-19<sup>50</sup> with regards to *Sukuk* and Islamic CIS in relation to such products being offered within the regulated capital market. Other than it dealing with products related to the regulated capital market, it addresses market intermediaries and issuers of securities, unlike the earlier issued CIS principles (mentioned below) that mainly address financial institutions. Additionally, the guidelines also mention that they should also be taken up as good market practice by the private offering market, and within the guidelines it states: “the IFSB notes that, even where disclosures are not required by regulation, they are often made as a matter of good practice. It hopes, ...this standard will be taken into account by those responsible for making disclosures in respect of such offerings” (IFSB-19: 13). The guidelines provide general principles concerning clear and accurate information, sufficient information and timely information. There is also a section on recommended disclosure for “Private

---

<sup>45</sup> As per the IFSB-9 Guiding principles on Conduct of Business for Institutions Offering Islamic Financial Services, item (7): “A principle-based approach encourages voluntary efforts by IIFS to develop their own systems and internal controls for governance, risk management and regulatory compliance, and leaves room for IIFS to choose the structures and processes that best suit their business models...” (December 2009).

<sup>46</sup> IFSB-3 “Guiding principles on corporate governance for institutions offering only Islamic financial services (Excluding Islamic insurance (*Takaful*) institutions and Islamic Mutual Funds)” - December 2006; IFSB-4 “Disclosure to promote transparency and market discipline for institutors offering Islamic financial services (Excluding Islamic insurance (*Takaful*) institutions and Islamic Mutual Funds)” - December 2007; IFSB-5 “Guidelines on key elements in the supervisory review process of institutions offering Islamic financial services (Excluding Islamic insurance (*Takaful*) institutions and Islamic Mutual Funds)” - December 2007; IFSB-6 “Principles on governance for Islamic collective Investment Schemes” - January 2009.

<sup>47</sup> IFSB-3, Principle (4): “Principle 4: IIFS shall make adequate and timely disclosure to IAH and the public of material and relevant information on the investment accounts that they manage”.

<sup>48</sup> As per AAOIFI financial accounting standard no. 6 on the equity of investment account holders and their equivalent, and under item 2/2/1: “...assets and liabilities relating to equity of restricted investment account holders and their equivalent shall be treated separately from the Islamic bank’s assets and liabilities”.

<sup>49</sup> IIFM currently have standards on the interbank unrestricted *Wakalah* Agreement.

<sup>50</sup> IFSB-19 “Guiding Principles of Disclosure Requirements for Islamic Capital Market Products (*Sukuk* and Islamic Collective Investment Schemes)”. They were published in April 2017 and are expected to be implemented by July 2018.

Equity/Venture Capital Funds” that is offered to sophisticated investors in the private market. However, the recommendation does not see any additional specific disclosure for Islamic private equity that is different to that of conventional private equity. Yet, it does advise that “Supervisors should pay particular attention to the *Shari’ah* governance disclosure, bearing in mind the need for scrutiny of individual transactions and operational arrangements” (IFSB-19:173).

Moving on from the international organisational setting standard bodies to the regulatory bodies at national level, the Malaysian Securities Commission (MSC) issued “Guidelines and best practices on Islamic venture capital” in May 2008. Under these guidelines, the venture capital corporation (VCC) and venture capital management (VCM) are only required to register with the MSC as a supervisory requirement. These guidelines and best practices are specific to Islamic venture capital (Islamic private equity), and set operating best practices requirements on the VCC and VCM. Requirements include the need for an independent *Shari’ah* advisor; requirements on the activities and investments of the portfolio management to be *Shari’ah* compliant; disclosure requirements by the *Shari’ah* advisor, and compliance officer and on maintaining the clients’ monies. Although, it specifically addresses Islamic venture capital, the requirements concerning the operations of the investment and LP/GP governance and standard form of reporting are not addressed.

Since the relationship between the IAH<sup>51</sup> and the IFI is similar to the collective investment scheme, there appears to be a move towards Islamic collective investment schemes (CIS), and treating private equity investments as private equity funds. “CIS participants stand in a better position than IAH, since securities regulations usually ensure that CIS operators meet stringent requirements before they can operate a CIS” (IFSB-3<sup>52</sup>, item 29). One of which is that they are to provide the CIS participants with a prospectus disclosing all the information that is relevant to the investment. Furthermore, in IFSB-4, it considers there being “broad similarities” (item 35:10) between profit sharing investment accounts (PSIA) and CIS, and recommends that the disclosure of the IOSCO’s principles on CIS can be used to design the “relevant disclosure for IAH, restricted IAH, and investment funds that operate in accordance with *Shari’ah*, including

---

<sup>51</sup> IAH - Investment Account Holders.

<sup>52</sup> IFSB-3 “Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (excluding Islamic insurance (*takaful*) institutions and Islamic mutual funds)”.

Islamic mutual funds managed by IIFS in the form of restricted investment accounts and stand-alone Islamic funds”<sup>53</sup> (item 37:10).

#### **4.5.2. *Shari’ah* Governance/Compliance**

A unique feature of Islamic finance is compliance of its products and operations with *Shari’ah* principles. The IFSB defines the *Shari’ah* non-compliance risk as “The risk that arises from the bank’s failure to comply with the *Shari’ah* rules and principles determined by the relevant *Shari’ah* regulatory councils”. In investing in Islamic Private Equity (IPE), *Shari’ah* compliance is an important matter for maintaining its *Shari’ah* features as well as its creditability. As per AAOIFI governance standards (GS-6.4/3), “The business model of an IFI is characterised by contracts that are designed to be compliant with *Shari’ah*, making it unique. The risks associated with such contracts are also unique...”. Hence, in investing in IPE, two essential risks (relevant to the study on the relationship between the IFI and the Investor) arise, *Shari’ah* risk and equity investment risk, which could also be referred to as legal risk. The *Shari’ah* risk is whereby the IFI fails to comply with the *Shari’ah* rules and principles approved by their *Shari’ah* Supervisory Board (SSB). While the equity investment risk arises due to the IFI entering/undertaking a partnership/investment contract (*Musharakah/Mudarabah*), and failing to validate and meet the terms of the undertaking/contract (Laldin, 2015:85). These two risks are somewhat related; the terms of the contractual relationship are set in line with the *Shari’ah* rules and principles and by maintaining and abiding by the *Shari’ah* rules and principles, non-compliance of both risks can be reduced. The IFI non-compliance of the above two risks could result in both financial and non-financial consequences. The non-compliance could invalidate the investment contract, and/or generate *non-halal* income. Subsequently, it could lead to legal disputes, reputation tarnish and thus affect its future business/investments (Ginena & Hamid 2015: 83-84; Hamza, 2013: 227). Hence, it is important for the IFI to have a proper *Shari’ah* governance system/framework for maintaining *Shari’ah* compliance of products and operations.

International standard setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Service Board (IFSB) have come up with guidelines that define the parameters of a sound *Shari’ah* governance regime. A

---

<sup>53</sup> IFSB-4 on Disclosure to promote transparency and market discipline for institutions offering Islamic financial services (excluding Islamic insurance (*takaful*) institutions and Islamic mutual funds), was issued in December 2007, and in January 2009 the IFSB issued IFSB-6 on the Guiding principles on governance for Islamic collective investment schemes.

key element of this framework is a *Shari'ah* Supervisory Board (SSB) constituting a number of *Shari'ah* scholars who review and approve all the products offered by the IFI. The IFSB puts forth the requirements for a *Shari'ah* governance system that the supervisory authorities are recommended to consider implementing. As per Principle 1.2 of IFISB-10, upon appointment of an independent SSB, the IFI should have in place "...Clear terms of reference regarding its mandates and responsibilities... well defined operating procedures and line of reporting...". The supervisory authority is to ensure that the IFI has a proper pre- and post-*Shari'ah* compliance monitoring mechanism in place (IFSB-10-3).<sup>54</sup>

As per AAOIFI's governance standards, the three main key components of *Shari'ah* supervision and compliance are for the IFI to have the following: *Shari'ah* Supervisory Board, *Sharia'h* Review and Internal *Shari'ah* Review. In AAOIFI Governance Standards (GS-1), the IFI is to have an independent *Shari'ah* Supervisory Board (SSB), to be appointed/dismissed by the shareholders upon nomination of the board of directors (GS-1/3 and GS-1/8).<sup>55</sup> The IFI is to have a minimum of three SSB members and the agreed terms of engagement are to be recorded in the appointment letter signed between the IFI and the SSB member (GS-1/4). Furthermore, the SSB "shall appoint from among its members or any person a supervisor(s) to help it in performing its duties (GS-1/6). In addition, to reduce the risk of independence of the SSB, the SSB is to be rotated every 5 years."<sup>56</sup>

A *Shari'ah* compliance system is an on-going process that starts pre-investment and continues post-investment. As can be seen from Figure 4.4 below, it starts from the inception, the pre-entry to an investment stage, to agreeing on the structure/legal set-up, to documenting and obtaining SSB approval and continues through to post-investment/transaction with a proper implementation and follow-up review and audit by examination and evaluation of the extent of compliance, of which the outcome of the proper execution is reported and any non-compliance matters are rectified. Failure to do so (rectifying non-compliance) could result in enforcement measures either by the regulator (withdrawal of license) or by the court (due to the legal case against the IFI by the investor) (Adawiah, 2012).

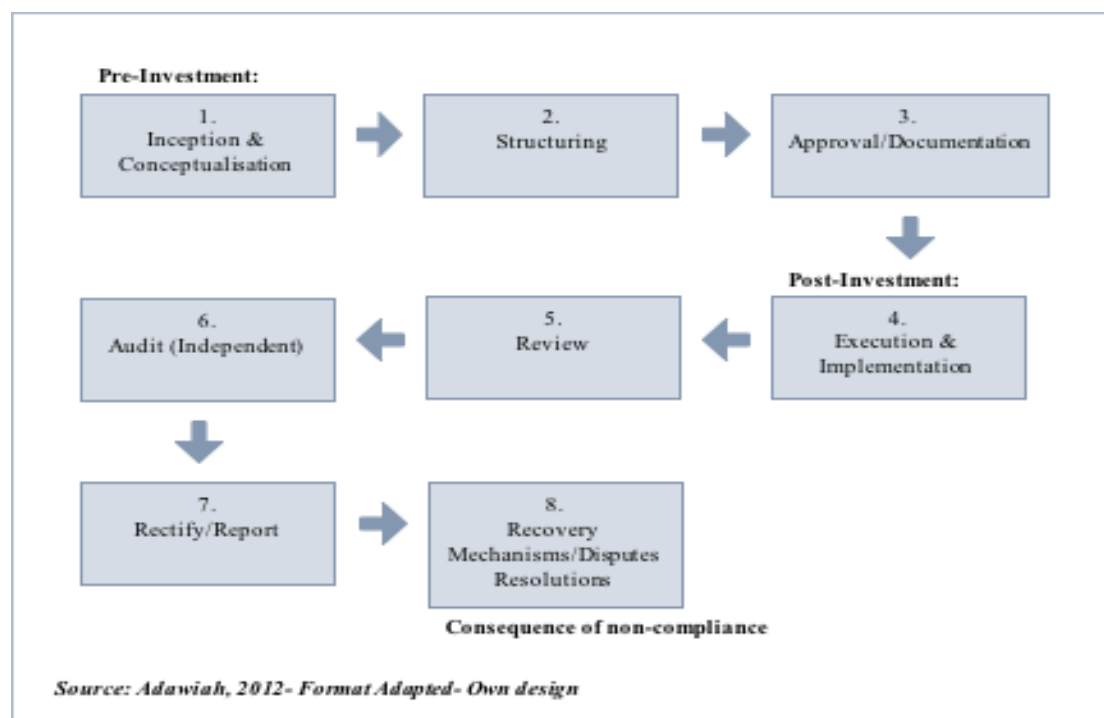
---

<sup>54</sup> IFSB-10 "Guiding Principles on *Shar'ah* Governance Systems for Institutions Offering Islamic Financial Services".

<sup>55</sup> AAOIFI Governance Standards (1): "*Shari'a* Supervisory Board: Appointment, Composition and Report".

<sup>56</sup> AAOIFI Governance standard (5): "The continuation of the same *Shari'ah* board member on a *Shari'ah* supervision engagement over a prolonged period of time may impose a threat to independence. The SSB member should take steps to ensure independence and objectivity are maintained on the engagement. There is a concern that a long involvement by an SSB member with a client could lead to a closed relationship which could be perceived to be a threat to independence and objectivity. An IFI should take steps to provide for an orderly rotation of SSB serving on an engagement, so as to ensure that at least one SSB should be rotated every five years".

Figure 4.4 - Mechanism of *Shari'ah* Compliance Process



The proper selection of the product being in line with *Shari'ah*, and the proper use by the IFI of the funds collected and invested in accordance with the IFI-Investor agreement<sup>57</sup> are paramount to the investment/IFI maintaining its creditability. *Shari'ah* compliance/assurance is maintained by the *Shari'ah* compliance review/audit that is carried out by the *Shari'ah* Review. The IFSB principles refer to both internal and external *Shari'ah* compliance reviews. As per Principle 3.1 (107)<sup>58</sup> of IFSB-3, the IFI is to undertake an internal *Shari'ah* compliance review to follow-up on the implementation and to monitor *Shari'ah* compliance. In addition, Principle 3.1 (106)<sup>59</sup> of IFSB-3, the *Shari'ah* review is to take place following the issuing of the SSB decision/ruling, to ensure its compliance with the ruling, through an external *Shari'ah*

<sup>57</sup> AAOIFI Governance Standard (4.9): "... off-balance sheet accounts, and this places greater responsibility on the Islamic bank's management to ensure that the funds are invested in accordance with the terms of the agreement and that profits are allocated according to the agreed terms between the Islamic bank and holders of investment accounts which should be in compliance with *Shari'ah* rules and principles..."

<sup>58</sup> IFSB-3.1 (107): "... This function may be carried out by an Audit Committee or Executive Committee, or by an internal set-up such as the Risk Management Department, Compliance Department, Investment Department, or *Fatāwā* and Research Department. In order to ensure that *Shari'ah* compliance reviews are conducted by competent and adequately trained professionals, the internal auditors/*Shari'ah* reviewers will be expected to carry out this task with the necessary competence".

<sup>59</sup> IFSB-3.1 (106): "... The Audit Committee of IFS should use their best efforts in ensuring that the external auditors are capable of accommodating ex-post *Shari'ah* compliance reviews (relying – where appropriate – on work carried out by internal auditors/*Shari'ah* reviewers) within their terms of reference. Where possible, the Audit Committee and the internal auditor/*Shari'ah* reviewer shall work closely with the external auditors to enhance the external auditors' capabilities for conducting such *Shari'ah* compliance reviews as part of their audits".

review. While the AAOIFI *Shari'ah* governance standards<sup>60</sup> place obligations on the IFI for a quarterly internal *Shari'ah* review to be performed on the *Shari'ah* compliance of the IFI, in line with the *Shari'ah* Supervisory Board's (SSB) approvals/decisions. Furthermore, the IFI's SSB are to review and determine that the investments entered into by IFI are and remain *Shari'ah* compliant throughout the investment term, and to produce an annual *Shari'ah* compliance report on the matter. The *Shari'ah* compliance review/audit report that is prepared by SSB (with the assistance of the IFI's internal *Shari'ah* department report)<sup>61</sup> is to be reviewed by the external auditor of the IFI, after which it forms part of the annual financial report.<sup>62</sup> The AAOIFI standards do not specify for an external *Shari'ah* audit to be performed by an external *Shari'ah* party/auditor,<sup>63</sup> but rather the requirement of an external audit is embedded within the requirement of issuing the external audit of the financial statement. The SSB are to report any violations in their opinion statement in the SSB report that they produce.<sup>64</sup> Moreover, although the standards do not specifically address the details of the format of the *Shari'ah* decision/fatwa, when the SSB produces the *Shari'ah* decision/fatwa it is expected that it is produced in detail and is clear and transparent, so as to increase awareness.<sup>65</sup>

Independence is an important element in the *Shari'ah* governance framework. It adds credibility and enhances confidence (public confidence) in the IFI. The IFSB in its definition of the *Shari'ah* governance system emphasises the importance of independence: "A set of institutional and organisational arrangements through which IFIs ensure that there is an effective independent oversight of *Shari'ah* compliance over the issuance of relevant *Shari'ah* pronouncements...dissemination of information and ...an internal *Shari'ah* compliance review" (IFSB-10). However, the matter of effective implementation of independence has

---

<sup>60</sup> AAOIFI Governance Standards (3.20): "The internal *Shari'ah* review shall be carried out by an independent division/department or be part of the internal audit department, depending on the size of an Islamic financial institution (FI). It shall be established with an IFI to examine and evaluate the extent of compliance with *Shari'ah* rules and principles, fatwas, guidelines, and instructions issued by the IFI's *Shari'ah* Supervisory Board (SBB)..."

<sup>61</sup> AAOIFI Governance Standard (3.20): "The head of the internal *Shari'ah* review shall discuss conclusions and recommendations with appropriate levels of management before issuing the final written report. On completion of the internal *Shari'ah* review, at least a quarterly written report shall be prepared which must be signed by the head of internal *shari'ah* review, addressed to the board of directors and copied to the SSB and management."

<sup>62</sup> AAOIFI Auditing Standards (4).

<sup>63</sup> AAOIFI, in December 2016, following the conclusion of its 3<sup>rd</sup> Governance and Ethics Board meeting announced it was working on standards on the External *Shari'ah* Audit.

<sup>64</sup> AAOIFI Governance Standard (1.21): "If the SSB has ascertained that the management of the IFI has violated Islamic *Shari'ah* Rules and Principles or *fatwas*, rulings and guidelines issued by its SSB; then the SSB has to report the violations in their opinion paragraph of its report".

<sup>65</sup> IFSB-3.54: "...the IIFS shall be transparent in the adoption and application of *Shari'ah* rules and principles issued by the IIFS's *Shari'ah* scholars"; IFSB-3.56: "An IIFS shall make available to the public, upon request, an explanation of any decision to adopt a *fatwā* issued by its *Shari'ah* scholars, whereby such explanation should be prepared in consultation with the *Shari'ah* scholars. Similarly, an IIFS should be prepared to provide a transparent clarification to the public should they decide to abandon a *fatwā* issued by its *Shari'ah* scholars." And AAOIFI (GS-6.4/4): "An IFI therefore understand and respond to the transparency needs of its stakeholders. For this the BOD and management of the IFI should ensure that its stakeholders are recognised and that their information needs are addressed."

resulted in differences in opinion. In AAOIFI, the independence is reflected in the requirement for the internal *Shari'ah* review to be carried out by “an independent division/department or part of the internal audit department, depending on the size of an IFI. It shall be established within the IFI to examine and evaluate the extent of compliance with the IFI’s SSB...” (AAOIFI GS-3). In addition, the SSB is to produce a report at year end of the IFI’s extent of *Shari'ah* compliance (AAOIFI-GS-2).

Such steps in establishing independence have generated some concerns. These concerns arise from the SSB having to produce an independent opinion where conflict of interest may exist. The concern being independence is affected when the SSB has some form of “economic stake” (remuneration and renewal) with the IFI, in addition to basing its review on the internal *Shari'ah* department that also has some economic stake with the IFI (Grais & Pellegrini, 2006). Let alone also expressing an opinion on the level of compliance they have approved and provided details on (Hamza, 2013: 228). Suggestions in the industry have been to rotate the SSB, as has been the case in the past with auditors. However, the issue of rotating the whole board could compromise the quality of the audit because the new board would not be familiar with the IFI’s business and its management (FEE, 2004). Grais and Pellegrini (2006:16), in defence of the arguments of the proposals to rotate the SSB in order to achieve greater independence, and the inefficiencies that may result (from the experience faced with internal auditors in the past), suggest that: “An alternative may be found in the practice of periodically rotating SSB members rather the entire boards. This would infuse fresh approaches in the SSB and may increase independence through peer reviews; it would not necessarily compromise audit quality, as the continuing members would assure continuity”.

Moreover, independence could be increased by delinking the economic benefits of the SSB and the IFI to an independent party. Hamza (2013:235), in relation to this, recommends “the appointment and the remuneration of the SB [*Shari'ah* Board] members should be done by another body like the central bank or government to ensure the independence of the SB which is crucial for credibility”. If this is done at the central level, then this reinforcement of the independence of the SSB role would reduce the conflict of interest concerns, enhance credibility of the *Shari'ah* compliance process and increase investors’ confidence in the IFI.

The discussion on the relevant literature on *Shari'ah* governance matters shows that a vital component of the *Shari'ah* governance system is the SSB (Grass, 2013:334). The investors rely

on the effective role and monitoring of the SSB, since they are expected to have access to internal information similar to that of the IFI's management (AlJifri & Khanselwal, 2013). Hence, SSB's decisions are only as good as the information that they are provided with. Therefore, for effective implementation of the above process (shown in Figure 4.4 above) and for efficient functioning of the SSB, establishment of an effective *Shari'ah* supervision set-up is required within the IFI. The proper selection of products that are compliant with *Shari'ah*, and the proper use by the IFI of the funds collected and invested in accordance with the IFI-investor agreements<sup>66</sup> and maintaining *Shari'ah* compliance throughout the term of agreement is paramount to the IFI maintaining its creditability. In carrying out its obligations the SSB needs a "clear framework and structure to ensure its independence and effectiveness" (Malkawi, 2013:544). This framework and structure (appointment, composition, procedures, qualifications, audit and *Shari'ah* report) form essential elements in the *Shari'ah* governance process (Malkawi, 2013:552).

Most studies in the past in relation to the *Shari'ah* governance system have been either theoretical or based on secondary data (Grais & Pellegrinni, 2006; Rammal, 2006; Suleiman, 2000; Alman, 2012; Grass, 2013; Malkawi, 2013; Injas et al., 2016). Some studies compare the *Shari'ah* governance system with the conventional system (Abu-Tapanjeh, 2009; Saif Alnasser & Muhammed, 2012), while others cover SSB and its role in governance of IFI (Garas & Pierce, 2010); *Shari'ah* audit (Lahsasna, Ibrahim & Othman, n.d.) and audit and *Shari'ah* control (Shaii & Salleh, 2010).

There are a few studies that report information on *Shari'ah* Scholars/SSB based on the primary data collected from interviews with *Shari'ah* scholars that were not only SSB members but also *Shari'ah* scholars involved in the IFI. Ullah, Harwood & Jamali (2016) report issues of fatwa rather than the *Shari'ah* governance system. Other primary data studies examine the SSB performance via seeking feedback/input from the Board of Directors and SSB members using survey questionnaires (scaling and multi-choice questions) on SSB performance (Nathan, 2010). A more recent study based on primary data collected from the SSB members mostly from Malaysia deals with some of the contemporary *Shari'ah* governance issues (Hasan, 2014).

While there is vast literature discussing various issues related to *Shari'ah* governance structures and regimes, studies examining the operations of the SSB are rare. As such, very little is known

---

<sup>66</sup> AAOIFI Governance Standard (4.9).



about the way the SSB operates and how decisions are made. While conducting this study and in meetings its aims, the study contributes in this specific area by exploring the black-box presenting the views of *Shari'ah* scholars on different aspects of *Shari'ah* governance in IFI. Specifically, the study presents the opinions of 13 *Shari'ah* scholars from the Gulf Cooperation Council (GCC) region on various issues related to *Shari'ah* governance such as the SSB structure, framework and *Shari'ah* process and views on the strengths and weaknesses of current practices. The findings of which are presented in Chapters 8 and 9.

Having discussed the relevant<sup>67</sup> *Shari'ah* regulations and governance matters, the following section will look at the GCC regulations with regards to investing in IPE and the related *Shari'ah* governance, before moving on to the empirical parts of the study.

#### **4.6 GCC REGULATIONS ON PRIVATE EQUITY**

The Gulf Corporation Council (GCC) countries consist (in alphabetical order) of: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates (UAE). Currently, all six states offer Islamic financing, with Oman being the most recent starting in 2011. All six jurisdictions aim to follow international standards and are ordinary members (with the exception of Kuwait<sup>68</sup>) of IOSCO, and thus work towards being in line with the IOSCO principles of the securities capital market. The regulations in the GCC are being developed in line with international standards developments, and the global and regional economic changes, keeping in mind the maturity of their particular industry/market. As is the case in the West, there is a move by some of the GCC countries towards CIS, and treating the pooling of funds of restricted accounts as a form of CIS. Whereby the CIS issues units of shares, representing ownership. As such, some of these countries have recently issued CIS regulations, as can be seen below.

Furthermore, with regards to following the AAOIFI *Shari'ah* and Accounting Standards, not all six countries do so. The AAOIFI *Shari'ah* Standards are mandatory in Bahrain and Oman, and they are voluntarily used in Kuwait, Qatar, Saudi Arabia, and UAE.<sup>69</sup>

---

<sup>67</sup> Only those *Shari'ah* governance matters that were related to the study were discussed.

<sup>68</sup> As of the date of this review, Kuwait has yet to sign with IOSCO.

<sup>69</sup> As per AAOIFI's website: "Adaptation of Standards", dated 30/4/2017.

## Bahrain

Bahrain has a single financial regulatory model<sup>70</sup>, whereby the financial sector (banking, insurance, and capital market) is regulated by one independent organisation/authoritative body, the Central Bank of Bahrain (CBB). The CBB Law and the CBB rulebooks are the regulatory framework that govern these industries. Currently, rule book volume 2 regulates Islamic financial institutions (IFI). It sets rules for the supervision of the prudential/functional aspect of the financial institution, and maintaining the financial soundness of the financial institution. While rulebook volume 6 deals with the capital market (excluding mutual funds, which is regulated under volume 7 of the CBB rulebook) and the regulation and supervision of the non-prudential/market conduct of businesses dealing in the securities market.

Private placement offerings<sup>71</sup> are exempt from the public offering regulations, however, registration and filing of the offering memorandum is required. They can only be offered to high net worth individuals and institutional investors defined as accredited investors.<sup>72</sup> The document is to be registered and a no objection to use the document is to be obtained. The offering document is required to contain certain responsibility statements and disclaimers, in addition to disclosure requirements. A list of the anticipated accredited investors (if known) is to be submitted with the document along with a copy of the subscription form, which should include a section on the accredited investors confirming his status as an accredited investor. Fees are expected to be reasonably justifiable, and at a level that would “not materially compromise the interest of both the issuer and the investor.”<sup>73</sup> A cap of 3%<sup>74</sup> has been given as guidance on the level of fees. No dissemination of information regarding the private offer is to be made in the public domain prior to the close of the offer. Furthermore, any dissemination of information after the offer is closed, must not give the impression to be viewed as an invitation to transact in the securities of the private offer.

---

<sup>70</sup> This was adopted in August 2002, under Decree 21/2002 (in respect of the establishment of the Bahrain Stock Exchange as amended - Decree 7/1987, in respect of the establishment and organisation of the Bahrain Stock Exchange).

<sup>71</sup> As defined in Offering of securities module of Rulebook Volume (6): “Private offer must only be made to accredited investors and must be for a minimum investment of USD 100,000.00. A private offer, excluding those offers made by way of private equity, is limited to a take up by less than 100 accredited investors”.

<sup>72</sup> Accredited investors are defined as: “(a) Individuals who have a minimum net worth (or joint net worth with their spouse) of USD 1,000,000, excluding that person's principal place of residence; (b) Companies, partnerships, trusts or other commercial undertakings, which have financial assets available for investment of not less than USD 1,000,000; or (c) Governments, supranational organisations, central banks or other national monetary authorities, and state organisations whose main activity is to invest in financial instruments (such as state pension funds)”.

<sup>73</sup> As per Article (OFS-2.4.7) of the Offering of Securities Module of Volume 6 of the CBB Rulebook.

<sup>74</sup> The fee guidance range is: Up to BD100,000,000: 3%; BD100,000,001-500,000,000: 2%; BD500,000,001 and above: 1%.

In addition to the requirements specific to a private offer, there are general requirements that all issuers of securities need to abide by. There are two that may interest private equity participants. The first being that any SPV created to act as an issuer of assets in Bahrain would need to incorporate the SPV as a company under the laws of Bahrain. The other is that the rights of securities holders should not be restricted other than what is permitted by the law “particularly regarding voting and granting of proxy to any eligible person(s) (no irrevocable proxies or any terms of issue subject to a grant of proxy will be permitted)”.<sup>75</sup> Furthermore, the appointed capital market advisory service provider (lead manager) needs to be either incorporated in Bahrain and a CBB licensee or authorised by the CBB to provide such a service.

These are general requirements for all private placements and private Islamic equity offerings<sup>76</sup> (such as *Mudaraba* contracts) in addition to the general requirements; they are subject to enclosing a *Shari’ah* certification on the compliance of the structure on offer and to the documentation being in line with *Shari’ah*. In March 2014, rules with regards to reporting the requirement for a semi-annual report on private placements issued or promoted by banks were issued.<sup>77</sup> The IFI are required to provide a progress report/letter on a semi-annual basis (as a minimum) to investors and the CCB on private placements/real estate projects; to provide a summary of the accounts in a letter to the investors, and to have reviewed (quarterly) and audited accounts (annually) made available for investors.

In March 2014, rules with regards to clarifying pertaining to SPVs were added. Among the clarified rules is a requirement placed on the SSB of the IFI to monitor on “...an ongoing basis the *Shari’a* compliance of the SPVs and must oversee the conduct of the annual *Shari’a* compliance review of transactions, assets, liabilities and other commitments and relationships entered into by all SPVs with which the Bahraini

---

<sup>75</sup> OFS-1.5.2 (f) of the Offering of Securities Module of Rulebook Volume 6 of the CBB’s Rulebook.

<sup>76</sup> The following additional information and documents must be provided with the application for the offering of *Shari’ah* compliant securities: (a) A copy of the *Shari’ah* pronouncement report that the transaction is in compliance with the principles of *Shari’ah*; (b) A copy of the trust deed or other document securing the *Shari’ah* compliant securities together with any trustees agreement; (c) A copy of any collateralising instruments and details of underlying assets; (d) A copy of the underlying asset valuation report produced by at least two independent valuers; and (e) Any other documents made available for inspection.

<sup>77</sup> BR-2.2 of Rulebook Volume (2).

Islamic bank licensee is involved ...The *Shari'a* compliance function of the Bahraini Islamic bank licensee must perform such reviews.”<sup>78</sup>

Furthermore, in April 2015 a resolution<sup>79</sup> emphasising the *Sharia'h* governance was issued with respect to the establishment of a centralised *Shari'ah* supervisory board and in February 2016, the members of the centralised *Shari'ah* board were elected.<sup>80</sup> Currently, there is no requirement for the IFI to perform an external *Shari'ah* audit, only an internal one. The SSB is to supervise the internal *Shari'ah* review/audit that is performed by the IFI's internal *Shari'ah* department. However, following its consultation with the industry in 2016, the CBB in August 2017 issued rules with regards to *Shari'ah* governance, whereby it requires the IFI to perform independent external *Shari'ah* compliance audit (ESCA).<sup>81</sup> The independent audit is to be performed before the issuance of the SSB report. The ESCA report (as per AAOIFI and guided by the International Standard on Assurance Engagement - ISAE 3000)<sup>82</sup> is to be submitted to the audit committee initially then to the SSB and IFI's management.<sup>83</sup> The proposed rules also require the SSB, in the event that the report contained non-compliance issues, in addition to submitting a report to the shareholders, to provide a copy to the CBB.<sup>84</sup>

As mentioned above, in line with the move towards CIS, in January 2013, IFI restricted sharing investment accounts are only to be opened in the form CIS.<sup>85</sup> Rulebook 7 has rules that regulate collective investment undertakings<sup>86</sup> (CIU) (which also includes *Shari'ah* compliance CIU); however, they are only relevant to fund structures. There are rules on private investment undertakings (PIU) that are only initiated by or offered to high net worth individuals<sup>87</sup> or

---

<sup>78</sup> BR-5.2.15 of Rulebook Volume (2).

<sup>79</sup> Resolution 20 of 2015, in respect of establishing of centralised *Shari'a* supervisory board.

<sup>80</sup> Resolution 3 of 2016, in respect of forming members of the centralised *Shari'a* supervisory board.

<sup>81</sup> Proposed *Shari'ah* Governance Module: SG-5.1.2.

<sup>82</sup> Proposed *Shari'ah* Governance Module: SG-5.1.3.

<sup>83</sup> Proposed *Shari'ah* Governance Module SG-5.2.1.

<sup>84</sup> Proposed *Shari'ah* Governance Module: SG-2.3.24.

<sup>85</sup> LR-1.3.17C of Rulebook Volume (2) “Any new restricted *Shari'a* compliant profit sharing investment relationships in the bank's own structured products may only be opened in the form of units or shares in a collective investment undertaking and will be subject to the Rules and Guidance contained in Volume 7 and relevant sections of Module BC Chapter 9 (Volume 2)”.

<sup>86</sup> As defined in the CIU module of volume (7) of the CBB Rulebook: “Collective investment undertakings ('CIUs') are undertakings: (i) The sole object of which is the collective investment of capital raised from the public or through private placement, including investment seeded by the operator, in financial instruments and other assets and which operates on the basis of risk-spreading as appropriate; and (ii) The holdings of which may be re-purchased or redeemed out of those undertakings' assets, as appropriate”.

<sup>87</sup> As defined in the CIU module of volume (7) of the CBB Rulebook: High net worth investors are: “(a) Individuals holding financial assets (either singly or jointly with their spouse) of USD 25 million or more; (b) Companies,

financial institutions and a minimum initial investment of the equivalent of USD3m. The PIU are subject to registration and reporting (such as annual reports and net worth) for statistical purposes.

In August 2016, a law<sup>88</sup> was issued, in respect of “Limited Partnership Companies”, which enables banks and financial institutions to establish investment vehicles in the form of limited partnerships. According to this, the investment in the form of a limited partner may be carried out in CIS and PIU.<sup>89</sup> Moreover, in October 2016 a law<sup>90</sup> was also issued, in respect of “Protective Cell Companies” (PCC). Whereby PIU, CIS are able to be taken up by PCC. This enables such investments to take place, having segregated and protected the assets of each cell (investment) from the other cells of the core company. It offers something similar to the concept of SPV, and ring-fencing of the assets of the investment (Willis, 2008).

## **Kuwait**

In 2010, the Capital Market Authority<sup>91</sup> (CMAK) was established in Kuwait to regulate the capital market and the securities activities in the country. And in September 2011, the regulation of investment funds and investment companies’ activities were moved from the Central Bank of Kuwait (CBK) to the CMAK.<sup>92</sup> The CBK only regulates the financial activities of these companies and foreign funds.

At present, as per the CMAK Law and executive by-laws, a private placement offer is an offer made to a certain group of people<sup>93</sup> to subscribe into closed companies (i.e. not public listed companies) or a subscription made for the increase of capital of an existing company. The private placement offering document is required to be submitted to the CMAK for approval. Certain disclaimer and responsibility statements, along with certain disclosures are required to be made in the document. The CMAK law states that the executive by-law shall provide for the procedures, rules and regulation of offering, trading and transferring of securities that are not

---

partnerships, trusts or other commercial undertakings, which have financial assets available for investment of not less than USD 25 million; or (c) Governments, supranational organisations, central banks or other national monetary authorities, and state organisations whose main activity is to invest in financial instruments (such as state pension funds)”.

<sup>88</sup> Law Degree No. 18 of 2016.

<sup>89</sup> As per Article (2) of the consultation paper on the law with respect to Investment Limited Partnerships.

<sup>90</sup> Law Degree No. 22 of 2016.

<sup>91</sup> Capital Markets Authority of Kuwait was established under Law 7/2010 - February 2010.

<sup>92</sup> In line with Article (162) of Law 7/2010, which stated that these companies were to be regulated by CMAK within one year of issuing the CMA’s executive by-laws (issued in March 2011).

<sup>93</sup> The definition does not specify the size or the type of group of people.

listed on the stock exchange. In 2015, the executive by-laws<sup>94</sup> were issued according to which offering securities by way of private placement requires the CMAK's approval, and the offering prospectus needs to be submitted for approval. Once the offer is complete the list with the details of subscribers is to be forwarded to the authority.

The CMAK law and executive by-law have regulations on collective investment schemes and investment funds. Investment funds are a private offer when the minimum investment is equivalent to KD100,000 and is offered to a certain group.<sup>95</sup> Some amendments were made to these regulations in February 2012, one of which was the form of an investment fund. It can take one of the following forms: securities investment fund; real estate investment fund; cash fund; debt instrument fund; private ownership fund; holding fund; or any other type approved by CMAK. The fund is subject to CMAK's approval and an offering document is required along with periodic reporting to be made to the CMAK. The fund manager is also required to publically disclose, through the exchange, monthly information on the fund, even if it is not listed. In 2015, further changes were made, but more to clarify matters related to the definition, widening the scope from the narrow concept of investment funds to collective investment schemes.

In June 2013, the CMAK issued rules on corporate governance (Resolution 25/2013), where listed companies and licensed (but not listed) companies that engage in securities activities are to abide by them no later than 31<sup>st</sup> December 2014. According to the Resolution, companies are to report the extent of their compliance with these rules in their annual reports. Furthermore, there are rules on the company's social responsibility, with the aim of encouraging the companies to widen their activities to cover activities in the areas of economic development, social development and environmental protection. They are also required to have procedures in place that will balance between the company's goals and the society's goals.

---

<sup>94</sup> Resolution 72 of 2015 regarding issuance of Executive By-Laws of Law No. 7/2010 and its amendments regarding the establishment of Capital Market Authority and regulating securities activities.

<sup>95</sup> As per Article (302) of the CMAK's executive by-law, an investment fund is a private offer when the minimum investment is the equivalent to KD100,000 and is addressed to: (a) government of Kuwait; (b) Kuwait Central Bank; (c) the exchange or any financial market approved by CMAK; (d) persons licensed to deal with their private account; (e) Investment companies licensed to deal with their own account; (f) any other person the CMAK approves to be offered to.

In December 2016, the Central Bank of Kuwait issued instructions regarding *Shari'ah* governance of Islamic banks in Kuwait.<sup>96</sup> The IFI's SSB is to consist of a minimum of three members, to be appointed by the General Assembly, upon nomination of the BOD. The BOD are to ensure that the IFI are aware of their appointed role and responsibilities. The term of appointment is not stated, however, no SSB member can be on more than three Islamic banks in Kuwait. As per the instructions, the SSB is to prepare a *Shari'ah* compliance report, by supervising the internal *Shari'ah* department/unit that would be undertaking the review and submitting their report to the SSB, upon which the SSB will issue their report. Furthermore, due to the SSB's continuous engagements and to them giving priority to the role of issuing *fatwa* more than *Shari'ah* supervision, the *Shari'ah* audit is required to be performed by an independent external *Shari'ah* firm (ESF). The ESF is to be appointed by the general assembly upon nomination by the board of directors. They are to provide their report along with a copy of the SSB report to the shareholders. The effective date of enforcement is set for 20/1/2020, due to the need of qualified persons (with both *Shari'ah* and audit knowledge), for the effective implementation of performing an external *Shari'ah* audit.

## **Oman**

The Capital Market Authority of Oman (CMAO) was established in November 1998 under Law Decree 9/80. The CMAO regulates the securities and insurance business in Oman. A private placement is an offer made by a publically listed company to a certain number of individuals. It is not related to non-listed companies. Venture investment companies fall under the Ministry of Commerce and Industry (MOCI), and the memorandum is reviewed by the MOCI. The venture investment companies are listed as part of the exit strategy of the investment, and at the time of listing an offering document is required to be approved by the CMAO. The CMAO have regulations on investment funds, and the offering document of the fund is required to be approved by the authority. The fund manager is required to provide the authority with an annual report. The open-ended fund does not need to be listed.

Under the Islamic banking regulatory framework of the Central Bank of Oman (CBO), project financing “involves attempting to raise capital on the basis of the forecasts through limited circulation of the prospectus to unconnected third parties.”<sup>97</sup> The regulation states that in cases

---

<sup>96</sup> Instructions on *Shari'ah* Supervision Governance for IFI, issued 20/12/2016. These instructions replace the ones issued earlier in 2003 and are to complement the corporate governance instructions on banks issued in June 2012. The effective date of the regulations is set for 1/1/2020.

<sup>97</sup> Article 5.2.2 of Licensing Requirements of the Islamic Banking Regulatory Framework, issued by the Central Bank of Oman.

of raising funds for specific purposes under the restricted investment accounts, the investment account holder (IAH) should meet certain eligible qualifications and that a minimum level of investment might be required as part of the eligibility requirements.<sup>98</sup> However, no set levels have been mentioned. Separate accounts are to be maintained for restricted IAH, and the AAOIFI standards are to be followed by the licensee. On matters where no AAOIFI standard exists, International Financial Reporting Standards (IFRS) are to be followed.<sup>99</sup> Furthermore, certain investment activities of the licensed bank may require the approval of CMAO, especially those for dealing with capital market instruments such as *mudarabah* or *wakala* structured under CIS where they are to abide by the CMAO's rules and regulations.<sup>100</sup>

The CBO law in line with AAOIFI *Shari'ah* governance standards, places a requirement for a SSB to be appointed by the shareholders, and a SSB member can only be appointed/selected for two consecutive terms. The SSB is required to produce a *Shari'ah* review report based on the assessment of the IFI's internal *Shari'ah* review (Article 2.2). The CBO Islamic banking regulatory framework also requires IFI to have both a *Shari'ah* compliance unit<sup>101</sup> and a *Shari'ah* internal audit unit.<sup>102</sup> The *Shari'ah* compliance unit is to monitor and control the *Shari'ah* risk<sup>103</sup> and *Shari'ah* compliance of the IFI's departments and to report to the Internal *Shari'ah* Reviewer. While the internal *Shari'ah* audit is to assist the SSB, to perform an audit and to submit quarterly reports to the SSB with a copy to the management and Audit Committee.<sup>104</sup> Moreover, the IFI is to conduct an annual external independent *Shari'ah* audit, to endorse the credibility of the internal *Shari'ah* audit.<sup>105</sup> The independent external report is to be submitted to the IFI's Board of Directors and the Central Bank with copies sent to the IFI's

---

<sup>98</sup> Article 1.6.3 of the Operational Risk of the Islamic Banking Regulatory Framework, issued by the Central Bank of Oman.

<sup>99</sup> Article 1.2.1 of the Accounting Standards and Auditor Reports of the Islamic Banking Regulatory Framework, issued by the Central Bank of Oman.

<sup>100</sup> Article 5.10.3 of Licensing Requirements of the Islamic Banking Regulatory Framework, issued by the Central Bank of Oman.

<sup>101</sup> CBO Islamic Banking Regulatory Framework (2.4) - *Shari'ah* Compliance Unit. (2.4.1.1): "Licenses are required to introduce a *Shari'ah* compliance unit as part of the *Shari'ah* Governance Framework, reporting to the Internal *Shari'ah* Reviewer".

<sup>102</sup> CBO Islamic Banking Regulatory Framework (2.5). (2.5.1.1): "Licenses shall establish a *Shari'ah* audit unit as part of the *Shari'ah* Governance Framework, reporting to the Internal *Shari'ah* Reviewer".

<sup>103</sup> CBO Islamic Banking Regulatory Framework (2.4.1.5): *Shari'ah* compliance shall also induce *Shari'ah* risk control whereby an appropriate senior shall identify, measure, monitor, control and manage... any real or perceived risk of *Shari'ah* non-compliance by licensees across the entire organization...".

<sup>104</sup> CBO Islamic Banking Regulatory Framework (2.5.1.12): "...On completion of the internal *Shari'ah* report, at least quarterly written reports shall be prepared which must be signed by the Internal *Shari'ah* Reviewer, addressed to the SSB and copied to the management". (2.5.1.15): "... A copy of the report shall also be presented to the Audit Committee of the Board".

<sup>105</sup> CBO Islamic Banking Regulatory Framework (2.5.1.22): "The Licensees shall engage an independent third party to conduct an annual external independent *Shari'ah* audit. The purpose of this audit is to add credibility to the internal *Shari'ah* audit of the Licensees through an independent endorsement. This will also enhance public confidence in the *Shari'ah* legitimacy of the Licensees".



SSB and management.<sup>106</sup> The SSB is to report any non-rectifying reoccurring *Shari'ah* non-compliance to the Central Bank and it is to be documented in the annual *Sharia'h* compliance report. The rules provide a sample of reporting of non-compliance to be reported under the opinion section of the report.

## **Qatar**

The securities market in Qatar is regulated by the Qatar Financial Markets Authority (QFMA), which was established under Law No. 33/2005 and later replaced by Law 8/2012. However, the operation of QFMA commenced in 2010. As per the QFMA rulebook, private offerings to “Qualified investors”<sup>107</sup> are exempt from submitting an offering document for QFMA’s approval as they are considered as “having sufficient experience to invest in the security market”<sup>108</sup> (Qatar, 2010:7).

The Qatar Financial Centre Regulatory Authority (QFCRA)<sup>109</sup> issued Private Placement Scheme Rules in 2010 (effective January 2011); however, these rules are applicable to collective investment schemes.<sup>110</sup> The permitted legal forms for the schemes are: a collective investment company; a collective investment partnership; a collective investment trust; and other permitted forms of schemes. The scheme<sup>111</sup> can only be offered to qualified investors<sup>112</sup> and there is no limit on the amount to be invested. Limited liability companies or limited

---

<sup>106</sup> CBO Islamic Banking Regulatory Framework (2.5.1.24): “Independent *Shari'ah* auditor shall submit its report to the Board of Directors of the Licensee and the Central Bank, with a copy to the SSB and management of the Licensee”.

<sup>107</sup> Qualified investors are defined as per QFMA’s Offering and Listing Rulebook of Securities (issued November 2010): “...including but not limited to: a) financial services companies licensed by QFMA or Qatar Central Bank or any other supervisory authority in Qatar; b) Insurance companies; c) Investment funds; d) Government and governmental institutions; e) Individual investors with high solvency; f) Strategic investors.” No definition for what constitutes an individual investor with high solvency or what defines a strategic investor.

<sup>108</sup> As per Article 5.3 of the Offering and Listing Rulebook of Securities-Main Market issued by Qatar Financial Markets Authority.

<sup>109</sup> The Qatar Financial Centre Regulatory Authority (QFCRA) authorises and regulates firms and individuals conducting financial services in or from the Qatar Financial Centre (QFC). They oversee entities established under the QFC which directly offers their own or indirectly (on behalf of clients) managing private placements. Through the QFC local and overseas companies can apply to establish banking, asset management and insurance businesses.

<sup>110</sup> As per the rules, a private placement scheme is defined as: “(a) it is established in the QFC; (b) it is registered under these rules as a private placement scheme; and (c) the number of unit holders does not at any time exceed 100”.

<sup>111</sup> “They may only be marketed to individuals who meet the definition of a qualified investor, that is, someone with the experience, knowledge and financial resources to manage the higher risk profile of these financial products” (A Guide to the QFC Collective Investment Scheme Regime, issued by QFCRA:8).

<sup>112</sup> The rules define qualified investor as: “(1) a person can be a qualified investor for a scheme or an authorised firm (or both). (2) A qualified investor for a scheme is: (a) a person who would be a business customer or market counterparty of the scheme in relation to dealings in investments that consist of (or include) units in the scheme if the scheme were an authorised firm and the person were a client of the scheme; or (b) a person who is a business customer or market counterparty of any authorised firm in relation to dealings in investments that consist of (or include) units in the scheme. (3) A qualified investor for an authorised firm in relation to units in a scheme is a person who is a business customer or market counterparty of the firm in relation to dealings in investments that consist of (or include) units in the scheme”.

partnership companies can be incorporated for the schemes, and the process of the incorporation and registration is at the Qatar Financial Centre (QFC) Companies Registration Office. The rules also cover Islamic funds, where a requisite of abiding by AAOIFI accounting standards and a *Shari'ah* board is required.

QFCRA have also issued rules on Islamic Finance for those interested in carrying out their business in “1 or more regulated activities in accordance with *Shari'ah*”<sup>113</sup> (restricted/unrestricted profit sharing investment accounts/portfolios/funds).<sup>114</sup> An SSB, comprising a minimum of 3 members is to be appointed/dismissed by the General Assembly upon nomination by the BOD. Their appointment is for 3 years and is renewable, and it is up to the BOD to decide on the terms of appointment. Both the internal *Shari'ah* review and the SSB *Shari'ah* review are to be performed in accordance with AAOIFI standards. The IFI is to have a proper mechanism of controls and a system for effective *Shari'ah* compliance. Furthermore, the IFI is required to disclose how it conducts its *Shari'ah* review and the frequency of the review, in response to the investor's request. As per the Investment Management and Advisory Rules (INMA)<sup>115</sup>, the Islamic firm is to provide the investor with periodic statements, as per the agreed period with the investor, but for no longer than a 6 month interval. The rules also provide minimum information that the IFI is to enclose in the terms of business it signs with the investor.<sup>116</sup>

In addition, the QFC have issued regulations (regulation 15/2012) on a special purpose company (SPC)<sup>117</sup> for the establishment of a transaction. The SPC has to provide the QFC on

---

<sup>113</sup> Article (1.2.1) of Islamic Finance Rules 2005 (ISFI), version 4, (includes amendments made by Islamic Finance Amendments Rules 2012 (QFCRA Rules 2012-3).

<sup>114</sup> A profit sharing investment account (or *PSIA*) “is an account, portfolio or fund that satisfies the following conditions: (a) it is managed by an authorised firm in accordance with *Shari'ah* and is held out as such; (b) under the management agreement with the firm — (i) the investor concerned and the firm agree to share any profit in a specified ratio; and (ii) the investor agrees to bear any loss not caused by the firm's negligence or breach of contract; (c) the management of the account, portfolio or fund is a *regulated activity*.” While, a restricted PSIA “is a PSIA that is subject to a restriction as to where, how or for what purpose the investment funds may be invested”. Article-1.2.3 of Islamic Finance Rules 2005 (IDFI), version 4, effective 1 February 2013, includes amendments made by Islamic Finance Amendments Rules 2012 (QFCRA Rules 2012-3).

<sup>115</sup> Article (9.1.7) of Islamic Management and Advisory Rules 2014 (INMA), effective January 2016. It includes amendments made by Islamic Banking Business Prudential (Consequential) and Miscellaneous Amendments Rules 2015 (QFCRA Rules 2015-3).

<sup>116</sup> Article (9.1.5) of Islamic Management and Advisory Rules 2014 (INMA).

<sup>117</sup> Of which some of its activities are: “a) the acquisition (by way of leasing, title transfer, risk transfer or otherwise), the holding and the disposal of any asset (tangible or intangible, including but not limited to receivables and shares) in connection with and for the purpose of a Transaction; (b) the obtaining of any type of financing (banking or capital markets), the granting of any type of security interest over its assets, the providing of any indemnity or similar support for the benefit of its Shareholders or the entering into any type of hedging arrangements, in connection with and for the purpose of a Transaction; (c) financing of the Initiator or another Special Purpose Company” (Article

an annual basis a “business plan outlining the activities that it intends to carry out in the upcoming calendar year.”<sup>118</sup>

## **Saudi Arabia**

The Capital Market Authority in the Kingdom of Saudi Arabia (CMAS) is the regulator of the securities market in Saudi Arabia. An offer is considered a private placement<sup>119</sup> if it is offered to sophisticated investors<sup>120</sup>, or to no more than 60 investors<sup>121</sup> (excluding sophisticated investors), where the minimum amount of investment is greater than the equivalent of SAR 1 million or the total value of the offer does not exceed the equivalent of SAR 5 million. In such offers the private placement prospectus (PPM) is required to be approved by the CMAS. The offer can only be made through persons authorised by CMAS to carry out the activity of arranging. No public advertising or public solicitation of the offer can be made, and certain disclaimer and responsibility statements are required to be disclosed in the PPM. The CMAS are to be notified within 10 days after completing the offer of the total proceeds and details of who have acquired the securities.<sup>122</sup> No other on-going disclosure obligation is required once the offer has been made. The CMAS is also to be notified in the event that the offer is not completed within the timetable of the offer. As it is expected that all Islamic offers are *Shari'ah* compliant<sup>123</sup>, there is no specific requirements to be made for being Islamic or for Islamic private equity offers.

---

(9.1. (a)-(c)).

<sup>118</sup> Article (17A1.(a)) of QFC Special Company Regulations-version-2, Regulation 15/2012 (amended), issued 22/12/ 2013.

<sup>119</sup> The issue of securities by the government or a supranational authority approved by the CMAS is also considered a private placement.

<sup>120</sup> Sophisticated investors are defined as per the CMAS' Offering of Securities Regulations (issued by Royal Decree No. (3) dated 2/6/1424H (2004) and amended by Resolution of the Board of CMA No. (3-151-2016) dated 22/3/1435H (21/12/2016)) Article (11): “An offer of securities is restricted to sophisticated investors where the offer is directed at any of the following persons: 1) Authorised persons acting for their own account; 2) Clients of a person authorised by the Authority to conduct managing activities provided that: (a) The offer is made through the authorised person and all relevant communications are made through the authorised person; and (b) The authorised person has been engaged as an investment manager on terms which enable it to make decisions concerning the acceptance of private offers of securities on the client's behalf without reference to the client; 3) The government of the Kingdom, any supranational authority recognised by the Authority, the Exchange and any other stock exchange recognised by the Authority or the Depository Centre. 4) Institutions acting for their own account; 5) Professional investors; or 6) Any other person prescribed by the Authority.

<sup>121</sup> The restriction on the number of investors is considered a limited offer, where the offer to the employees of the issuer/its affiliate also falls under the definition of a limited offer.

<sup>122</sup> Article (13) of the CMAS's Offering of Securities Regulations (issued by Royal Decree No. (M/3) dated 2/6/1424H (2004) and amended by Resolution of the Board of CMA No. (3-151-2016) dated 22/3/1435H (21/12/2016)).

<sup>123</sup> As per Article 6 of the Saudi Monetary Agency Law, issued by Royal Decree No. 23 dated 15/12/1957: “The Agency shall not undertake any of the following functions: a. Acting in any manner which conflicts with the teachings of the Islamic Law. The Agency shall not charge any interest on its receipts and payments”.

The CMAS has regulations on investment funds that were first issued in December 2006 and amended in 2016.<sup>124</sup> Private placement of investment funds can be offered to investors of a minimum investment of the equivalent of 1 million Saudi Riyals. Approval of the prospectus for a private placement offer needs to be submitted 15 days prior to the expected date of the offer. The contractual agreement is established by both parties signing on the terms and conditions of the fund.<sup>125</sup> The fund manager is required to make annual (quarterly for real estate funds) reporting to the investor<sup>126</sup> along with annual audited financial statements and to submit a copy to the CMAS.<sup>127</sup> Furthermore, the Saudi Monetary Agency (SAMA) has issued rules for regulations for investment funds and collective investment schemes<sup>128</sup> established by local banks, on the establishment, operating and marketing of open- and closed-end funds.<sup>129</sup> Under the banking regulation under SAMA, there are no specific regulations for Islamic banks, it is expected that they abide by the *Shari'ah* principles. However, under the regulations for a finance company it states that in addition to activities being in line with *Shari'ah*, the finance company should have a *Shari'ah* committee.<sup>130</sup>

In July 2012, SAMA issued principles of corporate governance for bank operations in Saudi Arabia to be applied on a mandatory basis.

---

<sup>124</sup> Investment Funds Regulations: Royal Decree No. (M/30) dated 2/6/1424H (24/12/2006) and Amended by Resolution of Board CMA1-61-2016 dated 16/2/1437H (23/5/2016).

<sup>125</sup> Article 76: Contractual form of Organisation of Private Fund: “b. The contractual relationship between a potential unit holder and the fund manager is established by them signing the fund's terms and conditions”.

<sup>126</sup> Article 89: Reporting to Unit holders: “a. Annual reports (including audited financial statements) and short form annual reports of the private fund must be prepared in accordance with the requirements set out Annex 5 of these regulations and must be provided by the fund manager to unit holders on request and without charge. Annual reports should be made available to unit holders no later than (70) calendar days from the end of the period to which it relates by such means as specified in the fund's terms and conditions. b. Interim reports for a private real estate funds shall be prepared every (6) months in accordance with the requirements of Annex 5 of these Regulations, and make available to unit holders within (35) days from the end of the reporting period, in the places and the means specified in the terms and conditions of the fund, and the fund manager must provide Unit holders initial reports of the Fund upon request at no charge”.

<sup>127</sup> Article 90: Reporting to the Authority: “a. After making the annual reports available to unit holder pursuant to Article (89) (including the annual audited financial statements), the fund manager must submit such reports to the Authority no later than (5) days following the day of which the reports request was made. b. The fund manager must submit to the Authority any information regarding the subscription or redemption of units in a private fund and no later than (10) days following the day of which the information request was made”.

<sup>128</sup> Ministerial Decision No. 3/2052 dated 24 Rajab 1413H (1993) via SAMA Circular dated June 1993.

<sup>129</sup> As per Article 4.10 of Ministerial Decision 3/2052, the legal framework of the: “Fund established in Saudi Arabia shall not be considered an independent legal entity but only as a contractual agreement between the investment department of the bank and the customers for the management of funds collectively subscribed to”.

<sup>130</sup> SAMA-Finance Companies Control Law published 27/8/2012.

## United Arab Emirates (UAE)

The Securities and Commodities Authority (SCA) is the securities regulator in the UAE. It was established under Federal Law 4/2000 in January 2000. The SCA regulates the securities business with regards to publically listed companies. All the official regulations are in relation to dealings in the market (the exchange), it does not appear to have regulations with regards to private offerings made outside the market place, and as such no registration or approval of the private placement memorandum with SCA appears to be necessary. The Ministry of Economy deals with company matters prior to listing on the exchange.

Joint ventures as per Federal Law 8/1984 and its amendments of the Commercial Companies Law (issued by the Ministry of Economy) are not required to register in the register of Commerce. Instead, it is the agreements between the parties that “shall regulate the entitlements and obligations of the partners and also the manner of distributions of the partners and also the manner of distribution of profit and loss.”<sup>131</sup>

In 2016, SCA issued regulations with regards to private funds. They are to be offered to qualified investors<sup>132</sup> and the minimum subscription is AED 180,000 per unit. To offer a private fund, a license (renewed annually) is required and the offering document needs to be approved by SCA.<sup>133</sup> Additionally, in January 2017, SCA issued Administrative Decisions on Funds: one on Private Equity Fund<sup>134</sup>, and the other on Venture Capital Controls.<sup>135</sup> The Private Fund controls introduces the concept of GP/LP as the investment relationship agreement, and is

---

<sup>131</sup> Article (57) of Chapter 4 of the Commercial Companies Law under Federal Law 8/1984 as amended by Federal Law 13/1988.

<sup>132</sup> Definition of Qualified Investor: 1. An investor that is capable of managing its investments by itself and on its own accord such as: a. The Federal Government and local governments, governmental institutions and authorities, or the companies fully owned by any of the aforementioned. b. International bodies and organisations. c. The person licensed to engage in a commercial business in the State, provided that one of the purposes of its business is investment. d. A natural person with financial solvency who declares that his annual income is not less than one million Dirhams annually (AED 1,000,000), or his net equity, with the exception of his main house, is valued at five million Dirhams (AED 5,000,000) and declares that he has the adequate knowledge and experience – whether solely or through a financial consultant – to assess the Prospectus, the advantages and risks associated with or arising from the investment. 2. The investor represented by an Investment Manager licensed by the Authority”.

<sup>133</sup> SCA Decision No. (9/R.M) of 2016 Concerning the Regulations as to Mutual Funds (issued 7/3/2016) - Private Mutual Fund Article (34): “1. Requirements for approving the licensing of a Private Mutual Fund:

a. The founder of the Fund shall be a Management Company or founders that meet the conditions of competence and integrity issued by the Authority. b. The minimum subscription limit per investor shall be 180 thousand Dirhams. 2. The application submitted to the Authority to license the Private Mutual Fund shall be submitted on the prescribed form together with the supporting information and statements and enclosed with the Prospectus, the KIID [Key Investor Information Document] and the investment policy of the Fund. 3. The Authority shall issue a decision approving or denying the license application within a period no later than 30 business days from the date of submitting a complete application...”

<sup>134</sup> Administrative Decision No. (2/R.T) of 2017.

<sup>135</sup> Administrative Decision No. (3/R.T) of 2017.

subject to the mutual funds regulations. While the Capital Venture controls introduces funds investing into venture capital companies and sets controls to maintain the risk involved. The institution is required to appoint a risk management officer and to produce an annual report as per IFRS (Article 2).

The principles on corporate governance issued in 2009<sup>136</sup> (concerning the criteria of corporate governance and standards for institutional discipline) are applicable for companies listed on the local licensed exchanges. The Central Bank has mandatory principles to be adhered to by licensed banks and financial institutions.

With regards to *Shari'ah* requirements, as per the UAE Central Bank Law<sup>137</sup>, IFIs are to conduct their business as per the *Shari'ah* law and each IFI is to have a supervisory body at the institutional level, with no less than three members. The IFI's Article of Association "shall determine the way in which this authority should be formed, the manner in which it will discharge its tasks and its other terms of reference" (Article 6). Moreover, as per the Law, a Higher Authority is to be formed under the Ministry of Justice and Islamic Affairs, who is to approve the SSB members and set-up before being appointed by the IFI. In 2016, the UAE cabinet approved the establishment of a Centralized Higher *Shari'ah* Authority to be established under the Central Bank. The role of the proposed authority is to lay down the principles and requirements for product approvals, as well supervise the IFI's internal *Shari'ah* controls compliance with *Shari'ah*.

With regards to the Dubai International Financial Centre (DIFC)<sup>138</sup>, in 2004 the DIFC Law No. 13 regulating Islamic Financial Business was issued. As per the Dubai Financial Service Authority's (DFSA)<sup>139</sup> Islamic Finance Rulebook (IFR), the IFI is to appoint an SSB to whom the BOD can select and agree on their terms of appointment. The IFI is to have proper *Shari'ah* compliance systems in place. In addition to having proper documented policies and processes for controls and for handling governance matters. The appointment and termination SSB is by the BOD. A *Shari'ah* review and internal *Shari'ah* review are required as per AAOIFI governance standards. The rules define profit sharing investment accounts (*mudarabah*) as financial products, and an IFI entering transacting in such products is required to sign an agreement, and to provide investors with periodic statements post-investment, in addition to

---

<sup>136</sup> Ministerial Decree No. 518 of 2009 (issued by The Ministry of Economy and Board Chairman of SCA) replaces SCA Board Decree No. 32/R of 2007.

<sup>137</sup> Federal Law No-6 of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies.

<sup>138</sup> Since a few of the IFI interviewed in the study were regulated by DIFC, their regulations were also reviewed.

<sup>139</sup> The Authority that set the rules and regulations implemented on DFIC.

enclosing the *Shari'ah* pronouncement in the marketing document. Details of the minimum requirements are covered in the rules (IFR).

#### **4.7 CONCLUDING REMARKS**

In looking at the “mechanisms of standard-setting, information gathering and behaviour modification” (Black, 2002:26) for the private equity industry in general and Islamic private equity in particular for the region, the regulatory framework was reviewed followed by the types of regulation.

The level of regulations and the effective implementation and enforcement of the regulations depends on the information structure of that economy. Economies with a high level of transparency and disclosure are considered economies that function on rule-based regulations, whereas economies with low transparency and low levels of disclosure function on relationship (trust)-based regulations. Moreover, there are regulations that are principle-based, where the general rule is provided, leaving the specifics/details to the domestic regulator. Also, there are regulations that are rule/market-based regulations, which are more specific and provide details of the rule. Whilst the market rule might be considered too specific, the principle rule might not be as efficient as anticipated because its elaboration depends on the experience and expertise available in a particular domestic market. Furthermore, when it comes to compliance with the regulation, consideration needs to be given to whether it is more effective if left to the regulative authorities alone or to include third parties such as industry associations.

The private equity sector's regulations neither appear to have much nor to have a coherent regulation regime. The reason being is that since it does not affect the general public then it would not affect systematic risk. However, of late (after the recent 2007/2008 financial crisis) this view is starting to change. Investments in this area, although involving high net worth investors and financial institutions, is a form of financing in the market and a provision of liquidity to the economy, and thus has an indirect effect on the financial market system. The preservation of this market sector is starting to be considered as a social good. In that investments in the private equity sector are important to continue for the growth of the economy and its developments. In order to encourage such investments, confidence needs to be maintained, by providing some disciplines and monitoring within such a sector. Recent developments of the views in the different forms of regulation have led to the development of

“Smart Regulation”; a contemporary form of regulation. Under this approach, the government in liaison with businesses (acting as self-regulators) and public interest groups (industry associations) work together to regulate and monitor compliance in the private equity market. However, compliance imposed by industry associations only applies to its members and not all are mandatory, some are voluntary or take the form of “comply or explain”.

While reviewing the GCC region’s regulation on private equity in general and Islamic private equity in particular, they did not differ much from the international market standards. Private equity/placement is considered as dealings among sophisticated investors that did not require much regulation. Furthermore, the regulation’s availability was not made clear or explicit by some of the six countries. Some of the countries, while reviewing the regulations/information on their website, did not provide a negative statement about not regulating such a form of investment, nor did they state the relevant supervisory authority. Moreover, different terms were used for what makes/constitutes a private offer, making it difficult to identify and compare the rules/regulations across the jurisdictions. In addition, on the websites, the rules/regulations were in both Arabic and English language, while on others they were only in one language (either Arabic or English). And at times, in order to understand the term/definition used, reading the English was required, due to the difference in the translation of the terminologies.<sup>140</sup> This leads to the importance of overcoming this deficiency in the quality of disclosure, so as the rules and regulations are more easily accessible and comprehensive, and hence reduce the reliance on informal networks, when wanting to deal in this market. In addition, the unification/standardisation of the form of regulating this market will work towards reducing legal arbitration behaviour.

Following the financial crisis, the trend in the international market as well as the GCC is to move towards private equity investments to take the form of collective investment schemes (similar to mutual funds and the issuing of units of shares). This is because such schemes (even the private placement schemes) have more requirements imposed on them by regulators. The requirements are more the availability of certain parties (investment administrator/custodian/transfer agents/investment advisor) to form part of the set-up of the scheme and their obligations. On-going obligations and the responsibility of monitoring, with regards to the compliance to protect/uphold investors’ rights, are not clearly provided in these regulations.

---

<sup>140</sup> Since the term being used is of English origin.



The IFI/GP's ability to operate in accordance with *Shari'ah* is an important factor in IPE. Hence, having an efficient and effective *Shari'ah* governance system is essential. The SSB along with the external *Shari'ah* audit perform the checks and balances towards maintaining *Shari'ah* compliance. Although not all of the GCC countries have adopted the IFSB principles or mandatorily enforce AAOIFI Governance Standards, all have requirements to have SSB and *Shari'ah* Review.

## Chapter Five:

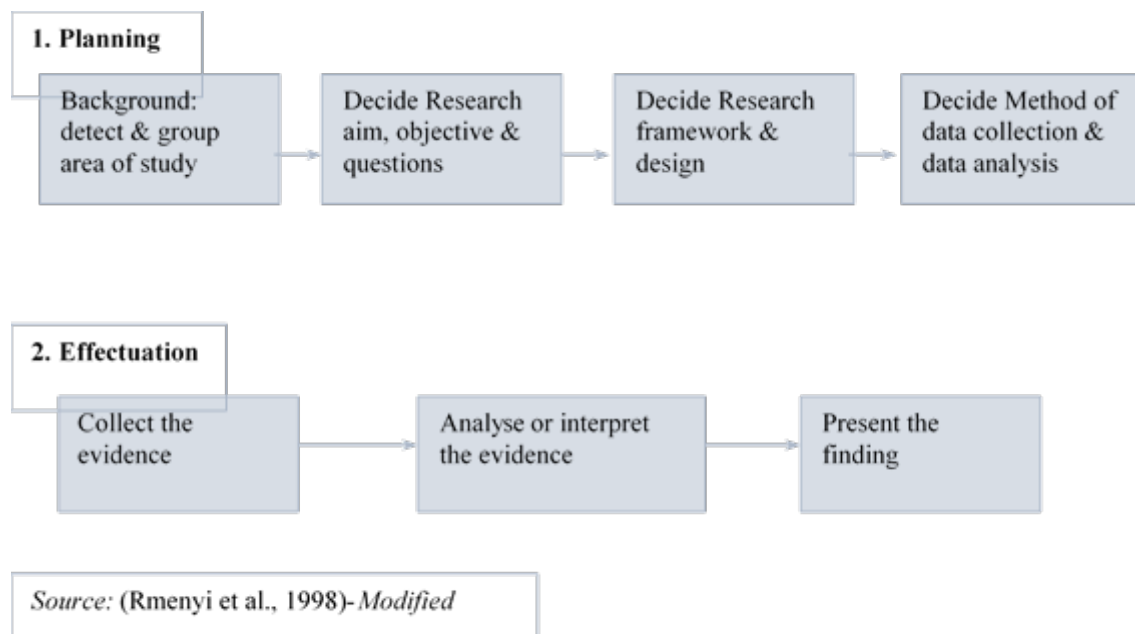
### RESEARCH METHODOLOGY

#### 5.1 INTRODUCTION

In exploring the literature on Islamic private equity in the previous chapters and in reviewing the related theories, some challenges/gaps were identified and some questions were raised. Using the knowledge acquired from the literature review as a springboard, this research study attempts to address some of the issues/questions related to Islamic private equity.

The research strategy/framework for the study is undertaken in two stages: the planning and the effectuation stages (Rmenyi, et al., 1998:104). Whereby the research methodology and research design fall under the planning stage and the actual conduct of the research (on the field) fall under the effectuation stage. The outcomes from the latter are the findings and the analysis covered in Chapters 6, 7, 8 and 9.

Figure 5.1 - Process Model of Research Process



In order to conduct a research study, a research design needs to be established to ascertain the most suitable way to answer the research questions and to meet the research aim and objectives. To have a better context of the research aim and objectives in the planning stage, this chapter starts by summarising the key issues identified in the literature review of the previous chapters. This will not only provide a background for the study, but will also assist in shaping the research aim, objectives and questions that this dissertation attempts to answer. The section also presents the appropriate methods used to collect and analyse the data.

## **5.2 PLANING STAGE**

### **5.2.1 Research Background**

The relationship in Islamic private equity (IPE) is based on the principal-agent notion, where the GP is the agent and the LP is the principal. Even though the LP is the owner of the capital/funds he only has formal authority; real authority in terms of decisions related to investments is in the hands of the GP. The LP permits such control based on reputation and trust. The IPE form of financing is affected by explicit and implicit variables. While some of the explicit variables are risk attitude, goal conflict, availability of information, outcome measurability, payoffs and type of governance structure, the implicit variables include social expectations, social embeddedness, culture, reputation and trust. In addition, IPE is also administered by *Shari'ah* parameters such as transparency, equality, risk-sharing, and actions (including intentions).

Furthermore, IPE is influenced more by the implicit variables, along with the demand and supply in the market for private financing capital. For the LP to continue the supply of capital/finance to such an industry the allocation of control rights and obligations would need to be clearly stated in the contract/agreement and investors' rights would need to be protected. Furthermore, for the investment relationship to be *Shari'ah* compliant<sup>141</sup>, the structural set-up has to be in an acceptable format (such as *Mudaraba*, *Musharaka*, *Wakala*) and arrangements need to be in place for an on-going process of checking and monitoring, making sure transparency, disclosure and investor rights are preserved.

---

<sup>141</sup> Due to the lack of familiarisation with the term “based”, “compliant” will be used.

The IPE relationship is also influenced by the interactionism theory, whereby actions and reactions are as a result of interactions with one another or within a group. Moral hazard and ethical concerns are to be considered in working at gaining the LP's trust. Reflections are to be made on the rational in making ethical judgments, in relation to being acceptable with self (moral-equity), within society/culture (relativism), and within contractual obligations/agreements (contractual). Culture acts as a social source, whereby trust is built through culture. There are times when trust and control are complementary (when large agency problems exist) and other times when trust acts as a substitute (when small agency problems exist) for control. Thus, to avoid opportunities for an abuse of such trust, contractual agreements need to be impersonal and outside the social tie trust. Hence, there may be a need to have contracts/agreements that are based on procedural regulations, whereby these are put in place by the industry/the regulators. Contracts under the contract theory are considered incomplete, in that it is not possible (or even costly) to determine all possible scenarios/factors that need to be considered. In addition, contracts are at times vague or silent on key features. As such, the legal and enforcement system is important for the protection of the rights of the parties involved.

In private equity financing supervisory rules and regulations are few. The governance supervisory arrangements are mostly on the governance of the GP (Islamic private equity firm) with regards to the investments/investment portfolio (the relationship between the GP, acting as the managing firm and the portfolio company it is managing). The relationship between the LP/investor and the GP (the first level of the private equity investment) is mainly left to the parties themselves. The investors/LPs in private equity financing are considered sophisticated enough and are able to conduct their own due diligence and protect themselves from risks. However, considering this market is greatly influenced by culture and social capital, the question arises about what is actually disclosed and transmitted to the LPs. Is the GP clear, transparent and efficient in the timing of the disclosure when they interact with their LPs? Are the GPs fully transparent and are they timely disclosing all the risks along with the benefits prior to investment (at the time of marketing/road show) to post-investment (on-going/during investment) in order for the LPs/investors to make satisfactory investment decisions? What ensures that the GP discloses all good and bad information/news to the LP on time? These are important factors that affect the IPE in being *Shari'ah* based compliant.

## 5.2.2 Research Aim, Objectives and Questions

### Research Aim and Objectives

The aim of this research is to explore the relationship between the investors and Islamic private equity firms in the GCC and to suggest ways in which these can be strengthened. In this regard issues related to information disclosure and transparency, *Shari'ah* and the regulatory environment will be examined. The goal is to identify the strengths and weaknesses of IPE to promote the growth of this industry. Moreover, for a better insight, especially since the IPE model is based on the conventional, and to have a comparative perspective about whether IPE investors' experience differed from that of CPE investors and whether experience and time (being in practice longer) had an effect, conventional investors' experience of investing in private equity is also explored. The specific research objectives of the study are given below.

6. To review the literature on private equity (PE) and identify the issues arising in the relationship between the investors and Islamic private equity (IPE) firms.
7. To identify certain specific issues related to agency problems and investors' rights from a transparency, *Shari'ah* and regulatory perspective in the relationship between investors and IPE.
8. To ascertain the views of investors regarding the specific issues (transparency, *Shari'ah*, and regulation) in IPE and assess their awareness of such issues.
9. To examine the operations of IFI (acting as an IPE firm) with regards to the specific issues of transparency, *Shari'ah*, and regulation.
10. To suggest some recommendations with regards to transparency, *Shari'ah* and regulations on improving the investor and IFI (acting as a PE firm) relationship in IPE.

### 5.2.2.3 Research Questions

In line with the interest in the specific issues in IPE, the research questions can be identified under three headings: Transparency and Information, *Shari'ah* and Regulation of private equity market.

#### **B. Transparency and Information**

- A1. How do the FI and investors handle activities in the pre-investment stage?
  - A. 1.a. What is the FI's/investor's approach to the investment?
  - A.1.b. What is the information shared and discussed prior to investing, undertaken by the FI/investor?
  - A.1.c. What is the due diligence performed and the documents prepared/received by the FI/investor, prior to investing?
  
- A.2 What are the pre-investment requirements regulating the PE market?
  - A.2.a. What pre-investment regulatory requirements apply to the FI/investor?
  
- A.3. How does the FI/investor handle the post investment stage?
  - A.3.a. What is the frequency and format of the update provided/received by the FI/investor?
  - A.3.b. How is the decision making on conflict of interest matters maintained by the FI/investor?
  
- A.4 What are the post-investment requirements regulating the PE market?
  - A.4.a. What post-investment regulatory requirements apply to the FI/investor?
  
- A.5. What is the investor's view on the investment relationship?
  - A.5.a. What is the investor's view on the contractual relationship with FI?
  - A.5.b. What is the investor's view on the FI's communication of information?
  - A.5.c. What is the investor's future investment plan?
  
- A.6. What are the issues of concern in the framework of PE with regards to transparency and information?

- A.6.a. What are the issues with regards to the investment set-up?
- A.6.b. What are the issues with regards to the information disclosure?

## **B. *Shari'ah***

- B.1. What is the FI/investor's/*Shari'ah* scholar's level of *Shari'ah* understanding?
  - B.1.a. What are the important *Shari'ah* principles to the FI/IPE Investor/ *Shari'ah* scholar?
  - B.1.b. What are the *Shari'ah* risks to FI/IPE investors/*Shari'ah* scholar?
- B.2. How is *Shari'ah* compliance maintained?
  - B.2.a. How is *Shari'ah* compliance maintained by the FI/IPE investor/*Shari'ah* scholar?
- B.3. What are the *Shari'ah* regulatory requirements?
  - B.3.a. What are the *Shari'ah* regulatory requirements that apply to the FI/IPE investor/*Shari'ah* scholar?
- B.4. What are the issues of concern in the framework of PE with regards to *Shari'ah*?
  - B.4.a. What are the issues with regards to the investment framework set-up?
  - B.4.b. What are the issues with regards to the information disclosure?

## **C. Regulating Private Equity Market**

- C.1 What are the views on regulating the PE market?
  - C.1.a. What are the FI's/investor's views on regulating the PE market?

## **5.3 RESEARCH PHILOSOPHY AND FRAMEWORK**

Research philosophy deals with issues related to the development of knowledge, whether it is acceptable or not and how it can be obtained (epistemology) and the nature of knowledge and how it can be understood (ontology). The ontological and epistemological assumptions will have different ways of influencing the research process. The two broad research philosophies used in management research are positivism and interpretivism (Sauders, 2009: 107-108). Which of these research philosophies is adopted depends on the researcher's views on certain assumptions such as the nature of reality (ontological), what constitutes acceptable knowledge (epistemological) and the role of value in research (axiological). Responding to these

assumptions would drive the researcher to arrive at the appropriate research methodology to pursue.

For those following the positivist philosophy, the assumptions are that an objective view is taken (ontological), where only observable and measurable facts are considered valid (epistemological) and the researcher excludes the social context, which is detached from that being researched and hence, the researcher's opinion is unbiased (axiological). While the assumptions under an interpretivist is that the researcher takes a subjective view (ontological), whereby a human element is involved and the researcher interacts with that being researched (epistemological), and hence interpretations are involved in making an opinion (axiological) (Hussey & Hussey, 1997). Accordingly, depending on the research questions and the approach the researcher is interested in undertaking, in line with the assumptions, and thus deciding on the paradigm approach, the research methodology process is decided.

Based on the above, whereby a human element is involved and the researcher's intention was to seek the investors' experience, the interpretivist philosophy was pursued. The following sections discuss the research methodology and methods used to address the above research questions.

### **5.3.1 Research Methodology**

According to Hennink et al. (2013:12), "methodology refers to how we gain knowledge about the world, and how we collect research data. In social research or "academic research" (Bryman, 2012:4), there are mainly two approaches to research: deductive and inductive. Deductive research mainly assumes the positivist philosophy, whereby the understanding/belief is that "it embodies a view of social reality as an external, objective reality" (Bryman, 2012:36) and the objective of the research is to examine the validity of such reality. In such a form of research, the researcher takes an "etic approach" (Kuttner, et al., 2008) which is also known as an "outsider" approach (Kuttner, Threlkeld, and Haste 2008) and starts with a general principle (underlying the literature)/theory, a hypothesis, and through a process of deductions and testing of the quantitative data collected, attempts to validate the theory/hypotheses.



The inductive research is conducted based on the interpretivism philosophy. Where the goal is to better understand the human behaviour, their experiences and their interpretations, to understand “the social meaning people attribute to their experiences, circumstances, and situations” (Hesse-Biber & Leavy, 2011:4). In other words, “hearing the voices of people themselves” (Hennink et al., 2013:42), and their insights into a central experience. In such a method the researcher takes an “emic approach” (Kuttner, Threlkeld, and Haste 2008), which is also known as an “insiders” approach (Kuttner, Threlkeld, and Haste 2008) and starts with an observation and through a process of qualitative data collection and induction, attempts to understand the matter from their perspective to arrive at a general principle of the observation (generating a hypothesis).

Furthermore, to better understand and assist in forming the research framework, it is also important to decide on the purpose of the study. There are mainly three purposes for conducting a research study: exploratory, descriptive and explanatory. If the area of study is untouched, then exploratory research is undertaken, where the data gathered will help “shape the direction of future research” (Hesse-Biber & Leavy, 2011:10). While if the area of research is more familiar, a further social aspect is sought and then the purpose of study would be more of a descriptive one. However, if further information was sought with regards to the “relationship between different components of a topic” (Hesse-Biber & Leavy, 2011:10), then the purpose of the study would be explanatory.

Based on the above, where the study was to pursue an interpretive philosophy and the intention is to hear the voices of the investors, and to enter into a fairly untouched area (investors’ experience in investing in private equity), the research followed an inductive methodology with an exploratory purpose. Drawing from the background analysis above, the following section reports on the appropriate research design and method of research conduct, based on the research aim, objectives and questions stated above.

### **5.3.1.2 Research Design**

Under the qualitative methodology there are mainly five traditional research approaches: narrative, phenomenology, grounded theory, ethnography and case study (Creswell, 2007). The narrative approach looks into the life of an individual, while the ethnography looks into the lives of a social group and their culture. The case study approach seeks to study and analyse a

specific case or multiple cases, while the phenomenology approach seeks to understand the experiences about an incident/a phenomenon. Through the grounded theory approach, a theory is developed from the data collected in the field/ground.

Phenomenology is not a method for capturing the experience of one individual, nor is it one-dimensional. It is an approach that attempts to capture people's experience of an incident across various dimensions. It is "how the experience is lived in time, space, and vis-à-vis our relationship with others..." (Hesse-Biber & Leavy, 2011:19). According to Creswell (2007: 58), the phenomenology approach assumes "that these experiences are conscious ones, and the development of descriptions of the essences of these experiences, not explanations or analyses". There are mainly two types of phenomenology: hermeneutical and transcendental. Under the hermeneutical phenomenology, the researcher, along with providing a description of the lived experience, undergoes an "interpretive process in which the researcher makes an interpretation ... of the meaning of the lived experience" (Creswell, 2007:59). While under the transcendental, the researcher focuses less on his interpretations and "more on the description of the experiences of participants" (Creswell, 2007:59), and attempts to suspend (brackets) his/her experiences/understandings (Creswell and Clark, 2006).

From the research aim of this study, whereby the relationship between the investor and the FI and their experiences are sought, in particular that of the investor, the appropriate research methodology used to carry out the research can be described as following a social constructivism and interpretative method, with an exploratory and inductive approach, through the collection of qualitative data (sections 5.3.2 and 5.4.1). The methodology facilitated addressing the objective of describing and explaining the relationship between the financial institutions and investors in order to ascertain the gaps and weaknesses and how to improve them.

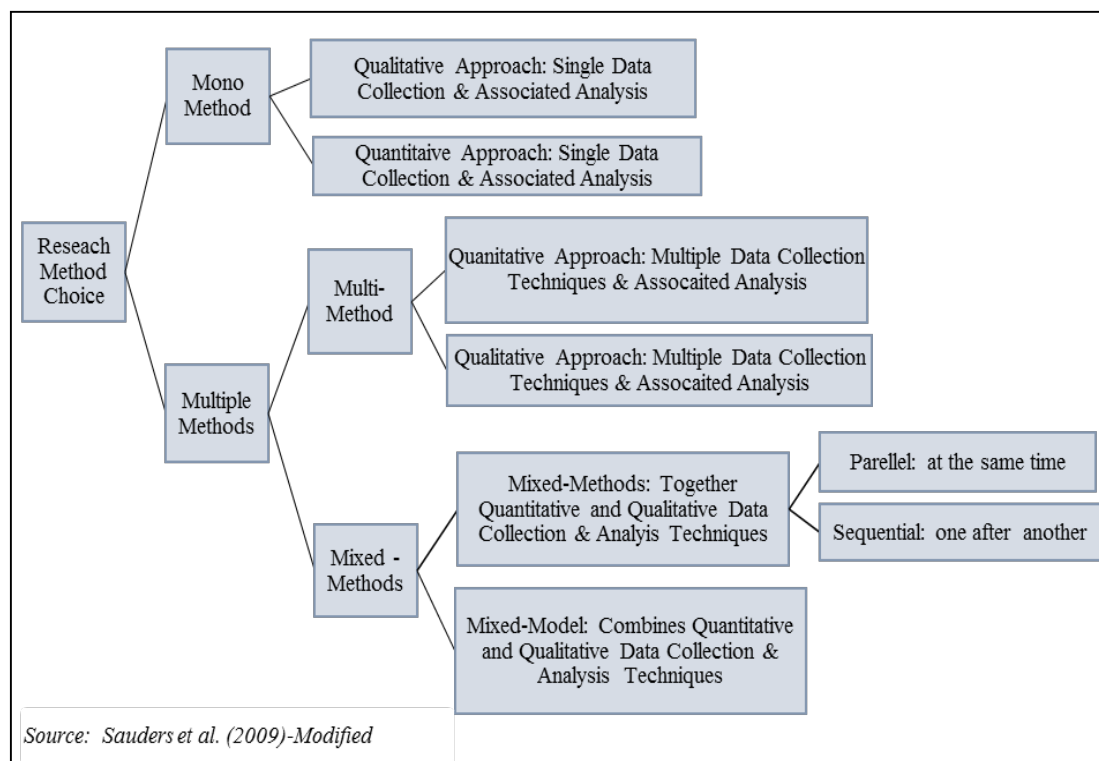
## **5.4. RESEARCH METHOD FOR COLLECTION OF DATA**

### **5.4.1. Research Method Instruments**

Research method choices can be classified as mono or multiple. With the mono method, the researcher chooses either the quantitative or qualitative approach when pursuing the data collection and data analysis process (Saunders, et al., 2009). If the qualitative approach is

selected then data collection and data analysis will be performed using the qualitative procedures only. While, the multiple method offers four different possibilities, whereby combinations of different data collection and data analysis techniques of the two approaches are either taken up together (mixed-method) or combined (mixed-model) (**Error! Reference source not found.**). Saunders et al. (2009), in agreeing with Tashakkori and Teddlie (2003), suggest that the use of multiple methods helps to better evaluate the research findings and in explaining and interoperating the answers of the research questions. By combining the approaches, the strategies can facilitate and or complement one another.

**Figure 5.2 - Research Method Choice**



Since the qualitative methodology was to be undertaken, then in this cross-sectional study<sup>142</sup>, the mixed-model approach was taken up and priority was given to the qualitative method (since the approach taken up was the inductive approach - section 5.3.1), where the dominant model was the qualitative, and the quantitative was secondary (Azorín & Cameron, 2010:98). This is known as the “nested methods design” (Hesse-Biber & Leavy, 2011:283), in that the quantitative method is “embedded” (Hesse-Biber & Leavy, 2011:283) in the qualitative.

<sup>142</sup> The study taking place at a particular time, as opposed to a longitudinal study, which is a study that is undertaken to study change and development over time (Saunders et al., 2009:155).

#### **5.4.1.1. Data Collection Tools**

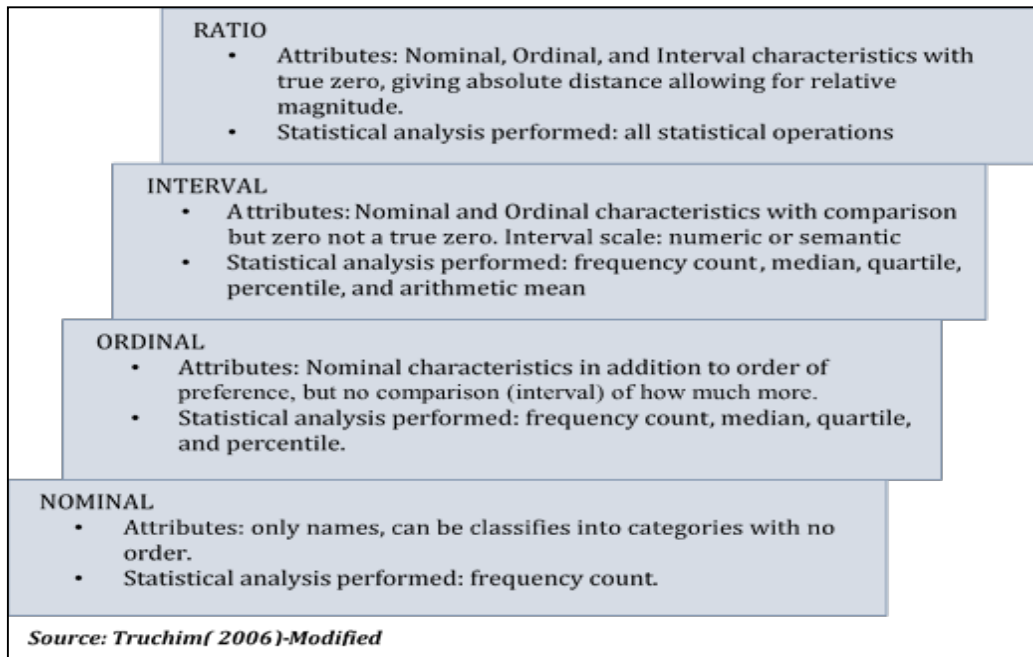
There are various techniques used for data collection and depending on the type of research the methods vary. In the quantitative method, surveys through questionnaires/structured interviews and experiments are conducted and numbers or attributes that can be converted into some form of amounts/scale are collected, analysed and statistics and correlations are generated, and findings are then generalised to represent the population. In such methods, a large sample of respondents is required. While with the qualitative method, participants are observed and interviewed (semi-structured/open-ended interviews/in-depth interviews/focus groups), to capture their experiences in words that are either spoken or written, which are then interoperated through codes into themes. The sample of participants in such a method is much smaller (Hennink, Hutter, and Baily, 2013).

When the aim in undertaking a study is to “investigate insights that go beyond the publically available data” (Nix & Chen, 2013:7), then it can only be done by directly communicating with the participants. Thus, personal interviews with the participants was the best method of approach for the collection of data, with the aim of accessing the “black box” (Nix & Chen, 2013:57) of their experience/perception. However, in order to have some form of standardisation in interoperating the responses from investors/LP, questionnaires (of closed-ended and open-ended questions) were used, through semi-structured interviews. Once these interviews had been conducted, in-depth interviews were performed with Islamic financial institutions (IFI) offering Islamic private equity, and with *Shari’ah* scholars (members of *Shari’ah* Supervisory Boards - SSB) to obtain input on the issues raised in the semi-structured interviews, and to perceive how the other party in the relationship handled matters.

#### **5.4.1.2. Level of Measurement**

The level of measurement “refers to the relationship among the values that are assigned to the attributes for a variable” (Trochim 2006). There are basically four levels of measurements: nominal scale, ordinal scale, interval scale and ratio. The mathematical/statistical property of each depends on which measurement scale is being used. The level of measurement helps in determining the level of interoperating in the relationship between variables and assists in the selection of the most suitable statistical analysis to be used.

Figure 5.3 - Hierarchy of Level of Measurement



As we move up the hierarchy, the type of measurement includes the qualities of the lower level in addition to a new quality, and therefore, the higher the level of measurement the greater the statistical analysis that can be performed on the results obtained. Furthermore, since the study to be undertaken was seeking the understanding of a social phenomenon through interviewing participants, then the level of measurement “seldom aspires beyond the interval level” (Crawford, 1997).

Moreover, there are basically two categories of measurement scales: comparative and non-comparative scales (Crawford, 1997). Scaling is used in measuring responses, and there are mainly three types of one dimensional scaling.<sup>143</sup> They are: Thurstone, Guttman and Likert scaling. Whereby the response items on the Thurstone scale, in its simplest form, offer participants to select responses from a set of comparing statements (agree/disagree), in the Guttman scale the response items are cumulative, in that by agreeing on a statement, among a set of listed statements/response items, the participants will also be agreeing with the statements of the previous questions. In the Likert scale (a non-comparative scale) the response items are summed to produce a total score. It is created by way of generating responses that can be rated on a scale, either by using an odd-numbered scale or an even-numbered scale. An odd-

<sup>143</sup> Versus using multi-dimensional scaling; this is more complex in constructing and understanding, and is usually used when more than one characteristic is being measured in one variable.

numbered scale (0-4, 1-5, 1-7, etc.) provides the participant with a neutral/undecided option<sup>144</sup> (2, 3, 4 respectively), while an even-numbered scale forces the participant to make a decision.<sup>145</sup> The ratings of all the items/statements are summed to arrive at the final score (Trochim, 2006). All three forms were used in the questionnaire. The choice of which form to use was based on which the researcher considered to be the most appropriate to suit the question being asked.

## **5.4.2. Sampling Process**

### **5.4.2.1. Determining the Sampling Methods**

There are mainly two types of sampling methods: probability and purposeful (non-probability). Probability sampling is where all cases of the population have a “specifiable chance of being selected” (Dawson, 2013:53), and is used when the researcher seeks to generalise the results. With the non-probability, “it is not possible to specify the possibility of one being included in the sample” (Dawson, 2013:53), and is used by researchers who are interested in description rather than generalising. With the probability sampling, the participants are selected randomly. While, under purposeful, the participants are selected based on meeting certain specifications. Some of the subcategories of purposeful sampling are: quota sampling, expert/judgment sampling, and snowball sampling. With the quota sampling, a certain target size is set for the sample. Whereas with the expert sampling, the specification is on the type of experience of the participant. Snowball sampling is used when participants are not easily identified; a second/next participant is reached based on the network connection of the first participant (Trochim, 2006). It works by “one subject gives the researcher the name of another subject” (Vogt, 2005).

The selection of the appropriate sample method depends on the purpose of the study. Since the purpose of this research was descriptive and exploratory rather than generalisation, then the purposive samples are more appropriate (Dawson, 2013:53). Whereby the sample cases are selected depending on the purpose of the study. With such a form of sampling, the appropriate form of data collection used is the snowballing form of sampling. It basically relies on

---

<sup>144</sup> For example, for an odd-numbered scale of 1-5: 1=strongly agree, 2=disagree, 3=undecided, 4=agree, 5=strongly disagree.

<sup>145</sup> For example, for an even-numbered scale of 1-4: 1=strongly agree, 2=disagree, 3=agree, 4=strongly disagree.

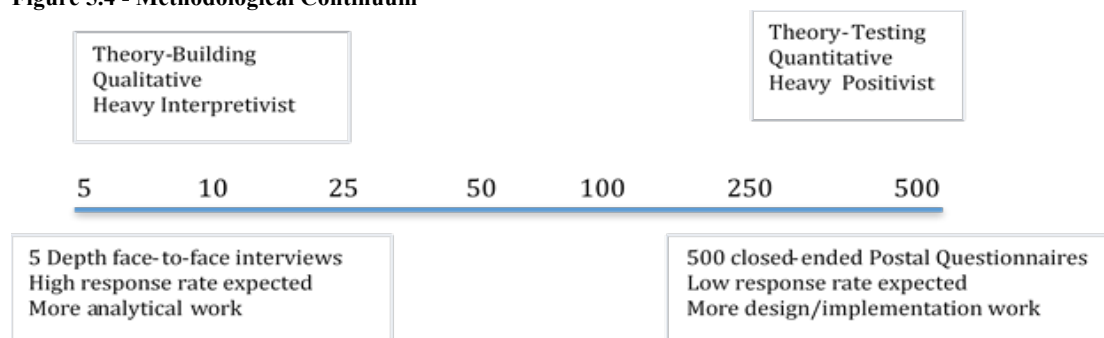
relationships and networks. In the private equity field (the area of this study) the participants are mainly financial institutions and high net worth individuals, who are not easily accessible to the normal individual. Entrance to this market is usually through gate-keepers. Hence, the snowballing research strategy was the most appropriate. In order to obtain responses from such a sample, some form of trust is required and “trust may be developed as referrals are made by acquaintances or peers rather than other more formal methods of identification” (Atkinson & Flint, 2001:2). The disadvantage to such a form of data collection is that it could be biased in representation in that it might not provide a fair and unified sample and could be more inclined to over-represent depending on the inter-relationship of the referred subject. Such biasness was reduced by increasing the sample size (as much as possible) and commencing with a wider selection of subject representation, from which referrals were made.

Furthermore, the judgment sampling was also used as a form of data collection. In this sampling method the person to be interviewed is directly approached for their “knowledge and information to provide useful ... insights” (Rmenyi et al., 1998:194). In this study, the judgment sample were the IFI and the *Shari’ah* scholars (members of SSB).

#### 5.4.2.2. Research Population and Sample Size

According to Raddon (2012), the sample size with a large response rate is important, for a qualitative study, where the reliance is heavily on the interpretivism of participants. This can only be achieved by conducting face-to-face, in-depth interviews. Thus, he sets the minimum number of participants as five. Furthermore, as the research moves from theory building (being more description and more explanation) towards theory testing (validating a hypothesis/theory), the number of participants increases. The maximum recommended is 500 (Figure 5.4).

Figure 5.4 - Methodological Continuum



Source: Raddon (2012)

The research population of this study was the six GCC countries, which is where the sample frame was drawn from. It was difficult to determine the exact size of the sample from the start of the research, since the area of study is not easily accessible (Dawson, 2013:54). However, initially, the attempt was to establish contact with equal numbers of LPs/investors from each of the GCC countries, with an intention to have a sample size of a minimum of 30 participants for both the Islamic and conventional investors.

With regards to the second part of the study, the expert sample, since GPs/IFIs operate across jurisdictions when trying to raise investment funds, they would be common to the GCC region, and it would not be necessary to attempt to have one from each GCC in the sample. Depending on accessibility and responses, ten GPs/IFIs were initially intended to be sought. For members of the *Shari'ah* Supervisory Board, ten scholars (since they are common to most investments) were also initially considered to be sought. Thus, the second part of the study intended to start with an initial sample size of 20 participants. Section 5.4.5 below covers the details of the actual size of the study.

### **5.4.3. Questionnaire Content and Interview Format**

#### **5.4.3.1. Questionnaire Content**

The intention of the data collection through questionnaires was to provide an explanation and to assist in interpreting the behaviour/decisions made, to address the research questions stated above. As such, the questions were designed in a way so that the responses/answers received could be measurable and assist in answering the research questions (section 5.2.2.3) and thereby achieve the objectives of the study.

To assist in designing the questions and response format of the questionnaire, the research questions were reviewed to decide on the type of 'data variable' (Saunders et al., 2009:368) that each of the questions being asked was seeking. According to Saunders et al. (2009), there are three types of data variables: opinion variables, behaviour variables, and attribute variables. The responses to the data containing opinion variables would reflect how the respondent thinks/feels/believes. While responses to a behaviour variable would help to reveal what the respondent did/does/will do, the response data of attribute variables would provide information on the characteristics of the respondent. Thus, once this step was established, then details of the



measurement responses were developed in line with the type of data variable required, for each of the questions.

In addition to having some open-ended questions, the questionnaire contained closed-ended questions (semi-structured questionnaire), which were designed so as to be able to give quantitative data. Responses to closed-ended questions were designed using either the Likert scale or a categorical list, in that the participant was provided with a list of answers to choose from. This helped in quantifying the responses and in finding patterns, whereby some statistical techniques could then be used in the analysis.

The questionnaire that was used with investors and the questions of the IFI interviews were in English. However, the questions addressed to the *Shari'ah* scholars were originally prepared in English and were then translated (by the researcher) into Arabic, since not all the *Shari'ah* scholars are fluent in English. Both (IPE and CPE) investors were asked the same questions, except for the *Shari'ah* questions. The *Shari'ah* questions were addressed only to IPE investors.

#### **5.4.3.2. Interview Format**

There are mainly two types of interviews: exploratory/in-depth interviews and standardised interviews. Usually, the research study would start with exploratory/in-depth interviews which are conducted to “collect precepts, and ideas, and to improve the conceptualisation of the research problem” (Oppenheim, 2001:70), and then if required, standardised interviews are conducted to seek in-put/opinion on the findings of the in-depth interviews. The in-depth interviews are conducted with experts in the field.

In this research study, however, the order was reversed. This was due to the fact that the study was seeking the LP's/investor's opinion and feedback on their experiences that they had undergone with GPs/IFIs, so as to raise awareness of any weaknesses in the hope of putting forward recommendations for developments. As such, LPs/investors were interviewed first. The interviews conducted with the LPs was standardised as much as possible, through the use of one-to-one “interview-administered questionnaires” (Saunders et al., 2009:320), to be filled/answered by the participants. The intention was to forward the questionnaire prior to the interview, if possible, to be discussed/answered during the interview (Hesse-Biber & Leavy,

2011:102). Other than assisting in comparability during the data analysis, standardising also minimises concerns such as “interview bias[ness], the attempt to impose one’s own benefit on the situation and interpretation of the responses” (Patton, 2001:74). The closed-end questions were to “reflect our own categorisations - what we think some of the key issues may be” (Hesse-Biber & Leavy, 2011:102) and may not cover all issues or if covered, they may be different “from how the respondents themselves would have discussed them” (Hesse-Biber & Leavy, 2011:102). Thus, the questionnaire also had some open-ended questions (semi-structured questionnaires) to overcome this drawback.

Once the LP’s/investor’s responses were collected, the input received was used as background information to explore the topics that would be discussed in the in-depth interviews conducted with GP/IFI and *Shari’ah* scholars (members of *Shari’ah* Supervisory Board - SSB). The interview took the form of “semi-structured interviews” (Saunders et al., 2009:320), using the information obtained in the earlier interviews to explore the opportunities and perceptions of the experts “to reveal and understand the ‘what’ and the ‘how’ ....the ‘why’” (Saunders et al., 2009:320) of the research question and objectives. With the anticipation of raising awareness of the current relationship and situation in the private market of IPE, among the supervisory and the experts, so as to seek improvement; with the intention to enhance confidence in the investment form of Islamic equity financing.

#### **5.4.4. Pilot Testing**

Pilot testing was undertaken prior to the actual commencement of the data collection/interviews. It was performed in order to test the questionnaire’s clarity and understandability (question wise, instruction wise and presentation wise), in addition to assessing the validity and representativeness of the questions. Pilot testing was performed by providing experts in the field of PE with the: information sheet, consent form, and the questionnaire. They were then asked to provide their feedback on the documents provided. In addition, feedback from normal (non-expert) professionals was also sought, so as to evaluate the understanding of the format of the questions and their presentation, as not all investors are experts (HNW individuals are usually businessmen). Based on the feedback received, amendments were made to the questions accordingly.

### **5.4.5. The Fieldwork**

#### **Investors**

Following obtaining the approval of the Durham University Business School's Sub-Committee for Ethics (DUBS SCE), the search for potential participants commenced. Initially, a few contacts were approached to assist in identifying/providing eligible participants (investors). However, due to the sensitivity of the matter (private/personal investments) and to confidentiality issues (client confidentiality), progress was fairly slow through direct contacts. Then an attempt was made to make use of the online business social network service LinkedIn. Through searching for possible eligible investors (individuals of private businesses, representatives of institutions, and representatives of family offices) requesting to connect and then once connected sending a request to assist and share their experience/expertise and participate in the study. Once a positive response was received, an introductory e-mail, including the information sheet, questionnaire, and consent form was sent to the new contact. Thereafter, follow-up e-mails or phone calls were made, until the questionnaire was returned. Furthermore, once a connection was made with a new participant, his connections/network would provide new possibilities for searching for other eligible participants. Moreover, searching online for individuals who talked (at conferences) or wrote or worked in a similar area to the study assisted in identifying potential participants, who were then approached through LinkedIn. Although time consuming (as the researcher had to wait until a response/acceptance to connect was received, and at times there were no responses), this method of snowball sampling, using the online business social network had a positive outcome in reaching the sample size. The sample size for the IPE questionnaire was 35 investors (with a rate of response of 58%) collected during a period of 4 months (January to April 2015). Additionally, information from 16 respondents of the CPE questionnaire (with a rate of response of 57%) was collected during a period of 4 months (September to December 2015), brings the total number of investor respondents to 51.

Although the aim was to conduct a face-to-face interview-administered questionnaire with the participants, it was not always possible. Even though the researcher was willing to travel to meet with the participant, this was not always the preference of the interviewee. The purpose of the face-to-face interview was mainly to ensure a response to the questionnaire. However, some of the participants preferred to respond to the questionnaire by themselves in their own time and then to e-mail it back. When correspondence was made by e-mail, the researcher followed up on any clarifications/explanations after reading through the responses. Some

participants preferred the researcher to call at a certain time and to take note of the participant's response and comments. In such instances, once the interview was conducted an e-mail would be sent to the participant to confirm the responses received during the telephone call. For those who were willing to meet, arrangements were made for a convenient date, time and place to meet, where the participants would respond to the questionnaires and provide their input.

Moreover, once contact was established and e-mails were sent, there were some who responded within a few days and there were those who took some time, after several reminders and follow-ups (due to work and travel). Furthermore, with regards to responding to clarifications, not all participants did so. Some investor participants, once they had responded to the questionnaire the first time round, did not respond the next time round when some clarifications or further explanations or examples were requested.

While the aim was to have an equal number of participants from across the GCC, this was not possible. Table 5.1 shows the number of respondents in the sample from different countries across IPE and CPE. Due to the recent happenings in the financial market<sup>146</sup>, and more specifically to private investment projects in the region, investors were not willing to share their experience either due to the negative experience and as such did not want to expose such an experience, or due to undergoing or planning to take-up legal action and did not want to participate, so as to not jeopardise their situation/case. Furthermore, some governmental authorities, such as endowment and investment authorities, declined to participate, with the reasoning that replying to the questionnaire would give away their investment strategy.

**Table 5.1 - Sample Size and Regional Coverage**

Investor Type	Domicile of Investor						Total
	Bahrain	Kuwait	Qatar	Oman	Saudi Arabia	UAE	
<b>IPE</b>	11	6	6	1	6	5	35
<b>CPE</b>	1	4	1	3	4	3	16
Total	12	10	7	4	10	8	51
	23.53%	19.61%	13.73%	7.84%	19.61%	15.69%	100.00%

<sup>146</sup> Following the financial crisis, exiting of some investments/projects was not possible and completion of some investments/projects was put on hold.

Thus, to conduct a more meaningful analysis, the investors were grouped. Those who invested in IPE, due to their greater sample size, were grouped according to the similarities in their organisational set-up. The investors of the IPE group were clustered into two broad groups as follows: ‘Institutional’ investors that included Financial Institutions, along with Takaful Companies, Investment Companies, Asset Managers, Advisor/Consultants and Pension Funds; ‘Individual’ investors constituting High Net Worth (HNW) and Family Offices. Although, CPE investors included both institutions (6) and individuals (10), they were kept as one group, due to the sample size of the group. Moreover, by doing so, the proportions among the groups were more balanced (18 individuals (IPE), 17 institutions (IPE) and 16 conventional (CPE)), which would assist in producing a more meaningful study.

Furthermore, not all interviews that were conducted were recorded, although this was the intention of the researcher. Prior to commencing the interview, the interviewee was asked if he/she would consent to the interview being recorded, and in a few cases, it was not preferred. As such, at those interviews and where the researcher sensed that it made the interviewee uneasy and could affect his/her response, recording was not done. Of those who agreed to the administered questionnaire-interview four did not agree to be recorded, however, all accepted to the use of anonymised quotes in publications.

### **IFI/GP/PE Firms**

In searching the market either online or via LinkedIn, or at conferences or through the researcher’s contacts, IFIs offering private equity private placements in the region were identified and accordingly approached. The approach was either direct contact or through e-mail or establishing contact via LinkedIn or via phone call and trying to arrange for a meeting for an interview. Once the meetings were set, the researcher then travelled to meet the IFI’s representative at their offices. Other than in Bahrain where the researcher resides, journeys were made to Qatar, Riyadh, Kuwait, and Dubai.<sup>147</sup> The sample size of the IFIs surveyed reached 15 over a period of 4 months (December 2015 - March 2016).

Interviews were conducted at the IFI’s offices, at their convenience. A set of questions was prepared beforehand, whereby it was used as guidance towards asking the same questions to

---

<sup>147</sup> There were no IFIs from Oman since Islamic Banking has recently been introduced in Oman as such IFI experience in offering private equity/placement investment does not exist.

everyone. However, at times the interviewee was left to freely talk about the experiences encountered without being restricted to specifically answer a specific question, giving them chance to share and contribute to actual events that took place in such investments in recent prior years. Furthermore, some people were a little reserved at first about talking in the event of bringing any liability to their IFI. Only after assurance was given, and after the interviewee was left to his own time to express himself and talk at the outcome of the interview, were the interview questions put forward to the interviewee.

Some were also apprehensive due to being wary that it would reflect on them, as licensees, on how they responded, since the researcher was at the time an employee of a regulated authority. Some were a little uncomfortable with being recorded at the beginning, but eventually settled, as the interview went on. All agreed to the interview being recorded, except for one. In addition, all IFI participants (except for one, other than the one who preferred not to be recorded) agreed to using anonymised quotes in publications.

As with the investors, some IFI participants, who during the interview/meeting mentioned that they would forward or provide further information post-interview, did not do so, nor did they respond to follow-up e-mails on the matter.

### ***Shari'ah* Scholars (SSB Members)**

Some members of SSB were identified via IFI's website and going over the information on their SSB, while others were through an online search. Initially their names were identified, and then their contact numbers were sought. The technique used was more of a snowballing/networking process. First by contacting those in the industry to provide a contact number for a scholar and then once the first few were contacted, the contact details of the other scholars were taken. Of the scholars who participated, at first some did not respond to the calls, and then based on advice given by one of the scholars, a message was sent (due to the scholars being very busy to respond to all calls), briefly explaining the reason for contact (to conduct an interview for a PhD study), a response would take place and a date and meeting was set. Some meetings took place in the scholar's country of residence, at their offices or at a convenient place or at conferences that they were attending or participating in.

Contacting and conducting interviews with SSB members was done at the same time/period as arranging for meetings with IFI. While travelling to meet with IFI, some *Shari'ah* scholars were

also met during the same trip but separately and independently from the IFI meetings. The researcher was able to interview 13 *Shari'ah* scholars over a period of 4 months (December 2015 - March 2106). All scholars were comfortable with conducting the interview and the recording. The interview was conducted in Arabic, as the scholars were from the GCC and preferred to discuss the issues in Arabic (even though some were known to speak in English), since the researcher spoke the language.

Furthermore, while conducting the interviews with the scholars, the *Shari'ah* review process was not very clear as to the extent of the SSB member's involvement in the review. As such, two *Shari'ah* Compliance Officers/Heads of the *Shari'ah* department of IFI were contacted for further explanation and clarifications.

#### **5.4.5. Data Quality and Reliability**

Since this study is undertaking the qualitative research approach, the aim is not to generalise the findings but rather to seek input on the experience from the participants. Thus, it is important to take measures that will increase the accuracy of the data/information being collected.

##### **5.4.5.1. Strategies for Validating the Findings**

Using mixed data collection methods and mixed paradigms can assist in validating the findings of a research study, in addition to providing a better understanding of the research study. Combining the qualitative and quantitative techniques of data collection, such as interviews (qualitative) and questionnaires (quantitative) while conducting a research study helps to “reduce the impact of personal biases on the part of the analysis” (Yauch & Steudel, 2003:478). The mixed method of research can also have a complementarity effect and can help to enrich and add depth to the analyses of the results. It helps to analyse the study on several levels: “the individual level as well as the societal level” (Hesse-Biber & Leavy, 2011:283).

Furthermore, conducting a pilot test also enhances the quality of the data to be collected because it assists in increasing understanding and clarity, enhancing validity. Additionally, most interviews were tape recorded, so as not to allow for any misleading or forgetting of data/information. Thus, providing more accuracy in the textual analysis and preventing the possibility of having influenced the “content of the participants' descriptions in such a way that

the descriptions do not truly reflect the participants' actual experience" (Creswell, 2007:215). Furthermore, attempting to conduct a one-to-one interview, and where not possible to correspond with the participant to respond, reduced the chances of not receiving a response (Nix & Chen, 2013:89).

### Testing For Reliability

The measure of internal consistency of the variables within a set of questions (that are drawn up to measure matter/construct) based on ordinal scale questions can be achieved by measuring the Cronbach Alpha Coefficient (CAC) (Green et al., 1977: 829). Hence, the CAC test was performed on questions with similar ordinal scales, measuring a particular set of constructs. In the investors' questionnaire, there were 6 sets of questions (6 different constructs measuring different issues) with similar ordinal scales, and as such they could be tested for reliability using the CAC test. Table 5.2 below summarises the results of the test.

**Table 5.2 - Reliability Testing: Cronbach Alpha**

Set of Questions	Questions Measuring	Number of Variables/Items	Cronbach's Alpha
1	Principles Discussed During Meeting	9	0.740
2	Information Decision Based on	15	0.785
3	Vote-Negotiate-Documents Conflict of Interest Process (Investors' Rights)	7	0.814
4	Meeting Expectations	4	0.828

The general acceptance of a good level of internal consistency is 0.7 and above. The set of questions being measured (with the exception of two sets of questions) have scored above the acceptable level of 0.7. An explanation for the low score on one set of questions could be due to there not being many communalities between items under the set of questions, since CAC "is a function of the extent to which items in a test have high communalities and thus low uniqueness" (Cortina, 1993:100). Moreover, the CAC is affected by the number of items, item intercorrelations, and dimensionality" (Cortina, 1993:103). This means that it is best applied and most reliable when used on variables with a similar scaling with multi items, rather than a single item: "single item reliabilities are generally very low, and without reliable items the validity of the item is poor at best and at worst unknown" (Glim & Glim, 2003:84). This could be the reason for the negative result obtained for the other set of questions because the number of items with the set of questions was two. Furthermore, since the remaining ordinal scale



questions in the questionnaire were of single items, calculating the CACs was considered inappropriate, and was not performed.

## **5.5. RESEARCH METHODS FOR DATA ANALYSIS**

Since the questions of the questionnaire (to investors) and the questions of the in-depth interview (to IFI and *shari'ah* scholars) are closed-ended and open-ended questions; the sample size is not comparatively large; the data that was collected was of the nominal (categorical) and ordinal (ranked) scale; and since the concern of the research is the sample (a deeper understanding of the participants) and not the population, then the use of descriptive, textual and content analysis, along with non-parametric statistics was used. The results and findings of the interviews with investors, IFIs and *Shari'ah* scholars are reported in Chapters 6, 7, and 8 respectively.

### **5.5.1. Descriptive and Inferential Analysis**

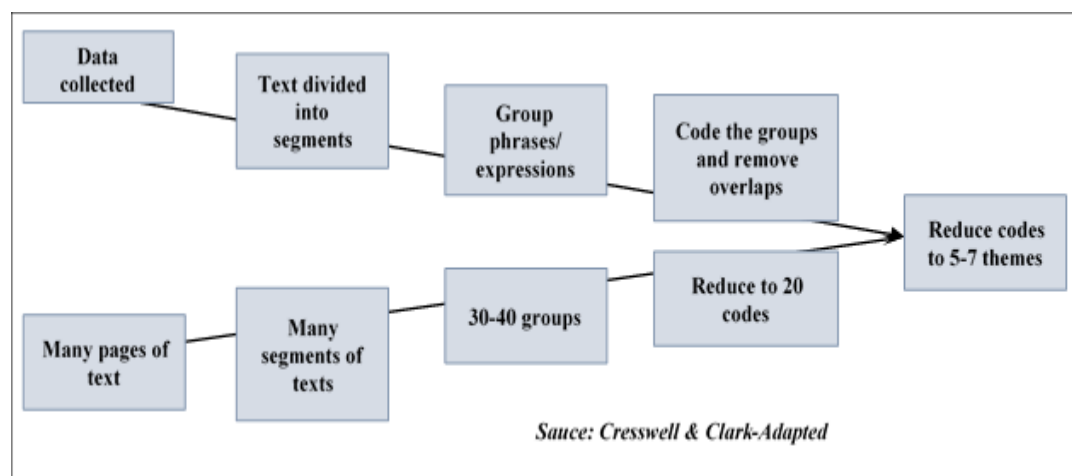
Descriptive analysis was used on the closed-end questions, of the investors' questionnaires. The analysis conducted of the descriptive statistics was performed to give an overview of the results of the data collected, with regards to the key variables identified in the research model. The analysis was carried out by using mathematical formulas (such as weighted score and medians), non-parametric tests (section 5.5.3), descriptive charts and graphs. SPSS-20 (a computer programme used to aid in statistical analysis) was used to do the statistical analysis of the investors' responses to the questionnaire. The responses were coded and entered into the SPSS. The generated statistical output was then exported to Excel. In Excel appropriate presentable formats of the statistical outputs were created and the weighted score (where applicable) was calculated.

### **5.5.2. Textual and Content Analysis**

Textual analysis was used to analyse the open-ended questions (of the IFI's and *Shari'ah* scholars' interview responses). The data/information (transcript) collected through interviewing was imported from Word into Nvivo-11 (a computer programme used to aid in the qualitative data analysis) and was analysed. With the aid of the software, the script was divided into segments of text, which through combining expressions and meanings were coded, after which the codes were grouped into categories of themes. The categories were derived

from the research questions and the topic/area the questions were seeking to cover. Initially, many code groups were formed and then a process of combining the related groups was undertaken, to clear out the overlapping in the codes among the groups (**Error! Reference source not found.**). The results were then put in a presentable format using Excel. Textual analysis was performed on the IFI's and *Shari'ah* scholars' interview responses. However, Nvivo software was used for the IFI interview transcripts only. With regards to the *Shari'ah* scholars' interview transcripts, similar analysis/procedures were used but with the use of Excel, due to Nvivo not being compatible with the Arabic language.

**Figure 5.5 - Textual Analysis**



Moreover, content analysis was performed on the qualitative data (collected under the open-ended questions of the questionnaire). The responses obtained from the open-ended questions in the questionnaire were converted to quantitative data by creating a form of frequency of the responses (repeated themes through the words used) and observations (repeated behaviour) (Trochim, 2006) and by calculating the number of counts of responses for each theme/set of information. Excel software was used to assist in the process of analysis.

### 5.5.3. Non-Parametric Inferential Statistics Methods

Of the non-parametric statistics available, the ones that were used in the study are identified by Turner (2014) and Pallant (2013). The specific tests used in inferential analyses are given below.

- Wilcoxon Rank Sum (Mann-Whitney U) statistics, an alternative to the t-test for independence between groups: used on data of ordinal/ranked scale to analyse data from two independent groups.
- Kruskal-Wallis statistics, an alternative to one-way ANOVA between groups: used on data of ordinal/ranked scale to analyse data from two or more independent groups.
- One-way Chi-squared goodness of fit statistics: used on data of nominal scale (using frequency counts) to analyse data for a single variable.
- Two-way Chi-squared of independence statistics: used on data of nominal scale to analyse data between two variables.
- Chi-squared homogeneity: used on three or more independent groups on a dichotomous dependent variable.

The Chi-square tests could only be used when the expected frequency count was at least 5 for all participants. Furthermore, the effective size and post-hoc test (adjusted standardised residuals and pairwise) were conducted on results with statistically significant differences between the groups/variables. Statistical significant levels of 5% and 10% were considered and were adjusted for multiple tests when post-hoc pairwise tests were conducted. The significant alpha (0.05/0.1) criteria was revised using the Bonferroni adjustment, whereby the alpha level was divided by the number of tests. Moreover, the SPSS statistics generate pairwise results, according to Dunn (1964), whereby for each pairwise comparison performed, the whole dataset is used; similar to the post-hoc test following a one-way ANOVA. The generated results were then compared to the adjusted significant alpha.

## **5.6. CHALLENGES AND OBSTACLES/LIMITATIONS/CONSTRAINTS**

### **5.6.1. Ethical Issues**

From the participants' side, the study aimed to look into the experiences of investors, and hence, confidentiality of the information provided at interviews and the anonymity of the participants are important matters to be covered. All participants were provided with an information sheet, which was given at the beginning, briefing them on: the purpose of the study, maintenance of information (confidentiality), anonymity of their identity, and their rights (Hesse-Biber &

Leavy, 2011:64). Participants also signed a consent sheet confirming their understanding and agreement to participate.

To maintain confidentiality, all participants, following the receipt of the questionnaire or interviews, were allocated with a code<sup>148</sup> and anonymised, upon which, from that point forward reference to the participants by the researcher was through the code allocated. Furthermore, all interview transcripts were typed personally by the researcher, to maintain confidentiality. Typing of the transcripts was for data analysis use only. All recordings and consent forms have been kept in the strict confidence.

From the researcher's side, the researcher, at the time of conducting the interviews, worked with the Central Bank of Bahrain at the Capital Markets Supervision Directorate and at some stage (2006-2010) part of the researcher's responsibilities was the review of private placement documents. Although to some this might seem to give rise to a conflict of interests, the intention of the research is not to fault the participants, but to try to improve the playing field, so as to encourage growth in the equity form of Islamic financing. For transparency and ethical purposes, being an employee of the Central Bank was clearly stated in the Information Sheet that was presented to the participant at the beginning of the meeting.

Moreover, in addition to obtaining Durham University Business School's Sub-Committee for Ethics' approval, all data/information obtained for the study was obtained from the participants themselves or was from the public domain. As such, the code of confidentiality of the workplace was maintained.

### **5.6.2. Limitations of Qualitative Research**

Under the qualitative method, which is based on the interpretive approach, subjectivity and reflexivity are two main issues that can affect the research, especially at the collection of data stage. Subjectivity, in that both the participant under study and the researcher each have their own views and come from different backgrounds, which might affect their interpretations.

---

<sup>148</sup> For example, Investor: INV-01, IFI: IFI-01, *Shari'ah* Scholars: ShSc-01, and *Shari'ah* Compliance Officer/Head: SCO-01.

Furthermore, the participant under study could be affected by the position of the researcher (as in this study (the researcher) working with the regulator), which could affect (unconsciously or consciously) the responses the participant provides (providing answers that the researcher would like to hear). This is known as “personal reflexivity” (Hennink et al., 2013:20). Also “interpersonal reflexivity” (Hennink et al., 2013:42) is to be considered. This is where the quality of the information generated through interviewing and data collection is determined based on the level of rapport that is developed between the researcher and the participant.

Another constraint is the time factor. Qualitative research is based on identifying reaching out, and interviews/liasing with the participant, and hence is time consuming. This in turn imposes some constraints on the time available to spend on the process versus keeping in line with the scheduled outline of the research study.

## **5.7. CONCLUDING REMARKS:**

The study followed the interpretivism methodology, with an inductive approach, and a phenomenological strategy. Whereas the choice of research method was the mixed method, along a cross-sectional horizon, interviews and questionnaires were used as forms of data collection with the aim of obtaining a deeper understanding of the relationship between the investor and the IFI, rather than the generalisation of the population. The next three chapters report the empirical results from the survey.

## Chapter Six:

### INVESTORS' APPROACH TO ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND ANALYSIS

#### 6.1 INTRODUCTION

This chapter presents the investors' responses gathered through a questionnaire-based survey. The data in this chapter is analysed using descriptive and inferential analysis examining the investors' profile, their investment approach, and their pre- and post-investment relationship with the FI. It looks into the perceptions of three groups of investors of their investment experience from transparency, disclosure and investors' rights perspectives; their views on how to govern the PE investment environment and their thoughts on continuing to invest in such investments. For comparative purposes, data on both investors investing in Islamic private equity (IPE) and investors investing in conventional private equity (CPE) was obtained. Hence, in addition to the above, for those who invested in IPE, their perception of *Shari'ah* compliance was also sought. The data was initially inputted into SSPS software and the tables used were generated using SSPS and modified in Excel. Since the study sample is small, non-parametric techniques were used. Moreover, the Mann-Whitney U test and the Kruskal-Wallis H test for the differences between independent groups (U test - between 2 groups and H test - between 2+ groups) were conducted, since they are a more suitable non-parametric alternative to the t-test, for independence between groups. Furthermore, where appropriate, the Chi-square (Chi-sq) test was carried out to ascertain the statistical significance for independence/differences.

While an initial attempt was made to discuss each set (investors, FI, and *Shari'ah* scholars) of findings in the related chapter as the results unfold, it was decided otherwise. The reason being, due to the inter-relationship between the three groups, especially the investors and FI, deliberating separately turned out to be more confusing and at times incomplete. Having part of the picture in one chapter and then the other in another chapter. Hence, it was decided to discuss all three in one chapter. Moreover, to bracket the researcher's work experience from the participants' experience, and thus not affect/influence the interpretations and discussions, the researcher considered it, as a precautionary measure, more appropriate to disclose the facts and finding separately. Thus, this chapter (6) and the next two chapters (7 & 8) will present the findings and results of the studies conducted. Then, the discussions on the results and findings, along with the contextualisation with the literature review, will be covered in Chapter 9.

## 6.2 INVESTOR PROFILE

A total of 51 investors participated in the study. Of the 51 participants, 35 were IPE investors and 16 were CPE investors. The participating investors were from across the GCC<sup>149</sup>, who had invested in private equity/private placement investments including real estate projects (PE).<sup>150</sup> The investors ranged from different segments of sophisticated/accredited<sup>151</sup> investors. As discussed in Chapter 5, section 5.4.5, the investors were grouped into 3 groups: individuals, institutions and conventional.

### 6.2.1 Investor Type and Domicile

As can be seen from Table 6.1 below, the participants were from across the GCC. Most of the respondents were from Bahrain with 23.53%, followed by Kuwait and Saudi Arabia with 19.61%, and the UAE made up 15.69%, followed by Qatar with 13.73% and Oman with 7.84%. The greater number of participants from within the individual group are from Bahrain (55.56%), and from Saudi Arabia (16.67%), and the greater number of participants from the institutional group are from Kuwait (29.41%) and Qatar (23.53%). While the greater number of participants from the conventional group are from Kuwait and Saudi Arabia (25.00% each).

**Table 6.1 - Investor Type and Domicile of Investor**

Investor Type	Descriptive Statistics	Domicile of Investor						Total
		Bahrain	Kuwait	Qatar	Oman	Saudi Arabia	UAE	
<b>Individuals</b>	Count	10	1	2	0	3	2	18
	% of within Investor Type	55.56%	5.56%	11.11%	0.00%	16.67%	11.11%	100.00%
<b>Institutions</b>	Count	1	5	4	1	3	3	17
	% of within Investor Type	5.88%	29.41%	23.53%	5.88%	17.65%	17.65%	100.00%
<b>Conventional</b>	Count	1	4	1	3	4	3	16
	% of within Investor Type	6.25%	25.00%	6.25%	18.75%	25.00%	18.75%	100.00%
<b>Total</b>	Count	12	10	7	4	10	8	51
	% of Total Investors	23.53%	19.61%	13.73%	7.84%	19.61%	15.69%	100.00%

<sup>149</sup> GCC - Gulf Cooperation Council Countries.

<sup>150</sup> For those who invested in IPE, the investments are in accordance with the *Shari'ah* principles.

<sup>151</sup> The sophisticated/accredited investors definition varies across jurisdictions, but generally, the assumption underlying sophistication/accreditation is that individuals or organisations who qualify will have sufficient financial sophistication and a certain level of income to understand and take on the risks associated with certain investment offerings.

## 6.2.2 Investors' Investment

To assist in identifying the form of investment relationship that the investor had with their FI and as such identify the legal set-up of the type of investment<sup>152</sup>, the respondents could choose from four ways of investing in IPE/CPE. They were either through direct investment (DI), some form of partnership/*Musharakh* or indirect investment (IN) where the funds are pooled into a special purpose vehicle (SPV), fund of funds (FF) or limited partnership (LP), which represented a form of *Mudarabah/Wakalah*. Participants had the option to select more than one type of investment.

**Table 6.2 - Investor Type and Investment Carried Through**

Investor Type	Descriptive Statistics	Investment Carried Through (ICT)				Total
		Direct Equity Investment	Indierct Equity Investment	Private Equity Fund of Fund	Limited Partnership	
<b>Individuals</b>	Count	12	8	4	6	18
	% within Total Investors	66.67%	44.44%	22.22%	33.33%	35.29%
<b>Institutions</b>	Count	13	9	4	4	17
	% within Total Investors	76.47%	52.94%	23.53%	23.53%	33.33%
<b>Conventional</b>	Count	12	12	5	9	16
	% within Total Investors	75.00%	75.00%	31.25%	56.25%	31.37%
Total	Count	37	29	13	19	51
	% of Total Investors	72.55%	56.86%	25.49%	37.25%	100.00%

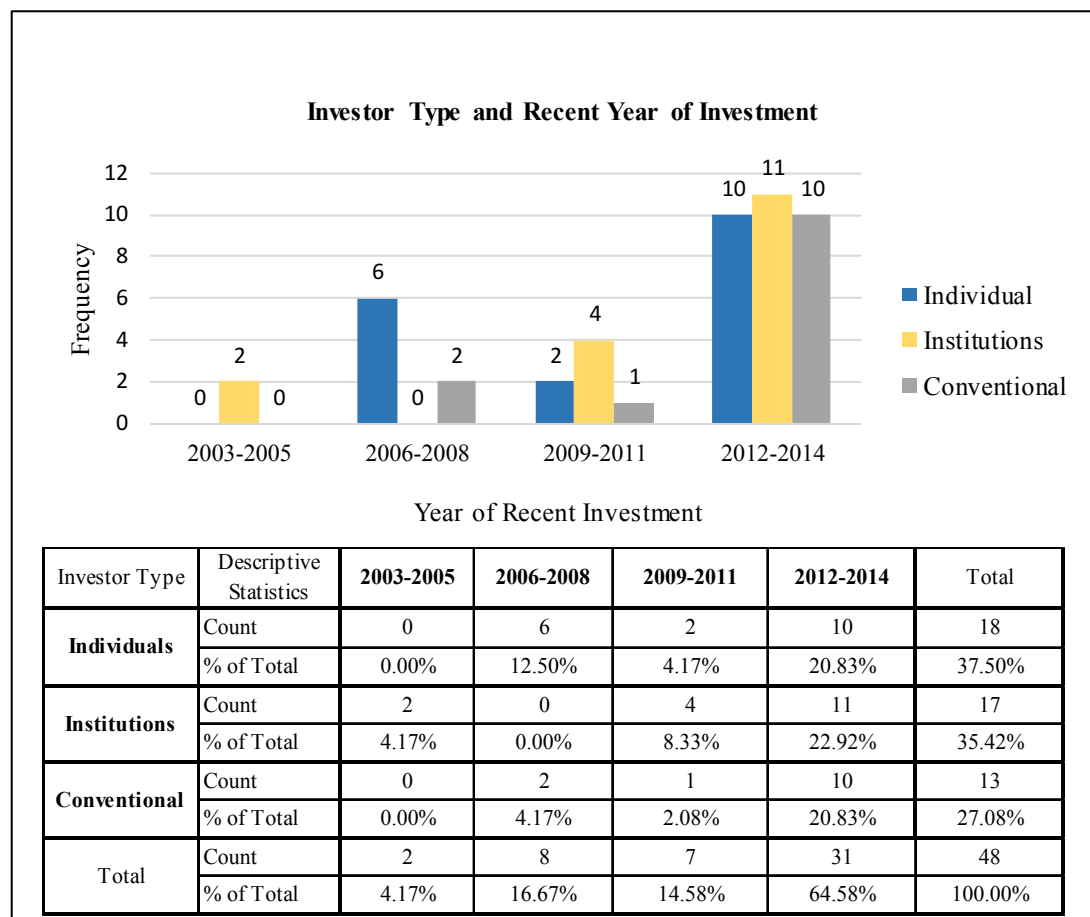
As can be seen from Table 6.2, the most popular form of investment among the participants was direct investment, whereby 37 of the participants, representing 72.55% of the total number of investors, had invested in DI. While the least form was through funds of funds, with 13 of the participants (25.49%) who had invested through them. Investing through an SPV (56.86%) was a more popular form through which 29 investors invested, than through LP, where only 19 had invested (37.25%). Furthermore, from within the groups, the order of preference between the three groups of investors appeared to be similar, with the individual and conventional investors having greater preference for carrying out investment through LP (6 individual participants (33.33); 9 conventional participants (56.25%)) than the institutional investors (4 participants (23.53%)).

<sup>152</sup> Part of research questions A.



The study questioned the participants on the last period of investment within the last 10 years.<sup>153</sup> Of the conventional investors, one investor's most recent investment was post-2014, and two participants did not select a response, all three were not included in the count. It appears from Figure 6.1 below that the period 2012-2014 was for all groups to be the period of their most recent years of investment. About 12.50% of the individual investors and about 4.17% of the institutional and conventional investors did not invest beyond the year 2008 (the start of the financial crises). Between the years 2009 and 2012, 12.50% of the investors invested in IPE (individual and institutions group) and then the sentiments of all three groups appears to have picked up with around 64.58% (43.75% - IPE, 20.83 - CPE) investing between the years 2012 and 2014.

Figure 6.1 - Recent Year of Investment



In order to find out how familiar the investors were with investing in private equity they were asked about their familiarity with equity financing. Those investing in IPE were more specifically asked with

<sup>153</sup> The response is to the last investment made, which means that they could have also invested in the years prior to the period they selected.

regards to the investment being a *Shari'ah* compliant investment<sup>154</sup> and about their familiarity with Islamic equity financing. The responses can be seen in Table 6.3 below. A weighted score<sup>155</sup> was calculated, by calculating the weighted average for each group of investors. With a weighted score of 3.00, both the institutional and conventional investors appear to be more familiar than the individual investors who have a weighted score of 2.00 on average. From the weighted score, it appears that the majority of both groups of investors fall between the ranges of being “Familiar” to “Very Familiar”, with institutional and conventional being closer to “Very Familiar” compared to the individual investors. Furthermore, it appears from the Percentage of the Count to Total Investors that the conventional investors are more specialised (13.73%) than the institutional investors (7.84%) and the individual investors (1.96%). Moreover, the Kruskal-Wallis H test conducted revealed a statistically significant difference in familiarity level between the three groups,  $H(2) = 8.988$ ,  $p = 0.011$ .

**Table 6.3 - Investor Type and Familiar in Equity Financing**

Investor Type	Descriptive Statistics	Familiar in Equity Finance				Weighted Score-a	Median
		Somewhat Familiar	Familiar	Very Familiar	Specialized		
Individuals	Count	2	9	6	1	2.33	2.00
	% of Total Investors	3.92%	17.65%	11.76%	1.96%		
Institutions	Count	1	6	6	4	2.76	3.00
	% of Total Investors	1.96%	11.76%	11.76%	7.84%		
Conventional	Count	0	3	6	7	3.25	3.00
	% of Total Investors	0.00%	5.88%	11.76%	13.73%		
Kruskal-Wallis						$H(2)$	$p$
						8.988	0.011

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 4, with 1 "Somewhat Familiar" to 4 "Specialized".

In order to find out which of the groups were statistically different from one another, a post hoc test was performed, using Dunn's (1964)<sup>156</sup> procedure with Bonferroni correction for multiple comparisons. Statistical significance was accepted at the  $p < 0.0167$ <sup>157</sup>. As can be seen in Figure 6.2 below, in conducting the pairwise comparison test, there appears to be a statistically significant difference

<sup>154</sup> The investors' understanding of *Shari'ah* principles and compliances will be covered later in the chapter under section 6.5.6 *Shari'ah* definition and compliance.

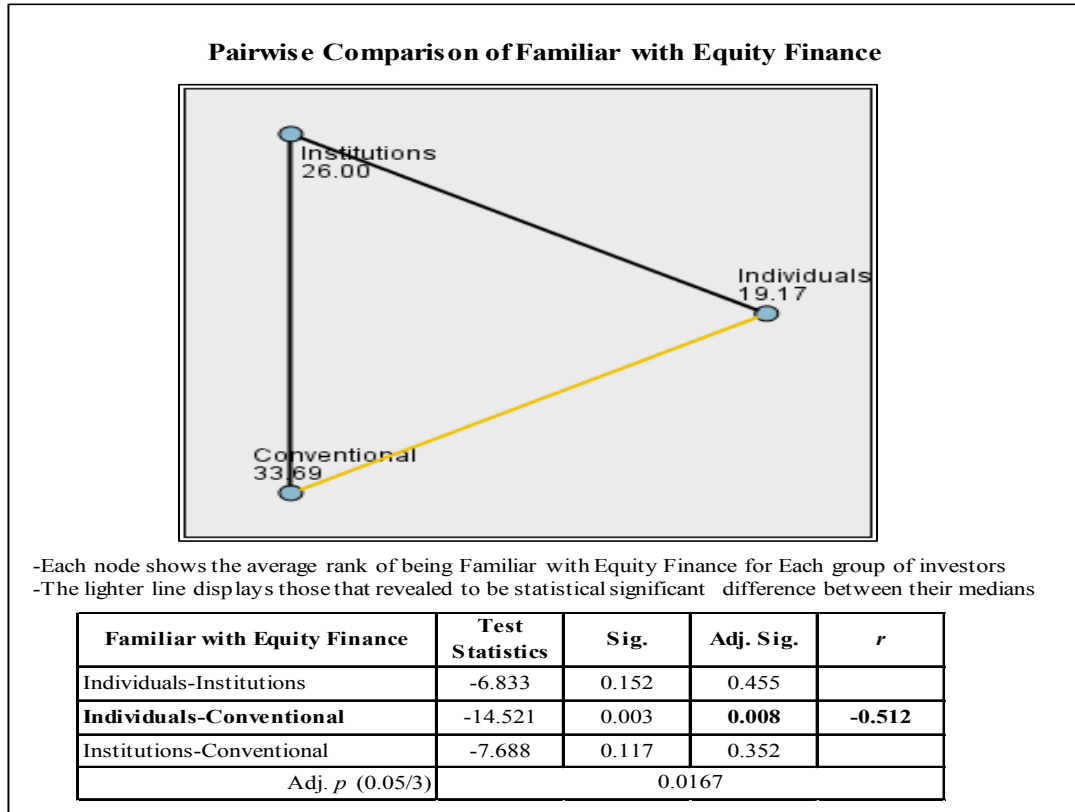
<sup>155</sup> The weighted score was calculated by multiplying the count from each category of responses within each group by the scores allocated to the specific category. Then within each group, the sum of the outcome of the responses is divided by the number of participants of that particular group.

<sup>156</sup> This procedure uses the whole data set when making each pairwise comparison in a manner similar/analogous to post hoc tests following a one-way ANOVA (Laerd Statistics, 2015).

<sup>157</sup>  $p$  is adjusted for multiple comparisons. Hence, in this case there are 3 groups, so  $p = 0.05/3 = 0.0167$ .

between the medians of the individual (2.00) and conventional (3.00) groups of participants, with a large size effect<sup>158</sup> ( $p = 0.008$ ,  $r = -0.512$ ).

Figure 6.2 - Post Hoc Test on the Distribution of Familiar with Equity Finance Across the Type of Investor Group



### 6.3 INVESTORS' APPROACH

In order to identify the investors' determining factors on the appropriate level of disclosure/type of information required in investing in IPE<sup>159</sup>/CPE, this section reports the sources of information that the participants looked into or considered as important in their decision making on an investment. They were questioned about how much of the information was based on personal sources versus impersonal sources, in addition to providing examples of both types of sources that they use.

<sup>158</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

<sup>159</sup> Part of research questions A.

### 6.3.1 Personal Source of Information

With regards to the investors' approach to investment, participants were asked to indicate how much of the information used prior to making an investment decision is based on personal sources (i.e. calls, meetings with FI/GP, personal network and so forth). The range of responses was from "None at All" to "Great Extent".

**Table 6.4 - Investor Type and Personal Source**

Investor Type	Descriptive Statistics	Personal Source						Weighted Score-a	Median
		None at All	Slight Extent	Certain Extent	Considerable Extent	Substantial Extent	Great Extent		
Individuals	Count	1	1	1	6	5	4	4.39	4.50
	% of Total Investors	1.96%	1.96%	1.96%	11.76%	9.80%	7.84%		
Institutions	Count	0	0	1	3	7	6	5.06	5.00
	% of Total Investors	0.00%	0.00%	1.96%	5.88%	13.73%	11.76%		
Conventional	Count	0	0	0	5	4	7	5.13	5.00
	% of Total Investors	0.00%	0.00%	0.00%	9.80%	7.84%	13.73%		
Kruskal-Wallis								<i>H</i> (2)	<i>p</i>
								3.321	0.190

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 6, with 1 "None at All" to 6 "Great Extent".

The outcomes of the responses are presented in Table 6.4 above. Overall, all three groups of investors appear to place a considerable portion on Personal Sources, with the conventional group placing the greatest weight (5.13). Unexpectedly, it seems that the institutional investors based more weight (5.06) of their decision making on personal sources than the individual investors, whose responses weighed 4.39. From the Percentage of the Count to Total Investors, all the institutional investors and conventional investors took Personal Sources into consideration, with no count (0%) for "None at All" and most of them consider it as forming a "Substantial Extent" (13.73% - institutional, 7.84% - conventional) to "Great Extent" (11.76% - institutional, 13.73% - conventional) of their decision making. While the individual investors were more towards "Considerable Extent" (11.76%) to "Substantial Extent" (9.80%). However, the Kruskal-Wallis H test that was conducted showed the distribution of Personal Sources for all three groups was similar, and the median for individuals (4.50), institutions (5.00), and conventional (5.00) was not statistically significantly different,  $H(2) = 3.321$ ,  $p = 0.190$ .

Participants were also asked to list three types of Personal Sources of information upon which they base their investment decision. This was an open question, and only 49 of the 51 participants provided a response to the question. Furthermore, some respondents provided less than three types of Personal Sources of information. The responses are presented in Table 6.5 below. As can be seen from the table,

“Calls and Meeting Manager/Placement Officer, Investee Company and Related Parties” (Calls with FI) scored the highest source of personal information overall, representing 65.31%, followed by “Professional/Authorities’ Advice” (Professional Advice) and “Friends and Personal Network Advice” (Personal Network), representing 42.86% each. While inquiring internally within the institution itself or with partners scored the least with 20.41% (other than no personal sources and relied on own experience).

**Table 6.5 - Investor Type and Personal Source Investing Based On**

Investor Type	Descriptive Statistics	Personal Source Investment Based on					Total Responses
		Calls & Meeting Manager/ Placement Officer Investee Company & Related Parties	Professional/ Authorities Advice	Friends & Personal Network Advice	Internal- Investment Team -Partners Call/Meet	Own Experience- None	
<b>Individuals</b>	Count	9	9	8	3	3	17
	% within Investor Type	52.94%	52.94%	47.06%	17.65%	17.65%	34.69%
<b>Institutions</b>	Count	7	6	8	3	4	16
	% within Investor Type	43.75%	37.50%	50.00%	18.75%	25.00%	32.65%
<b>Conventional</b>	Count	16	6	5	4	1	16
	% within Investor Type	100.00%	37.50%	31.25%	25.00%	6.25%	32.65%
<b>Total</b>	Count	32	21	21	10	8	49
	% of Total Responses	65.31%	42.86%	42.86%	20.41%	16.33%	100.00%

Based on the percentage of count of the responses within each group, the top three personal sources for all three groups of investors were the same, yet the order of preference was slightly different. For individuals and conventional investors the order of preference of Personal Sources upon which they based their decisions were the same: Calls with FI (52.94% - individuals, 100% - conventional) and Professional Advice (52.94% - individuals, 37.50% - conventional), Personal Network (47.06%- individuals, 31.25% - conventional). While for the institutional investors they were: Personal Network (50.00%), Calls with FI (43.75%), and Professional Advice (37.50%). With regards to basing it on “Own Experience”, conventional (6.25%) was the group that relied on it the least.

### 6.3.2 Impersonal Source of Information

Along with how much of the personal information formed part of the decision making, impersonal information was also looked at to see how much of their investment decision was based on it.

Impersonal sources include documents, reports, press releases and so forth. The range of responses given by the respondents is shown in Table 6.6.

**Table 6.6 - Investor Type and Impersonal Source**

Investor Type	Descriptive Statistics	Impersonal Source						Weighted Score-a	Median
		None at All	Slight Extent	Certain Extent	Considerable Extent	Substantial Extent	Great Extent		
Individuals	Count	1	2	1	5	5	4	4.28	4.50
	% of Total Investors	1.96%	3.92%	1.96%	9.80%	9.80%	7.84%		
Institutions	Count	2	1	2	8	3	1	3.71	4.00
	% of Total Investors	3.92%	1.96%	3.92%	15.69%	5.88%	1.96%		
Conventional	Count	0	1	2	2	7	4	4.69	5.00
	% of Total Investors	0.00%	1.96%	3.92%	3.92%	13.73%	7.84%		
Kruskal-Wallis								<i>H</i> (2)	<i>p</i> *
								4.982	0.083

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 6, with 1 "None at All" to 6 "Great Extent".

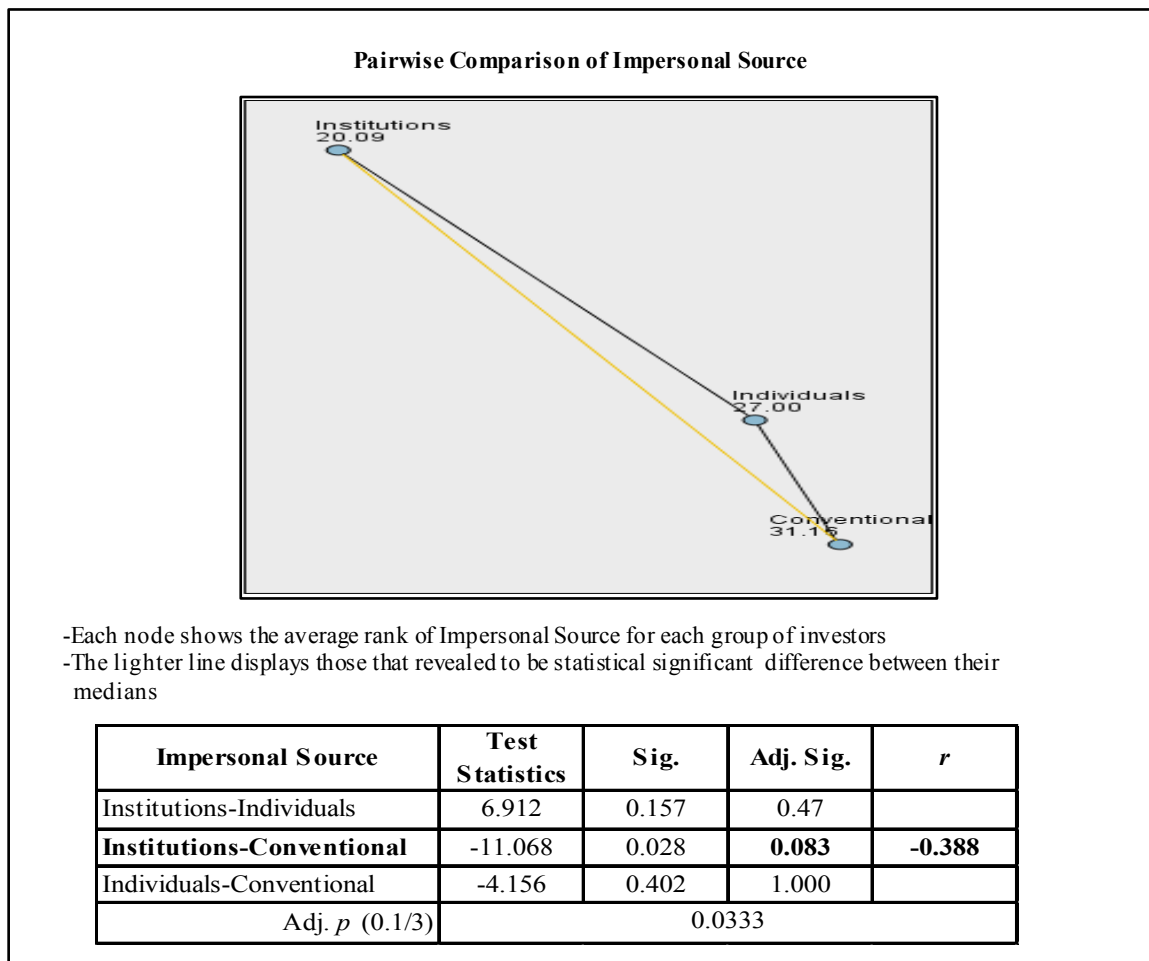
\* at 10% significant level

As can be seen from the table above, overall, participants placed considerable weight on Impersonal Sources. Individuals were mainly between “Considerable Extent” and “Substantial Extent” with 9.80% of the respondents for each. While institutions (15.69%) were more inclined towards “Considerable Extent” and the conventional investors (13.73%) were more towards “Substantial Extent” in how much they relied on Impersonal Sources. The conventional investors placed more weight on impersonal information with a weighted score of (5.00), than both the individuals (4.50) and institutional investors (4.00). The Kruskal-Wallis H test that was conducted showed the distribution of Impersonal Sources across the group of investors was the same, and that the medians for individual (4.50) and institutions (4.00) and conventional (5.00) were statistically significantly different at the 10% significance level,  $H(2) = 4.982$ ,  $p = 0.083$ . However, when the pairwise comparison was performed (Figure 6.3) using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons, it revealed that although there was a pairing between the institutions and conventional, with a medium size effect<sup>160</sup> ( $p = 0.083$ ,  $r = -0.388$ ), it was not statistically significant at the statistical significant acceptance  $p < 0.0333$ <sup>161</sup>.

<sup>160</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

<sup>161</sup>  $p$  is adjusted for multiple comparisons. Hence,  $P$  at 10% significance adjusted for 3 groups,  $p = 0.1/3 = 0.0333$ .

Figure 6.3 - Post hoc Test on the Distribution of Impersonal Source



Participants were then asked to list three types of impersonal sources of information upon which they based their investment decisions. This was an open question and the responses were grouped as seen in Table 6.7 below. Some investors provided more than three impersonal sources. All sources provided were taken into consideration when the responses were grouped. “Market Research, Industry Report and Intelligence Platform” (Market Research) collectively represented the highest source, with a representation of 72.55% of responses from all responses, with more conventional investors (87.50%) relying on them more than institutions (76.47%) and individual (55.56%) investors. This was followed by “Financials, Ratios and Valuation” (Financials) with 43.14%, followed by “Offering Document and Subscription Agreement” (Offering Document) with 31.37%, followed by “Press Releases, Magazines and Conferences” (Presses) with 29.41%, followed by “Business Plan, Investment Strategy, Legal Structure and Exit” (Business Plan) with 25.49% and “Due Diligence” (Diligence) with 19.61%, followed by “Management Performance and Reputation” (Reputation) with 15.69%. Last of all was “Professional Advice, Meeting and Recommendation” and “Own Experience-None” with 9.80% each. Based on the percentage of count of responses, the top three impersonal sources for the individuals group were: Market Research (55.56%), Financials (44.44%) and Offering Document (44.44%). While

the three impersonal sources for the institutional investors were: Market Research (76.47%), Presses (47.06) and Financials (35.29%). For conventional investors, the top three Impersonal Sources were: Market Research (87.50%), Financials (50.00%) and Diligence (43.75%).

**Table 6.7 - Investor Type and Impersonal Source Investing Based On**

Investor Type	Descriptive Statistics	Impersonal Source Investment Based on									Total
		Offering Document & Subscription Agreement-Investor Pack	Financials, Ratios & Valuation	Business plan, Investment Strategy, Legal Structure & Exit	Management Performance & Reputation	Due Diligence	Market Research, Industry Report & Intelligence Platform	Press Releases, Magazines & Conferences	Professional Advice, Meeting & Recommendation	Own Experience-None	
<b>Individuals</b>	Count	8	8	5	2	1	10	2	2	3	18
	% within Investor Type	44.44%	44.44%	27.78%	11.11%	5.56%	55.56%	11.11%	11.11%	16.67%	35.29%
<b>Institutions</b>	Count	4	6	5	3	2	13	8	2	2	17
	% within Investor Type	23.53%	35.29%	29.41%	17.65%	11.76%	76.47%	47.06%	11.76%	11.76%	33.33%
<b>Conventional</b>	Count	4	8	3	3	7	14	5	1	0	16
	% within Investor Type	25.00%	50.00%	18.75%	18.75%	43.75%	87.50%	31.25%	6.25%	0.00%	31.37%
<b>Total</b>	Count	16	22	13	8	10	37	15	5	5	51
	% of Total Responses	31.37%	43.14%	25.49%	15.69%	19.61%	72.55%	29.41%	9.80%	9.80%	100.00%

### 6.3.3 Obtaining Market Information

As discussed under section 6.3.2, Market Research scored the highest as an impersonal source of information upon which investment decisions were based. Hence, the participants were also asked how easy it was to obtain market information on the IPE/CPE market. Table 6.8 summarises their responses. As can be seen from the weighted score of those who tried to seek market information, conventional (3.88) and institutional investors (3.76) had more difficulty than individual investors (2.94). However, 27.78% of the investors within the individual group did not try to obtain any market information. Moreover, the Kruskal-Wallis H test that was conducted showed the distribution of obtaining market information for all three groups was similar, and the median for individuals (3.50), institutions (4.00) and conventional (4.00) was not statistically significantly different,  $H(2) = 4.064$ ,  $p = 0.131$ .



**Table 6.8 - Investor Type and Obtaining Market Information**

Investor Type	Descriptive Statistics	Obtain Market Informaion					Weighted Score-a	Median
		With Difficulty	Somewhat Difficult	Somewhat Easy	Easy	Didn't Try		
<b>Individuals</b>	Count	2	7	2	2	5	2.94	3.50
	% within Total Investors	11.11%	38.89%	11.11%	11.11%	27.78%		
<b>Institutions</b>	Count	4	7	4	2	0	3.76	4.00
	% within Total Investors	23.53%	41.18%	23.53%	11.76%	0.00%		
<b>Conventional</b>	Count	3	9	3	1	0	3.88	4.00
	% within Total Investors	18.75%	56.25%	18.75%	6.25%	0.00%		
Kruskal-Wallis						<i>H</i> (2)	<i>p</i>	
						4.064	0.131	

a-To calculate the weighted score, scores were allocated in descending order from 5 to 1, with 5 to "With Difficulty" to 1 "Didn't Try".

### 6.3.4 Environmental, Social and Governance Matters

Before moving on to the next section on the investor and FI relationship, investors were asked whether the Environmental, Social and Governance (ESG) matters formed part of the information that they considered while investing. The option of responses provided ranged from “None at All” to “Great Extent”. As can be seen from Table 6.9 below, conventional investors (3.75) gave more weight to ESG when making investment decisions than individual investors (2.94) and institutions (3.12). The conventional investors gave EGC consideration to a “Substantial Extent” and the institutional investors were more inclined towards “Considerable Extent”, while individual investors were more towards “Certain Extent”. It also appears that 23.53% of the institutional investors, 22.22% of the individual investors, and 6.25% of conventional investors did not take ESG matters into consideration at all. The Kruskal-Wallis H test that was conducted showed the distribution of EGC matters for the three groups was similar, and the median for individuals (3.00), institutions (3.00) and conventional (4.00) was not statistically significantly different,  $H(2) = 2.876$ ,  $p = 0.237$ .

**Table 6.9 - Investor Type and Environmental Social Governance Issues Affect Investment Decisions**

Investor Type	Descriptive Statistics	Environmental Social Governance Issues						Weighted Score-a	Median
		None at All	Slight Extent	Certain Extent	Considerable Extent	Substantial Extent	Great Extent		
<b>Individuals</b>	Count	4	1	7	4	2	0	2.94	3.00
	% within Total Investors	22.22%	5.56%	38.89%	22.22%	11.11%	0.00%		
<b>Institutions</b>	Count	4	3	3	4	0	3	3.12	3.00
	% within Total Investors	23.53%	17.65%	17.65%	23.53%	0.00%	17.65%		
<b>Conventional</b>	Count	1	2	4	2	7	0	3.75	4.00
	% within Total Investors	6.25%	12.50%	25.00%	12.50%	43.75%	0.00%		
Kruskal-Wallis							<i>H</i> (2)	<i>p</i>	
							2.876	0.237	

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 6, with 1 "None at All" to 6 "Great Extent".

## 6.4 PRE-INVESTMENT INVESTORS' RELATIONSHIP WITH FINANCIAL INSTITUTIONS

In order to determine the level of information disclosure and transparency between the investor and FI in an IPE/CPE investment<sup>162</sup>, investors were questioned on their pre-investment relationship with the FI. The following section reports on the findings with regards to the investors' relationship prior to investing. It looks into the documents the investors received, read and on the language and comprehensiveness of the documents; the area of discussion prior to investing; whether their decision was based on information or trust; the agreements they signed and their ability to negotiate prior to signing.

### 6.4.1 Type and Language of Documents Received

Investors were asked about the type of documents they received from the FI when approached with an investment opportunity. Table 6.10 below shows that the majority (86.30%) of participants had received a full set of documents (offering document, term sheet and subscription form/agreement). It was only the institutional investors that received a subscription form/agreement (2.00%), and for the individuals, the smallest set of documents they received was the term sheet along with the subscription form/agreement (3.90%). While the least set of documents received by the conventional was "Others" (3.90%). The others that were reported by the conventional were: one reported that in past investments they did not receive any documents and the other participant relied more on site visits and the management's reputation (since the related PPM documents were old and represented the first stage of

<sup>162</sup> For the IPE investment - part of research questions A.

the investment). Moreover, the institutional investor that only accepted a subscription agreement was an investor alongside (partnership) the FI, in a form of *Musharaka*, and was well aware of the details of the investment.

**Table 6.10 - Investor Type and Documents Provided to Investors**

Investor Type	Descriptive Statistics	Documents Provided				Total
		Provided Full Set	Provided Term Sheet and Subscription Form/Agreement Only	Provided Subscription Form/Agreement Only	Other	
<b>Individuals</b>	Count	16	2	0	0	18
	% of Total	31.40%	3.90%	0.00%	0.00%	35.30%
<b>Institutions</b>	Count	15	1	1	0	17
	% of Total	29.40%	2.00%	2.00%	0.00%	33.30%
<b>Conventional</b>	Count	13	1	0	2	16
	% of Total	25.50%	2.00%	0.00%	3.90%	31.40%
Total	Count	44	4	1	2	51
	% of Total	86.30%	7.80%	2.00%	3.90%	100.00%

Investors were also asked how they found the language of the documents, agreements/contracts that they had signed. Was the language easy to understand or complex? Was it comprehensive enough to protect their rights and were adequate covenants in place to address the conflict of interest? Table 6.11 summarises their responses. It appears from the weighted score that the individual investors (1.25) found the language of the agreement/document simpler than the other groups of investors (1.50). Within the groups of institutions and conventional there were equal numbers of participants who found the language “Simple” (12.50% - institutions, 25.00% - conventional), easy to understand and “Complex Not Easy to Understand” (12.50% - institutions, 25.00% - conventional). However, 10 from individuals and 9 from institutions did not select a response. While with regards to the comprehensiveness, it appears that conventional investors (25.00%) considered the agreement more comprehensive than that of individual investors (20.45%) and institutions (18.18%). Although 5 institutional investors and 2 individuals did not select a response.

**Table 6.11 - Investor Type and Language of Agreement and Document Comprehensiveness**

Investor Type	Descriptive Statistics	Language of Document/Agreement		Weighted Score-a	Median	Document Comprehensive Protect Rights and Address Conflict of Interest		Weighted Score-b	Median
		Simple	Complex			Comprehensive	Not Comprehensive		
<b>Individuals</b>	Count	6	2	1.25	1.00	9	7	1.44	1.00
	% of Total	18.75%	6.25%			20.45%	15.91%		
<b>Institutions</b>	Count	4	4	1.5	1.50	8	4	1.33	1.00
	% of Total	12.50%	12.50%			18.18%	9.09%		
<b>Conventional</b>	Count	8	8	1.5	1.50	11	5	1.31	1.00
	% of Total	25.00%	25.00%			25.00%	11.36%		
Total	Count	18	14			28	16		
	% of Total	56.25%	43.75%			63.64%	36.36%		
Kruskal Wallis		H (2)		p	Kruskal Wallis			H (2)	p
		1.476		0.478				0.592	0.744

a-To calculate the weighted score, scores were allocated with 1 to "Simple" and 2 to "Complex".

b-To calculate the weighted score, scores were allocated with 1 to "Comprehensive" and 2 to "Not Comprehensive".

It is interesting to see within the investors who invested in IPE that the individuals found the agreements/documents more simple and easy to understand (18.75% - individuals, 12.50% - institutions) as opposed to the institutional investors, who found it complex and not easy to understand (12.50% - institutions, 6.25% - individuals). This could be due to some individual investors, although having received the full set of documents, relied on the presentation made by the FI and questions put forward to them, as commented on by an individual investor. On the other hand, looking at the break-up within the conventional group (Table 6.12), it was the conventional institutions that found the language simpler (66.6% - conventional institutions, 40.00% - conventional individuals) and more comprehensive (83.33% - conventional institutions, 60.00% - conventional individuals) than the conventional individuals.

**Table 6.12 - Break-up of Conventional Investor Group and Language of Agreement and Document Comprehensiveness**

Investor Type	Descriptive Statistics	Language of Document/Agreement		Weighted Score-a	Median	Document Comprehensive Protect Rights and Address Conflict of Interest		Weighted Score-b	Median
		Simple	Complex			Comprehensive	Not Comprehensive		
<b>Conventional Individual</b>	Count	4	6	1.60	2.00	6	4	1.40	1.00
	%Within Investor Type	40.00%	60.00%			60.00%	40.00%		
<b>Conventional Institutional</b>	Count	4	2	1.33	1.00	5	1	1.17	1.00
	%Within Investor Type	66.67%	33.33%			83.33%	16.67%		
Total	Count	8	8			11	5		
	% of Total	50.00%	50.00%			68.75%	31.25%		

a-To calculate the weighted score, scores were allocated with 1 to "Simple" and 2 to "Complex".

b-To calculate the weighted score, scores were allocated with 1 to "Comprehensive" and 2 to "Not Comprehensive".

The participants were also asked whether they had read the documents provided to them, or they had someone else read them on their behalf, or they did not read them in detail and relied on the meeting and FI's promoting of the investment.

**Table 6.13 - Investor Type and Reading of Documents**

Investor Type	Descriptive Statistics	Reading of Documents					Total
		Read Personally	Expert/ Advisors Read Provide Feedback	Read Personally-Expert	Read Personally-Promoting FI	Relied on Network	
<b>Individuals</b>	Count	13	0	3	2	0	18
	% of Total	25.49%	0.00%	5.88%	3.92%	0.00%	35.29%
<b>Institutions</b>	Count	9	3	5	0	0	17
	% of Total	17.65%	5.88%	9.80%	0.00%	0.00%	33.33%
<b>Conventional</b>	Count	14	5	0	0	1	16
	% of Total	27.45%	9.80%	0.00%	0.00%	1.96%	31.37%
<b>Total</b>	Count	36	8	8	2	1	51
	% of Total	70.59%	15.69%	15.69%	3.92%	1.96%	100.00%

As can be seen from Table 6.13 above, the greater portion of all groups of participants read the documents with individuals 25.49%, institutions 17.65% and conventional 27.45%. While it was only the institutional and conventional investors that relied solely on the reading of experts and their feedback (5.88% - institutions, 9.80% - conventional). However, 5.88% of the individuals did seek the experts' feedback but had also read the documents personally, in addition to 9.80% of the institutional participants also doing so. It appears that none of the individual or institutional participants relied solely on either just the FI's promotion or on their network and relations. These were the options provided as part of the set of responses, and only one conventional participant selected having relied solely on Network. Only individuals appeared to rely on the promotion of the FI of the investment, but not solely, as they had also read the document.

Participants were questioned about whether certain matters were discussed in their meetings with the FI (promoter of investment), and in what detail. The choices of responses were: "In Detail", "Some Detail", "Briefly" and "Not Discussed" and the weighted score was calculated for each issue discussed and tabulated in Table 6.14 below. Some participants could not recall (4 participants) whether certain issues were discussed, while some other participants did not select a response on certain issues (6

participants). The weighted score was calculated on the total number of participants that provided a response for each issue.

It appears that on all issues discussed, more details were discussed with institutional and conventional investors than individual investors. This was especially pronounced with regards to Alignment of Interest matters, where institutions and conventional weighted scores were 3.41 and 3.60 respectively versus individuals with 2.60. In addition, Risk Factors (3), *Shari'ah* Non-Compliance (3), Rights and Obligations (3), Transparency-Disclosure (3), Governance (2), Investment Plan (1), and Reporting Update (1) also appear to be issues, where individual participants experienced a shortfall, in that these matters were not discussed. While with institutions and conventional there was only one matter each that was not discussed; with institutions, it was Governance (1) and with conventional it was Alignment of Interest (1). In all groups Exit Strategy was discussed and mainly in "Some Detail" to "In Detail".

Although it appears that there might be some difference in the level of discussion on a few of the issues that were discussed between the FI and the three groups of investors, the Kruskal-Wallis H test that was conducted on all matters discussed presented otherwise. The test showed the distribution of all matters for all three groups was similar (with the exception of Alignment of Interest, Governance and *Shari'ah* Non-Compliance), and there was statistically no significant difference between individuals, institutions, and conventional, as can be seen in Table 6.14 below. However, the test showed that there is a statistically significant difference in Alignment of Interest between individuals (3.00), institutions (3.00), and conventional (4.00) with a large size effect<sup>163</sup>,  $H(2) = 10.867, p = 0.003$ . The test also showed that there is a statistically significant difference in Governance between individuals (2.00), institutions (3.00), and conventional (4.00),  $H(2) = 9.352, p = 0.009$ . Furthermore, the test that was conducted on *Shari'ah* compliance also showed that there is a statistically significant difference between individuals (3.00) and institutions (4.00), with a medium size effect,  $H(1) = 4.066, p = 0.044, r = -0.341$ .

---

<sup>163</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

**Table 6.14 - Investor Type and Issues Discussed with FI\***

Issue Discussed	Investor Type	Descriptive Statistics	In Details	Some Detail	Briefly	Not Discussed	Weighted Score-a	Median
Alignment of Interest	Individuals	Count	3	6	3	3	2.60	2.50
	Institutions	Count	8	8	1	0	3.41	2.00
	Conventional	Count	11	3	0	1	3.60	1.00
Kruskal-Wallis							$H(2)$	$p$
							11.732	0.003
Governance	Individuals	Count	3	5	8	2	2.50	3.00
	Institutions	Count	7	4	5	1	3.00	2.00
	Conventional	Count	9	6	1	0	3.50	1.00
Kruskal-Wallis							$H(2)$	$p$
							9.352	0.009
Transparency-Disclosure	Individuals	Count	4	8	1	3	2.81	2.00
	Institutions	Count	7	6	4	0	3.18	2.00
	Conventional	Count	8	5	2	0	3.40	1.50
Kruskal-Wallis							$H(2)$	$p$
							3.381	0.184
Investment Plan	Individuals	Count	9	6	1	1	3.35	1.50
	Institutions	Count	13	2	2	0	3.65	1.00
	Conventional	Count	13	3	0	0	3.81	1.00
Kruskal-Wallis							$H(2)$	$p$
							4.822	0.090
Exit Strategy	Individuals	Count	7	6	4		3.18	2.00
	Institutions	Count	7	7	3		3.24	2.00
	Conventional	Count	8	8	0		3.50	1.50
Kruskal-Wallis							$H(2)$	$p$
							1.962	0.375
Reporting Update	Individuals	Count	6	5	5	1	2.94	2.00
	Institutions	Count	8	9	0	0	3.47	2.00
	Conventional	Count	7	7	2	0	3.31	2.00
Kruskal-Wallis							$H(2)$	$p$
							3.846	0.146
Rights and Obligations	Individuals	Count	5	4	4	3	2.69	2.00
	Institutions	Count	8	6	3	0	3.29	2.00
	Conventional	Count	8	6	2	0	3.38	1.50
Kruskal-Wallis							$H(2)$	$p^{**}$
							4.931	0.085
Risk Factors	Individuals	Count	6	4	4	3	2.76	2.00
	Institutions	Count	8	5	4	0	3.24	2.00
	Conventional	Count	8	7	1	0	3.44	1.50
Kruskal-Wallis							$H(2)$	$p$
							4.115	0.128
Shari'ah Non-Compliance	Individuals	Count	8	6	1	3	3.06	2.00
	Institutions	Count	13	3	1	0	3.71	1.00
Kruskal-Wallis						$H(1)$	$p$	$r$
						4.066	0.044	-0.341

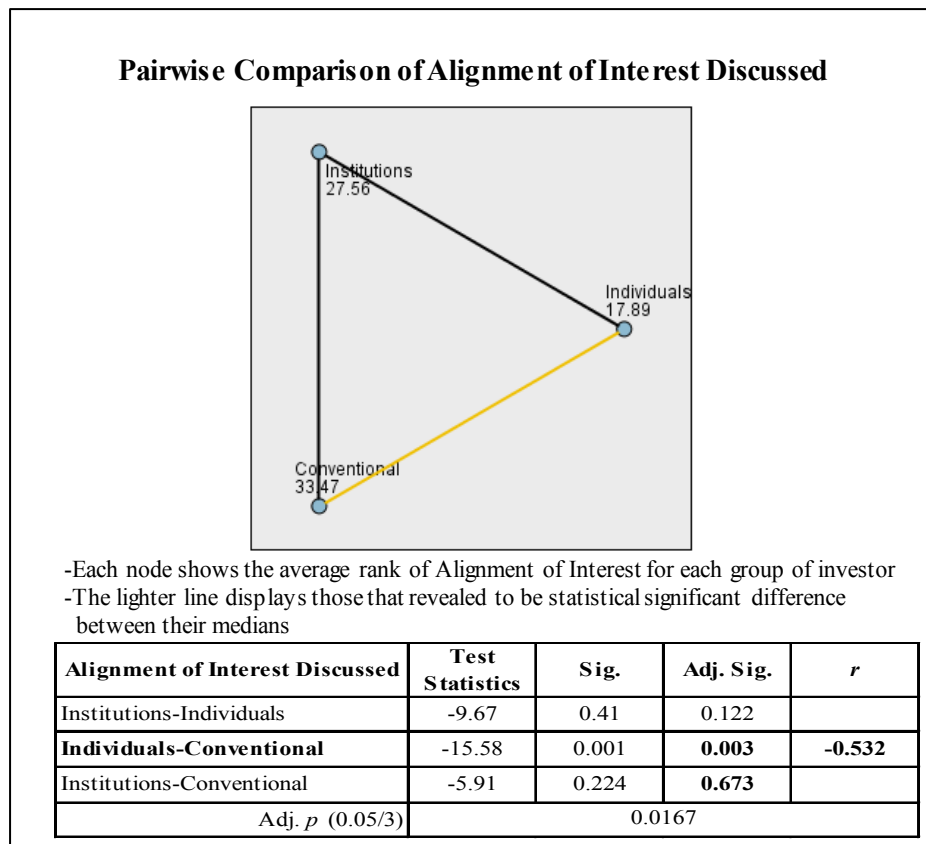
a-To calculate the weighted score, scores were allocated in descending order from 4 to 1, with a score of 4 to In Detail" to 1 "Not Discussed".

\*All the  $p$ -values reported are the 5% significant level.

\*\* At 10% significant level.

Accordingly, post hoc tests were performed to see which groups differed from one another. The pairwise comparison test was performed using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons. Statistically significant was accepted at the  $p < 0.0167^{164}$  level. The post hoc analysis of Alignment of Interest (Figure 6.4) revealed that there was a statistically significant difference in the median scores between the individuals (3.00) and conventional (4.00), with a large size effect ( $p = 0.003$ ,  $r = -0.532$ ), but not between institutions and conventional or between institutions and individuals.

Figure 6.4 - Post Hoc Test on the Distribution of Discussed Alignment of Interest Across the Type of Investor Groups

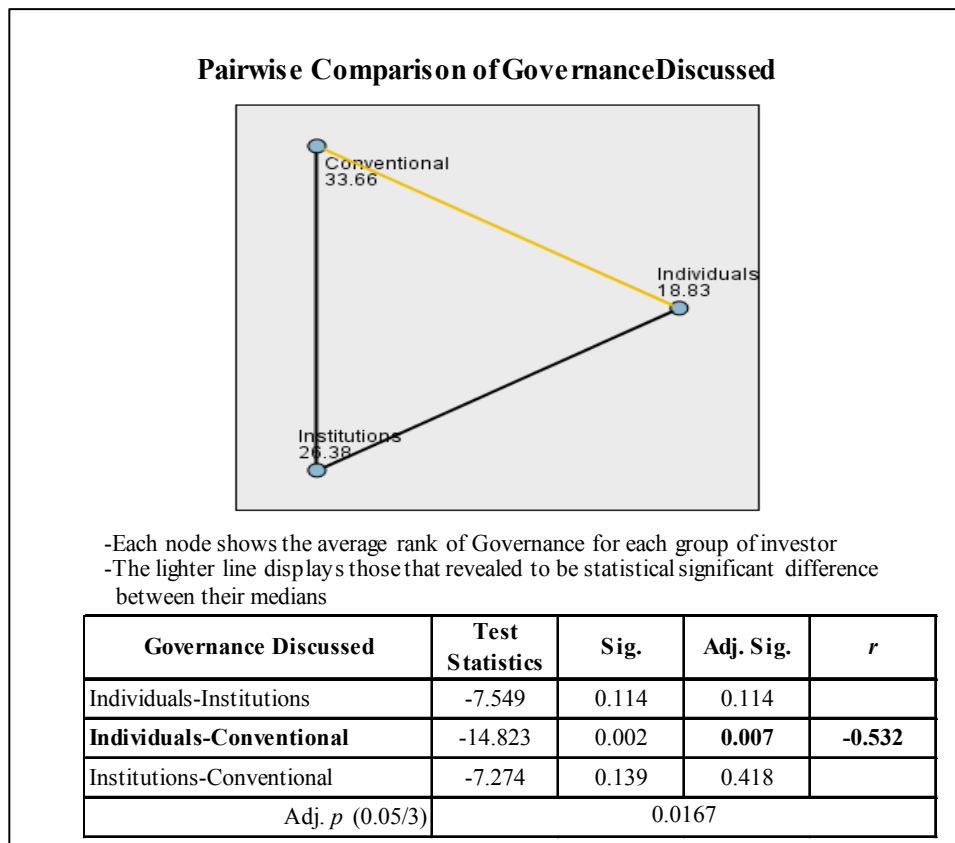


Furthermore, the post hoc analysis on Governance (Figure 6.5) revealed that there was a statistically significant difference in the median scores between the individuals (2.00) and conventional (4.00), with a large size effect ( $p = 0.007$ ,  $r = -0.532$ ) but not between institutions and conventional or individuals and institutions.

<sup>164</sup> *P* is adjusted for multiple comparisons. Hence in this case there are 3 groups, so  $p = 0.05/3 = 0.0167$ .



Figure 6.5 - Post Hoc Test on the Distribution of Discussed Governance Across the Type of Investor Groups



With regards to *Shari'ah* compliance, no pairwise post hoc test was conducted to find out which group differed from the other because it only involves two groups of investors.

### 6.4.2 Information vs. Trust

Taking into consideration the documents the investors received and the meetings they had with the FI, participants were questioned on whether they assessed how sufficient the information they had prior to making an investment decision, was on the information provided, or was it on trust in the FI, or was it both (information and trust).

**Table 6.15 - Investor Type and Benchmarking of Sufficient Information/Trust**

Investor Type	Descriptive Statistics	Benchmarking Sufficient Information				Total
		Information Provided	Trust FI-GP	Information and Trust-Both	Other	
<b>Individuals</b>	Count	6	2	9	1	18
	% of Total	11.76%	3.92%	17.65%	1.96%	35.29%
<b>Institutions</b>	Count	5	1	10	1	17
	% of Total	9.80%	1.96%	19.61%	1.96%	33.33%
<b>Conventional</b>	Count	3	1	12	0	16
	% of Total	5.88%	1.96%	23.53%	0.00%	31.37%
Total	Count	14	4	31	2	51
	% of Total	27.45%	7.84%	60.78%	3.92%	100.00%

From Table 6.15 above, it appears that the majority of the participants (60.78%) had benchmarked on both the information provided and trust, with conventional (23.53%) being the greater group to do so and institutions (19.61%) were slightly more than individuals (17.61%). When it came to depending just on the information provided, individuals (11.76%) depend more on information alone than institutions (9.80%) or conventional (5.88%). Although benchmarking to make an investment decision solely on trust in FI was low, it was more for the individual (5.7%) than the institutional (2.9%) or the conventional (1.96%) participants. Those depending on “other” were mainly conducting their own investigation/research and discussing this with colleagues and experts, as commented by two of the participants.

Participants who relied on information were asked to select the type of information and to rank this in order of priority. A list of 15 types of information was provided (as can be seen in Table 6.16 below). In order to allocate the ranking of responses, the ranking scale was grouped into five groups: ranging from “Not Important” to “Very Highly Important” and the weighted score was calculated. The results are reported in Table 6.16. To further facilitate the analysis the responses were grouped into either “Important” or “Not Important”. From the grouping, it appears that the top five sources of information to the participants were: Financial Performance (individuals - 17, institutions - 14, conventional - 14), then Investment Opportunity (individuals - 14, institutions - 15, conventional - 13), followed by Management Team (individuals - 11, institutions - 9, conventional - 12), followed by Risk and Mitigation (individuals - 17, institutions - 14, conventional - 14), and then Terms and Conditions

**Table 6.16 - Investor Type and Source of Information\***

Information Type	Investor Type	Descriptive Statistics	Not Important (a)	Very Low Importance (b)	Low Importance (C)	Important (d)	Highly Important (e)	Very Highly Important (f)	Not so Important (a+b+c)	Important (d+e+f)	Weighted Score-g	Median
Current Events	Individuals	Count	5	0	2	2	2	7	7	11	3.94	4.50
	Institutions	Count	5	1	2	5	3	0	8	8	3.00	3.50
	Conventional	Count	3	0	1	4	4	3	4	11	4.00	4.00
Kruskal-Wallis											H(2)	p
											3.610	0.164
Investment Opportunity	Individuals	Count	3	0	1	3	3	8	4	14	4.50	5.00
	Institutions	Count	1	0	0	2	1	12	1	15	5.38	6.00
	Conventional	Count	2	0	0	1	2	10	2	13	5.07	6.00
Kruskal-Wallis											H(2)	p
											3.416	0.181
Financial Performance	Individuals	Count	1	0	0	0	3	14	1	17	5.56	6.00
	Institutions	Count	2	0	0	2	5	7	2	14	4.81	5.00
	Conventional	Count	0	1	0	2	2	10	1	14	5.33	6.00
Kruskal-Wallis											H(2)	p
											4.258	0.119
Management Team	Individuals	Count	4	0	0	0	6	8	4	14	4.56	5.00
	Institutions	Count	3	1	0	3	1	8	4	12	4.38	5.50
	Conventional	Count	0	0	0	1	1	13	0	15	5.80	6.00
Kruskal-Wallis											H(2)	p
											6.864	0.032
Investor Protection & Rights	Individuals	Count	9	0	0	2	4	3	9	9	3.06	2.50
	Institutions	Count	7	0	2	3	4	0	9	7	2.81	3.00
	Conventional	Count	2	1	2	3	5	2	5	10	3.93	4.00
Kruskal-Wallis											H(2)	p
											2.970	0.227
Risk & Mitigation	Individuals	Count	7	0	0	3	6	2	7	11	3.39	4.00
	Institutions	Count	7	0	0	3	1	5	7	9	3.38	4.00
	Conventional	Count	2	0	1	4	5	3	3	12	4.27	5.00
Kruskal-Wallis											H(2)	p
											1.286	0.526
Regulatory Requirements	Individuals	Count	11	0	1	5	1	0	12	6	2.17	1.00
	Institutions	Count	5	0	2	5	2	2	7	9	3.31	4.00
	Conventional	Count	3	1	4	2	4	1	8	7	3.40	3.00
Kruskal-Wallis											H(2)	p
											5.229	0.073
Terms & Conditions	Individuals	Count	8	1	0	1	7	1	9	9	3.06	3.00
	Institutions	Count	5	1	1	2	4	3	7	9	3.50	4.00
	Conventional	Count	1	0	1	4	7	2	2	13	4.47	5.00
Kruskal-Wallis											H(2)	p
											3.109	0.211
Alignment of Interests & Transparency	Individuals	Count	6	1	3	2	2	4	10	8	3.28	3.00
	Institutions	Count	4	0	3	3	3	3	7	9	3.63	4.00
	Conventional	Count	0	0	2	6	2	5	2	13	4.67	4.00
Kruskal-Wallis											H(2)	p
											4.329	0.115
Applicable Law	Individuals	Count	11	0	3	3	1	0	14	4	2.06	1.00
	Institutions	Count	5	1	1	4	4	1	7	9	3.25	4.00
	Conventional	Count	3	2	6	1	3	0	11	4	2.93	3.00
Kruskal-Wallis											H(2)	p
											5.207	0.074
Consultant Recommendation	Individuals	Count	12	0	3	1	1	1	15	3	2.00	1.00
	Institutions	Count	8	3	0	3	0	2	11	5	2.38	1.50
	Conventional	Count	3	2	5	3	1	1	10	5	3.00	3.00
Kruskal-Wallis											H(2)	p
											4.650	0.098
Policies & Procedure	Individuals	Count	7	2	3	2	3	1	12	6	2.72	2.50
	Institutions	Count	7	0	1	6	2	0	8	8	2.75	3.50
	Conventional	Count	3	0	3	5	3	1	6	9	3.53	4.00
Kruskal-Wallis											H(2)	p
											2.134	0.344
Family & Friends	Individuals	Count	10	3	0	1	1	3	13	5	2.39	1.00
	Institutions	Count	11	3	0	1	0	1	14	2	1.69	1.00
	Conventional	Count	6	6	2	1	0	0	14	1	1.87	2.00
Kruskal-Wallis											H(2)	p
											1.741	0.419
Personal Experience	Individuals	Count	11	3	2	1	0	1	16	2	1.83	1.00
	Institutions	Count	9	1	2	3	1	0	12	4	2.13	1.00
	Conventional	Count	3	5	2	3	2	0	10	5	2.73	2.00
Kruskal-Wallis											H(2)	p
											4.851	0.088
Shari'ah Pronouncement	Individuals	Count	7	0	2	3	1	5	9	9	3.33	3.50
	Institutions	Count	7	1	2	3	1	2	10	6	2.75	2.50
Kruskal-Wallis											H(1)	p
											0.601	0.438

g-To calculate the weighted score, scores were allocated in ascending order from 1 to 5 with a score of 1 to "Not Important" to 5 "Very Highly Important".

\*All the p-values reported are the 10% significance level.

(individuals - 9, institutions - 9, conventional - 13). While the five least important sources of information were: Family and Friends (individuals - 13, institutions - 14, conventional - 14), then Personal Experience (individuals - 16, institutions - 12, conventional - 10), then Consultant Recommendation (individuals - 15, institutions - 11, conventional - 10), followed by Applicable Law (individuals - 14, institutions - 7, conventional - 11), and then Regulatory Requirements (individuals - 12, institutions - 7, conventional - 8).

It was interesting to see that the group of investors that invested in IPE (individuals and institutions), unlike those that invested in CPE (conventional), found Alignment of Interest and Transparency (IPE : individuals - 6, institutions - 4, CPE: conventional - 0), Terms and Conditions (IPE: individuals - 9, institutions - 7, CPE: conventional - 2), Team Management (IPE: individuals - 4, institutions - 4, CPE: conventional - 0), Risk and Mitigation (IPE: individuals - 7, institutions - 7, CPE: conventional - 3), and Current Events (IPE: individuals - 7, institutions - 8, conventional - 4) were not an important source/factor of information. Moreover, with the group of investors that invested in IPE, 19 as opposed to 15 participants did not think *Shari'ah* compliance was important information. The overall comment received by participants with regards to *Shari'ah* compliance was that they relied on the SSB of the FI or on the investment and took it for granted that the investment opportunity was *Sharia'h* compliant.

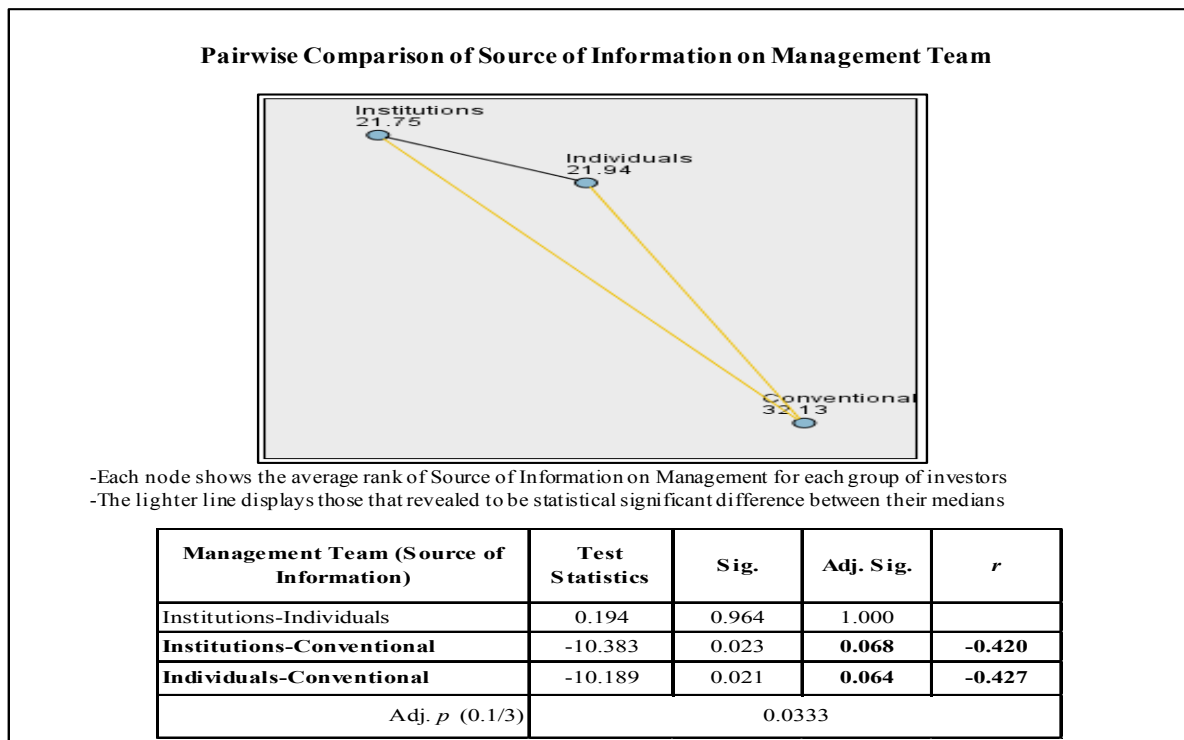
The Kruskal-Wallis H test that was conducted showed that the distribution of all source information for all three groups was similar (with the exception of Management Team, Regulatory Requirements, Applicable Law, Consultant Recommendation, and Personal Experience), and that there was no statistically significant difference for all three groups of investors, as can be seen in Table 6.16 above. The test showed, at the 10% significance level, that there is a statistically significant difference in the median scores of the three groups of investors on Management Team,  $H(2) = 6.864, p = 0.032$ . However, when the post hoc pairwise was performed (Figure 6.6) using Dunn's (1964) procedure with a Bonferroni correction for multiple comparisons, although there appeared to be a difference between institutions (5.50) and conventional (6.00), ( $p = 0.032, r = -0.420$ ) and individuals (5.00) and conventional, with a medium size effect<sup>165</sup> ( $p = 0.064, r = -0.427$ ), it was not statistically significantly accepted at the  $p < 0.0333$ <sup>166</sup>, as can be seen in Figure 6.7 below.

---

<sup>165</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

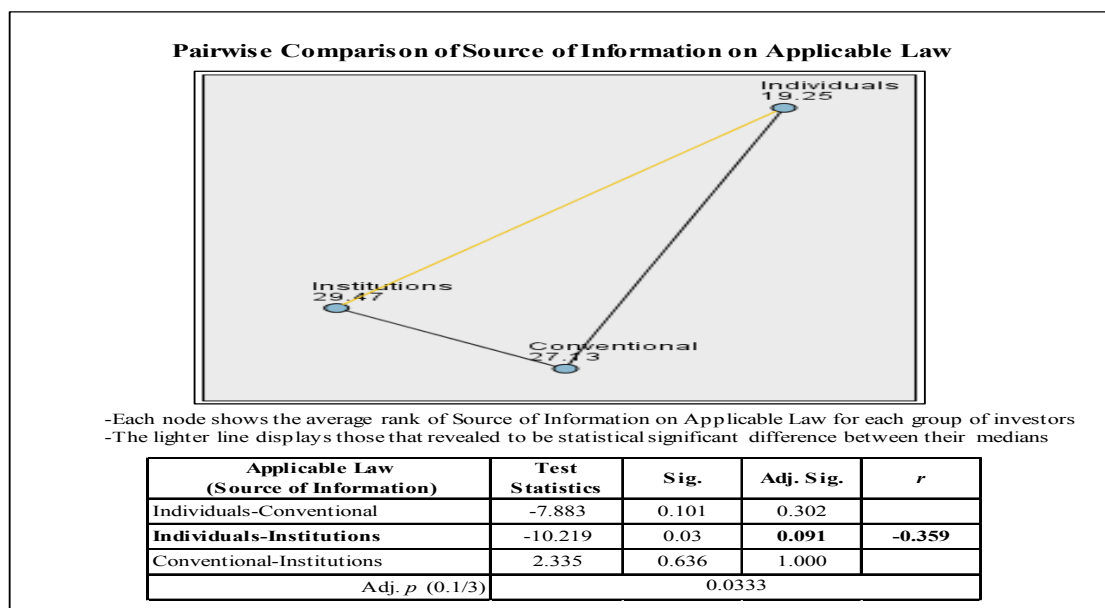
<sup>166</sup>  $P$  is adjusted for multiple comparisons. Hence in this case there are 3 groups at 10% significance, so  $p = 0.1/3=0.0333$ .

Figure 6.6 - Post Hoc Test on the Distribution of Management Team (Source of Information)



Similar outcomes were reached when the Regulatory Requirements<sup>167</sup>, Applicable Law, Consultant Recommendation, and Personal Experience were tested.

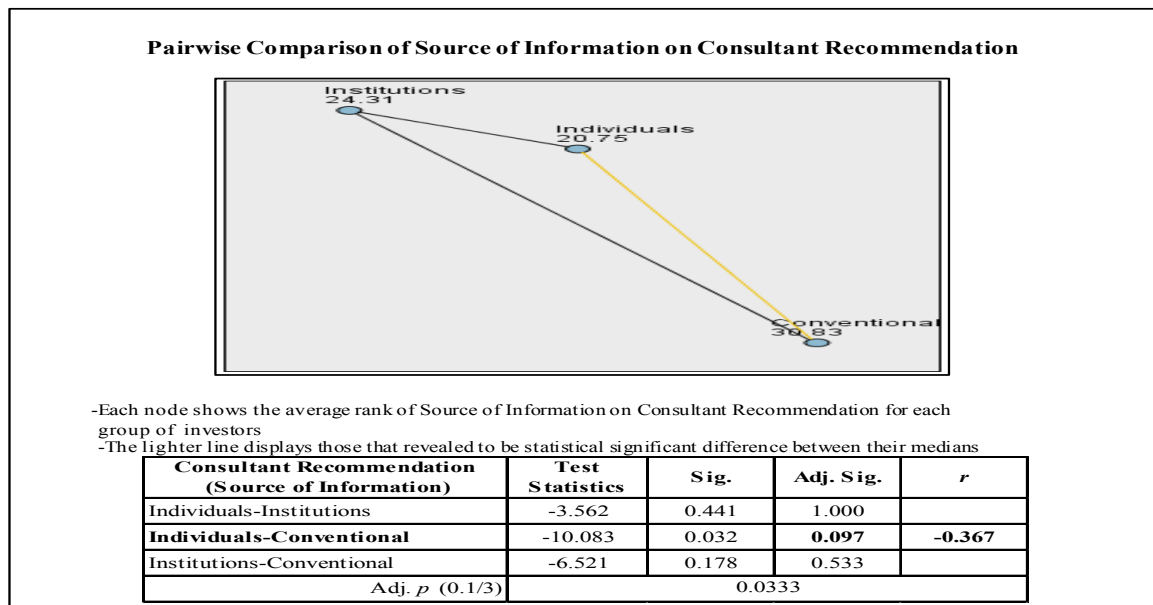
Figure 6.7 - Post Hoc Test on the Distribution of Applicable Law (Source of Information)



<sup>167</sup> A post hoc pairwise test on regulatory requirements revealed there was no significant difference between the three investor groups.

With Applicable Law, initially, there was a difference between the three groups of investors at the 10% significance level ( $H(2) = 5.207, p = 0.074$ ) and more specifically a comparison between the median scores of individuals (1.00) and institutions (4.00), with a medium size effect<sup>168</sup> ( $p = 0.091, r = -0.359$ ), using Dunn's (1964) procedure with a Bonferroni correction for multiple comparisons, yet, it was not statistically significantly accepted at the  $p < 0.0333$ , as can be seen in Figure 6.7 above.

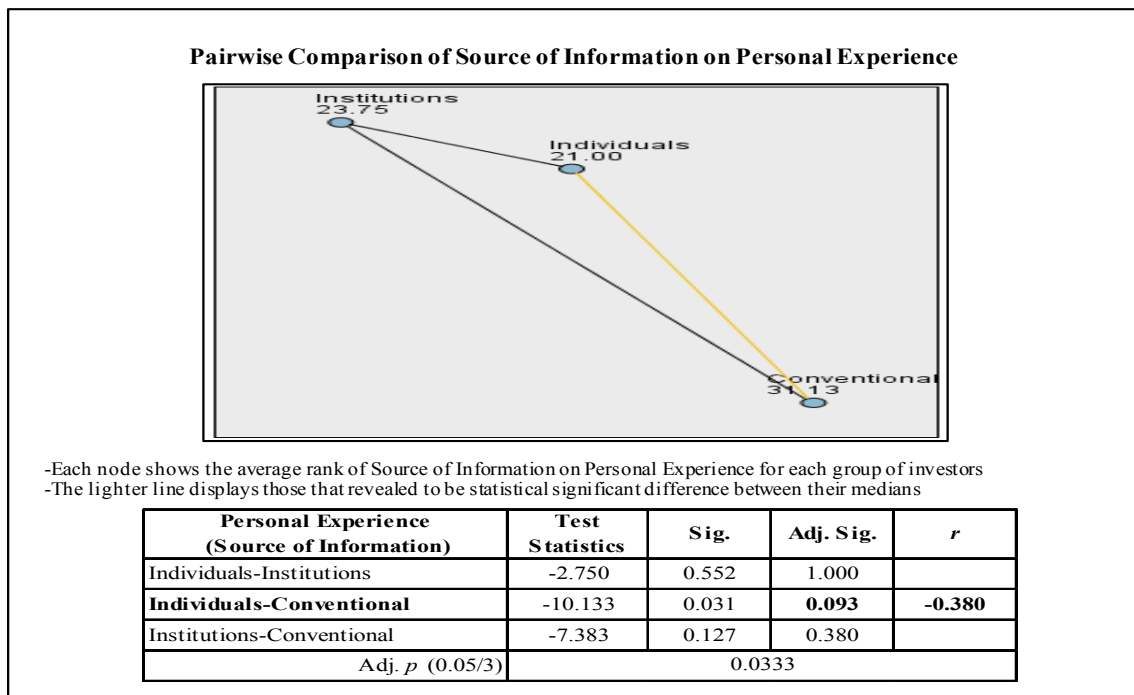
Figure 6.8 1- Post Hoc Test on the Distribution of Consultant Recommendation (Source of Information)



Furthermore, when the H test on Consultant Recommendation was performed, it also initially revealed there was a difference at the 10% significance level ( $H(2) = 4.650, p = 0.098$ ). In addition, when the post hoc pairwise comparison was conducted, there was a difference between the median scores of the individual (1.00) and conventional (3.00) groups, with a medium size effect ( $p = 0.097, r = -0.367$ ), using Dunn's (1964) procedure with a Bonferroni correction for multiple comparisons, yet it was not statistically significantly accepted at the  $p < 0.033$ , as can be seen in Figure 6.8 above.

<sup>168</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

Figure 6.9 - Post Hoc Test on the Distribution of Personal Experience (Source of Information)



A similar outcome was experienced with Personal Experience. Whereby the H test conducted revealed there to be a difference at the 10% significance level, ( $H(2) = 4.851, p = 0.088$ ), yet the post hoc comparison revealed that although there appears to be a difference between the median scores of individuals (1.00) and conventional (2.00), with a medium size effect ( $p = 0.093, r = -0.380$ ) using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons, it was not statistically significantly accepted at the  $p < 0.033$ , as can be seen in Figure 6.9 above.

Next the individuals who had based their decisions on trust, whether fully or partially, were asked about how much they rated trust. The range of rating options was: “High”, “High-Medium”, “Medium”, “Medium-Low” to “Low”. With regards to the responses to this question, of the participants who were not applicable<sup>169</sup> to provide a response, four participants provided a response. They were 3 individuals (Low - 1, Medium - 1, High - 1) and one institution (High - 1). Their responses were included in Table 6.17 below. Moreover, one participant that was applicable to respond did not do so.

<sup>169</sup> Those who had not selected trust as part of basing their decision making on (in the previous question), were not applicable to respond to rate trust.

**Table 6.17 - Investor Type and Based on Trust in FI**

Investor Type	Descriptive Statistics	Based on Trust					Weighted Score-a	Median
		High	High-Medium	Medium	Medium-Low	Low		
<b>Individuals</b>	Count	5	3	3	0	2	3.69	4.00
	% of Total	12.50%	7.50%	7.50%	0.00%	5.00%		
<b>Institutions</b>	Count	0	5	5	1	0	3.36	3.50
	% of Total	0.0%	12.50%	12.50%	2.50%	0.00%		
<b>Conventional</b>	Count	5	2	3	2	3	3.27	3.00
	% of Total	12.50%	5.00%	7.50%	5.00%	7.50%		
Kruskal-Wallis						$H(2)$	$P$	
						0.704	0.703	

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 5 with a score of 1 to "Low" to 5 "High".

It appears that the individual participants (3.69) had more weight on trust in the FI promoting the investment, than the institutional (3.36) and conventional (3.27) participants. Although institutions were not as high on trust as individuals, there appears to be no “Low” in trust among the institutional participants as opposed to two individual and three conventional participants who had low trust in the FI. This reflects the comments made by individuals that the element of trust had played a big part in them subscribing to the investment. Especially for those who had known the FI, and had prior investments with them, as noted by two of the participants. While comments made by the “Low” conventional were that they did not believe in promoters nor did they have much trust in the industry and they are guided by the outcome of the due diligence in their decision making. The Kruskal-Wallis H test that was conducted showed the distribution of basing decisions on trust for individuals, institutions and conventional was similar, and the median for individuals (4.00), institutions (3.50) and conventional (3.00) was not statistically significantly different,  $H(2) = 0.704, p = 0.703$ .

### 6.4.3 Agreement Signed

The investors’ views on the contract/agreement the investor had signed with the FI were assessed by the participants’ ratings of how satisfied they were with the agreements they had signed. The options of responses ranged from “Fully Satisfied” to Not Satisfied” (Table 6.18).



**Table 6.18 - Investor Type and Satisfied with Agreement**

Investor Type	Descriptive Statistics	Satisfied with Agreement					Weighted Score-a	Median
		Fully Satisfied	Fairly Satisfied	Satisfied	Somewhat Satisfied	Not Satisfied		
Individuals	Count	2	3	10	2	1	3.17	3.00
	% of Total	3.92%	5.88%	19.61%	3.92%	1.96%		
Institutions	Count	3	11	2	1	0	3.94	4.00
	% of Total	5.88%	21.57%	3.92%	1.96%	0.00%		
Conventional	Count	4	9	1	1	1	3.88	4.00
	% of Total	7.84%	17.65%	1.96%	1.96%	1.96%		
Total	Count	9	23	13	4	2	51	
	% of Total	17.65%	45.10%	25.49%	7.84%	3.92%	100.00%	
Kruskal-Wallis							<i>H</i> (2)	<i>p</i>
							8.658	0.013

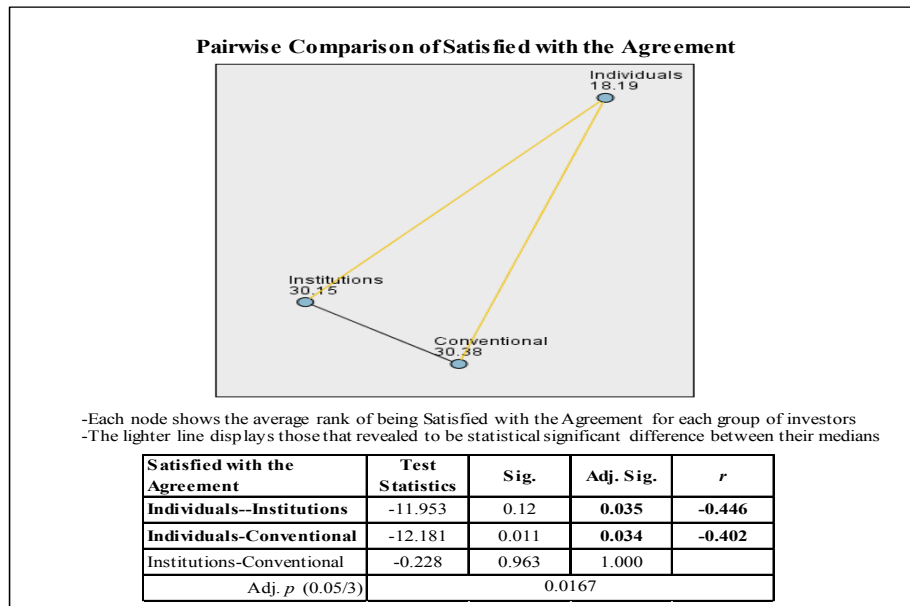
a-To calculate the weighted score, scores were allocated in descending order from 5 to 1 with a score of 5 to "Fully Satisfied" to 1 "Not Satisfied".

It appears that the institutional investors were more satisfied with the agreements they had signed than the individuals and conventional, with a weighted score of approximately 3.94 as opposed to 3.17 for individuals and 3.88 for conventional. The majority of institutional and conventional investors were “Fairly Satisfied” with 21.57% and 17.65% respectively, while 19.61% of individual investors were “Satisfied”. Those institutional investors that were satisfied commented that the agreement is negotiated until it is acceptable for all parties. The Islamic commercial laws and regulations need a lot of work to improve, and as such the agreement is negotiated so as to cover all aspects of the investment and the obligations. Of those institutional investors who were fairly satisfied, they reasoned that there were some subscription agreements that covered everything, and there were some that were very light where they had to request more protection. This is similar to one of the individual’s comments that he was not satisfied, in that the agreement was poorly drafted and vague. Some individuals remarked that agreements are written up in a way that they are more fully protecting the financial institution than the investor. Furthermore, another individual, who was fairly satisfied, noted that if he could go back in time, he would give more attention to every detail, rather than to the basis of trust and a booming market. On the other hand, the comments of fairly satisfied conventional investors were not that much different. One commented that contracts are more biased towards the PE firm. While another remarked that the agreement faced legal issues when being implemented in some jurisdictions, resulting in costs and time trying to find legal solutions.

The Kruskal-Wallis H test that was conducted showed that the distribution of satisfied with the agreement signed is the same across the group of investors, and that there is a statistically significant difference, in the satisfaction between the group of investors,  $H(2) = 8.658$ ,  $p = 0.013$ . Accordingly, a post hoc analysis, using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons

was performed (Figure 6.10 below). Statistical significance was accepted at the  $p < 0.0167^{170}$  level. The analysis revealed there to be differences in the median scores between individuals (3.00) and conventional (4.00), with a medium size effect<sup>171</sup> ( $p = 0.034$ ,  $r = -0.402$ ), and between individuals and institutions (4.00), with a medium size effect, ( $p = 0.035$ ,  $r = -0.446$ ), but not between institutions and conventional. However, the differences were not statistically significant,  $p > 0.0167$ .

**Figure 6.10 2- Post Hoc Test of the Distribution of Satisfied with the Agreement Across the Type of Investor Groups**



The participants were also asked whether they had the ability to negotiate any of the contractual clauses. It appears from Table 6.19

Table 6. below that 52.17% of individuals of the total proportion of the Opportunity to Negotiate do not appear to have negotiated any of the contractual clauses, while only 17.39% of the conventional and 30.43% of institutional investors appear not to have been able to do so. Moreover, in performing the Chi-square analysis of the goodness-of-fit and the representation of the actual portions (of “No” or “Yes”) between the group of investors and the expected, there appears to be some discrepancies between the expected and observed actual counts. It was expected that 8 individuals would say “No”, but actually 12 individuals said “No” (adjusted residual = 2). It was also expected that 7 conventional investors would say “No”, but actually 4 said “No” (adjusted residual = -2). While the expected and actual for institutions was much closer (adjusted residual = 1).

<sup>170</sup> *P* is adjusted for multiple comparisons. Hence in this case there are 3 groups, so  $p = 0.05/3 = 0.0167$ .

<sup>171</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

**Table 6.19 - Investor Type and Opportunity to Negotiate Contractual Clauses**

Investor Types	Descriptive Statistics	Opportunity to Negotiate Contractual Clauses		Weighted Score-a	Median
		No	Yes		
<b>Individuals</b>	Count	12	6	1.33	1.00
	Expected Count	8.10	9.90		
	% Within Opportunity to Negotiate	52.17%	21.43%		
	Adjusted Residual	2.29	-2.29		
<b>Institutions</b>	Count	7	10	1.59	2.00
	Expected Count	7.67	9.33		
	% Within Opportunity to Negotiate	30.43%	35.71%		
	Adjusted Residual	-0.40	0.40		
<b>Conventional</b>	Count	4	12	1.75	2.00
	Expected Count	7	9		
	% Within Opportunity to Negotiate	17.39%	42.86%		
	Adjusted Residual	-1.95	1.95		
<b>Total</b>	Count	23	28		
	Expected Count	23.00	28.00		
	% Within Opportunity to Negotiate	100.00%	100.00%		
Pearson Chi-Square*		Value	df	<i>p</i>	<i>V</i>
		6.098	2	0.047	0.346

a-To calculate the weighted score, scores were allocated with 1 to "No" and 2 to "Yes".  
 \* 5% significance level

Accordingly, a Chi-square test of homogeneity was performed and the test revealed that a statistically significant difference exists between the Yes/No proportions of the investor type (see Table 6.20 below). Of the 51 participants' responses, where the investor group sizes were unequal, 12 conventional (75%) were able to negotiate compared to 6 (33.3%) individuals and 10 institutions (58.8%) when signing the agreement, with a statistically significant difference in proportions,  $p = 0.047$ . The post hoc analysis that was performed involved pairwise comparisons using the z-test of two proportions with a Bonferroni correction, and  $p$  adjusted for multiple comparisons. The proportion of “Yes” of conventional investors was statistically higher than the individual investors,  $p < 0.05$ , but there is no statistically significant difference between the proportions between individuals and institutions and between conventional and institutional investors,  $p > 0.05$ .

**Table 6.20 - Opportunity to Negotiate Contractual Clauses and Investor Type**

Opportunity to Negotiate Contractual Clauses	Descriptive Statistics	Investor Type			Total
		Individuals	Institutions	Conventional	
No	Count	12 <sub>a</sub>	7 <sub>a, b</sub>	4 <sub>b</sub>	23
	Expected Count	8.12	7.67	7.22	23
	% within Investor Type	66.67%	41.18%	25.00%	45.10%
Yes	Count	6 <sub>a</sub>	10 <sub>a, b</sub>	12 <sub>b</sub>	28
	Expected Count	9.88	9.33	8.78	28
	% within Investor Type	33.33%	58.82%	75.00%	54.90%
Pearson Chi-Square Test		Value	df	<i>p</i>	V
		6.098	2	.047	0.346
Number of Valid Cases			51		

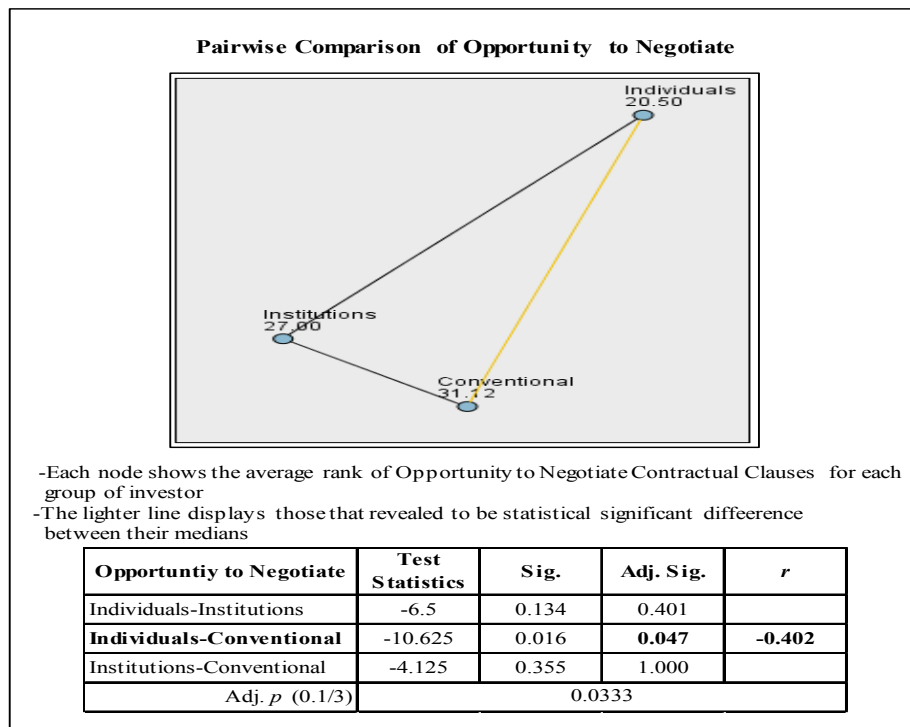
a, b :Each subscript letter denotes a subset of Investor Type categories and the proportions significant from each other at the 0.05 level: Those with same letters, there are no statistically significant differences in the portions between those groups. Those with different letters there are statistically significant difference between those groups.

Subsequently, a Chi-square test of independence was conducted between investor types and Opportunity to Negotiate. All expected cell frequencies were greater than five. There was a statistically significant association between investor type and Opportunity to Negotiate,  $X^2(2) = 6.098$ ,  $p = 0.047$ . The association was moderately strong (Cohen, 1988),  $V^{172} = 0.346$ . The post hoc pairwise analysis that was performed at a statistically significant acceptance level  $p < 0.0167$  ( $p < 0.05$  adjusted for multiple comparisons) did not reveal there to be a difference between the groups of investors. However, when it was accepted at  $p < 0.0333$  ( $p < 0.1$  adjusted for multiple comparisons) it revealed statistically significant differences in the median scores between individuals (1.00) and conventional (2.00) with a medium size effect<sup>173</sup> ( $p = 0.047$ ,  $r = -0.402$ ), but neither between individuals and institutions nor between institutions and conventional (see Figure 6.11).

<sup>172</sup> V is the Cramer's V measure used to determine the effective size for tables larger than 2 by 2, which takes into account the degrees of freedom. And the standard for interpreting Cramer's V as proposed by Cohen (1988) for df (2): 0.07=small effect, 0.21=medium effect, and 0.35=large effect.

<sup>173</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

Figure 6.11-Post Hoc Test on the Opportunity to Negotiate Contractual Clauses Across the Type of Investor Groups



From Table 6.21 below, where the opportunity to negotiate was compared to the amount invested, it appears that most of those who had the opportunity to negotiate any clauses were mainly those investors who had invested \$10m+. As per comments made in the questionnaire and correspondence with participants, individual participants that were able to negotiate was mainly with the wavering or reducing of fees and at times the yield. While big ticket size investors (from all groups of investors), who had the muscle to do so, due to the large commitment, were able to negotiate certain terms, such as: board representation, valuation at exit, warrants and reserve matters. Some of those who had invested in a partnership were also able to negotiate everything, as per comments made. In such events if the agreement could not be touched, a side letter would be signed with the negotiated terms. Although the Kruskal-Wallis H test that was carried out revealed there to be a statistically significant difference, at statistical acceptance  $p < 0.05$ , between the opportunity to negotiate and the amount invested  $H(3) = 8.469, p = 0.037$ , post hoc pairwise analysis for comparison between the groups revealed there to be no difference between the groups of investors.

**Table 6.21 - Amount Invested and Opportunity to Negotiate Contractual Clauses by Investor Type**

Investment Amount	Descriptive Statistics	Opportunity to Negotiate Contractual Clauses		Total	No. of Investors in Investment Amount*			Total
		No	Yes		Individuals	Institutions	Conventional	
\$100,000-\$1m	Count	4	2	6	5	0	1	6
\$1m-\$5m	Count	5	2	7	3	2	2	7
\$5.1m-\$10m	Count	5	2	7	1	4	2	7
\$10m+	Count	8	21	29	9	10	10	19
Total	Count	22	27	49	18	16	15	49
Kruskal Wallis			H (3)	p				
			8.469	0.037				
Number of Valid Cases		49						

\*This table is provided to give an indication of the number of investors investing in each group of Amount Invested. To give an indication of the size of investment and ability to negotiate (e.g. 5 Individuals invested in the range of \$100,000-\$1m and no Institution and 1 conventional had invested in that range. Of the 5 in that investment range (\$100,000-

Participants were also questioned as to whether signing the agreement was conditional to giving proxy to the FI for decision making. From Table 6.22 below it appears that the number of counts for both the individual and institutional groups of investors were similar, and of approximately equal counts, for both signing the agreement, being conditional (8 - individuals, 8 - institutions) and non-conditional (7- individuals, 8 - institutions). While with regards to the conventional investors, it appears to be more optional (10 participants) than conditional (4 participants). Looking into the break-up of conventional investors' weighted scores (Table 6.23 below), it appears that more conventional individuals (2.60) than conventional institutions (2.33) experienced the signing a proxy to FI upon subscribing to the investment as optional, in comparison to the individuals (2.22) investor group (who invested in IPE). The Kruskal-Wallis H test was performed and no statistically significant differences were found between investor type and subscribing being conditional to giving proxy,  $H(2) = 1.615, p = 0.446$ .

**Table 6.22 - Investor Type and the Independence of Subscribing and Proxy**

Investor Type	Descriptive Statistics	Subscribing & Proxy Independence			Weighted Score	Median
		Signing Proxy Optional to Subscribing	Signing Proxy Conditional to Subscribing	Other		
<b>Individuals</b>	Count	7	8	3	2.22	2.00
	% of Total	13.73%	15.69%	5.88%		
<b>Institutions</b>	Count	8	8	1	2.41	2.00
	% of Total	15.69%	15.69%	1.96%		
<b>Conventional</b>	Count	10	4	2	2.50	3.00
	% of Total	19.6%	7.8%	3.9%		
Total	Count	25	20	6	51	
	% of Total	49.02%	39.22%	11.76%	100.00%	
Kruskal-Wallis					H (2)	p
					1.615	0.446

a-To calculate the weighted score, scores were allocated in ascending order with 3 to Signing proxy being Optional, 2 Conditional and 1 to Other. The allocated weights do not reflect any qualitative ranking.

**Table 6.23 - Break-up of Conventional Investor and the Independence of Subscribing and Proxy**

Conventional Investor	Descriptive Statistics	Subscribing & Proxy Independence			Weighted Score	Median
		Signing Proxy Optional to Subscribing	Signing Proxy Conditional to Subscribing	Other		
<b>Conventional Individuals</b>	Count	7	2	1	2.60	3.00
	% of Total	43.75%	12.50%	6.25%		
<b>Conventional Institutions</b>	Count	3	2	1	2.33	2.50
	% of Total	18.75%	12.50%	6.25%		

a-To calculate the weighted score, scores were allocated in ascending order with 3 to Signing proxy being Optional, 2 Conditional and 1 to Other. The allocated weights do not reflect any qualitative ranking.

Those participants who selected “Other” was either because they had invested directly into the first stage of the investment, and so no proxy was involved; or because they did not do so initially, in advance, and proxy was given later. Some selected “Other” for whether proxy was offered or not, depending on the type of investment/product that they were investing in. In addition, an individual participant noted that his selection of “Other” was due to him signing a share purchase agreement rather than a subscription agreement. This means that he had invested in the second level of the investment structure, at the investee company level<sup>174</sup>, and so was a direct shareholder with a board seat. Furthermore, it was interesting to see that some participants who had selected “Conditional” were permitted to vote.<sup>175</sup> The

<sup>174</sup> As per understanding from an interview conducted with an FI, as covered in Chapter 7 on the results and analysis of FI.

<sup>175</sup> Covered in section 6.5.2 on analysis on permitted to vote question.

explanations given were: proxy was given for management and voting was permitted on investment issues (as explained by conventional (institutional) participant) and this was permissible due to a side letter alongside the main agreement, giving them a board seat on the investee company (as elaborated by conventional (individual) participant). At the same time, some participants (institutions and conventional) remarked that signing a proxy was conditional, which is specifically relevant to PE investments done through the SPV partnership route, in that the managers are given proxy, assigning them the right to vote on any matter on the investor's behalf or to pass any resolution requiring the approval of all partners/shareholders. There are even times when managers are also given power of attorney for restructuring purposes.

Table 6.24 below shows that 36 of the 49<sup>176</sup> participants confirmed the FI participation alongside the investor in the investment being offered, in 7 cases the FI did not participate, while the other 5 participants did not have any idea about whether the FI had participated or not. The weighted score that was calculated showed a very small difference in the weighted averages of the three groups. This was also reflected in the Kruskal-Wallis H test that was conducted, which showed the distributions were similar and that statistically there was no significant relationship between the FI participation and the type of investor,  $H(2) = 0.771, p = 0.680$ .

**Table 6.24 - Investor Type and FI Participation in the Investment**

Investor Type	Descriptive Statistics	IFI participation in the Investment			Weighted Score-a	Median
		Participated	Didn't Participate	Don't Know		
<b>Individuals</b>	Count	14	1	3	2.61	3.00
	% of Total	28.57%	2.04%	6.12%		
<b>Institutions</b>	Count	11	4	2	2.53	3.00
	% of Total	22.45%	8.16%	4.08%		
<b>Conventional</b>	Count	11	2	1	2.71	3.00
	% of Total	22.45%	4.08%	2.04%		
<b>Total</b>	Count	36	7	6	49	
	% of Total	73.47%	14.29%	12.24%	100.00%	
Kruskal-Wallis					$H(2)$	$p$
					0.771	0.680

a-To calculate weighted score, scores were allocated in descending order with 3 to "Participated" 2 to "Didn't Participate" and 1 to "Don't Know".

<sup>176</sup> Two participants did not provide a response.



## 6.5 INVESTORS' RELATIONSHIP WITH FI POST INVESTMENT

In order to determine the post investment relationship, questions on whether the FI had maintained a relationship with participants were asked. The respondents were also questioned on the extent of their involvement in the decision making of any key issues post investment, and if there was an agreed upon process for deciding on any conflict of interest matters that may arise during the investment period. This was in addition to the form and frequency of the updates they received post investment.<sup>177</sup>

### 6.5.1 Maintaining Relationship with FI

Table 6.25 below looks into whether the FI maintained a relationship with the investor in the post investment period. One conventional participant did not provide a response. The majority of participants from all three groups seem to have a relationship with 13 of the 18 individual participants, 14 of the 17 institutional participants and 13 of the 16 conventional participants indicating some form of relationship with the FI, post investment. The results are similar and are also reflected in the weighted score calculated on the participants' responses with the weighted average for individuals being 1.76, institutions 1.81 and conventional 1.93. There were three who selected "Other", two (1 -individual, 1 -conventional) of which commented that in some investments there was a relationship and in some there was not. While the third (institution) participant who selected "Other" remarked that they had a relationship manager within their institution that managed the relationship with the FI. Moreover, due to the closeness in responses, the Kruskal-Wallis H test showed that the distributions were similar and that there was no statistically significant difference between the medians of individuals, institutions and conventional with regards to having a relationship with the FI,  $H(2) = 1.479, p = 0.477$ .

---

<sup>177</sup> Part of research questions A.

**Table 6.25 - Investor Type and Relationship with FI**

Investor Type	Descriptive Statistics	Relationship with IFI (Manged)		Weighted Score-a	Median
		No	Yes		
<b>Individuals</b>	Count	4	13	1.76	2.00
	% of Total	8.51%	27.66%		
<b>Institutions</b>	Count	3	13	1.81	2.00
	% of Total	6.38%	27.66%		
<b>Conventional</b>	Count	1	13	1.93	2.00
	% of Total	2.13%	27.66%		
Total	Count	8	39	47	
	% of Total	17.02%	82.98%		
Kruskal Wallis				H (2)	p
				1.479	0.477

a-To calculate the weighted score, scores were allocated with 1 to "No", 2 to "Yes".

Participants were also asked whether, as part of the post-relationship, the FI had established and agreed with the investor beforehand on a defined documented methodology upon which it will deal with matters of conflict of interest that may arise after the investment has been made. It appears from Table 6.26 below that such a mechanism was not available to the majority (13) of the individual investors and in only (5) cases did the FI have such a documented process with individuals. While with regards to the other two groups: institutions, those that did have a mechanism, were close to half of the participants (8) while with the conventional, they were more than half (10) of the participants. Some of the individual participants commented that such matters would be raised, unofficially during investment review meetings, or that they would be the ones raising them directly with FI/GP. Furthermore, the institutional participants noted that it depended on the quality of the GP. Some GPs developed “related party transactions policy procedures” that covered such matters. While others noted that although it is not documented, as partners, such issues are discussed and settled amicably. With regards to conventional participants, one (conventional individual participant) remarked that it is provided for at the inception of the agreement. While another commented that it should be stipulated that the GP develop and implement a solid and transparent process and it is applicable to direct, indirect and LP forms of investment (excluding funds of funds). Moreover, one of the conventional (individual) participants who had selected “No” noted that it is difficult to evaluate the absence of conflict of interest without being involved in the business and that the lack of conflict of interest process does not mean that there are no conflicts.

**Table 6.26 - Investor Type and Document Process with FI**

Clearly Documented Process Regarding Consultation on Conflict Matters	Descriptive Statistics	Investor Type			Total
		Individuals	Institutions	Conventional	
No	Count	13 <sub>a</sub>	9 <sub>a</sub>	5 <sub>a</sub>	27
	Expected Count	9.72	9.18	8.10	27
	Adjusted Residual	1.94	-0.11	-1.92	
	% Within Clearly Documented	48.15%	33.33%	18.52%	100.00%
Yes	Count	5 <sub>a</sub>	8 <sub>a</sub>	10 <sub>a</sub>	23
	Expected Count	8.28	7.82	6.90	23
	Adjusted Residual	-1.94	0.11	1.92	
	% Within Clearly Documented	21.74%	34.78%	43.48%	100.00%
Total	Count	18	17	15	50
	Expected Count	18.00	17.00	15.00	50
	% Within Clearly Documented	36.00%	34.00%	30.00%	100.00%
Pearson Chi-Square Test		Value	df	<i>p</i>	V
		4.993	2	.082	0.316
Number of Valid Cases			50		

a, b :Each subscript letter denotes a subset of Investor Type categories and the proportions significant from each other at the .05 level: Those with same letters, there are no statistically significant differences in the portions between those groups. Those with different letters there are statistically significant difference between those groups.

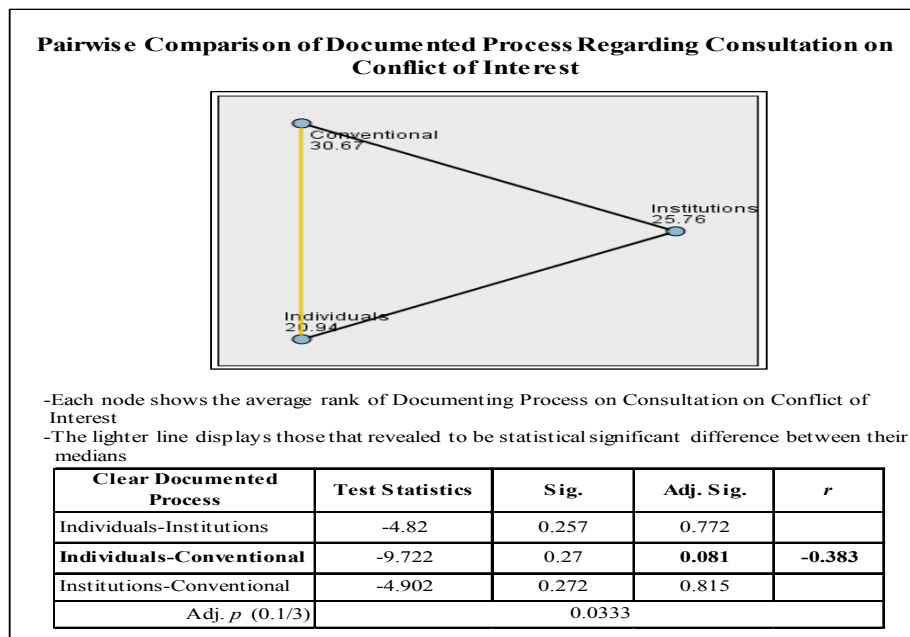
Moreover, in performing the Chi-square analysis of the representation of the actual portions (of “No” or “Yes”) between the group of investors and the expected, there appears to be some discrepancies between the expected and observed actual counts. It was expected that 8 individuals would say “Yes”, but actually 5 individuals said “Yes” (adjusted residual = -2). It was also expected that 7 conventional investors would say “Yes”, but actually 10 said “Yes” (adjusted residual = 2). While the expected and actual for institutions were the same (adjusted residual = 0). The test revealed there was statistical significance at the 10% significance level, with a large size effect<sup>178</sup>,  $X^2(2) = 4.993$ ,  $p = 0.082$ ,  $V = 0.316$ . However, although in the post hoc pairwise analysis that was performed presented there was a difference between individuals and conventional with regards to the Documented Process of Conflict of Interest, with a large size effect<sup>179</sup> ( $p = 0.081$ ,  $r = -0.383$ ), it was not statistically significant,  $p > 0.0333$ <sup>180</sup> (see Figure 6.12 below). This was confirmed by the outcome of the Chi-square test of homogeneity that was performed and the test revealed there was no statistical difference between the two portions across the types of investors (as can be seen from the subscript letters in Table 6.26 above).

<sup>178</sup> The standard for interpreting Cramer’s V as proposed by Cohen (1988) for df (2): 0.07=small effect, 0.21=medium effect, and 0.35=large effect.

<sup>179</sup> The standard for interpreting Cramer’s V as proposed by Cohen (1988) for df (2): 0.07=small effect, 0.21=medium effect, and 0.35=large effect.

<sup>180</sup> P adjusted for multiple comparisons. Hence, in this case there are 3 groups, so  $P = 0.1/3 = 0.0333$ .

**Figure 6.12-Post Hoc Test on the Distribution of Clearly Documented Process Regarding Consultation on Conflict of Interest Across Type of Investor Groups**



### 6.5.2 Permitted to Vote

To determine the level of the investors’ participation in the level of decision making post-investment, participants were asked if they were permitted to vote on key issues, such as amendment of the agreement, dissolution before the end of the investment period, extension of the investment period, conflict of interest, and removal of manager. The responses reported in Table 6.27 below show that more than half of the institutional participants were able to vote on the key issues (ranging between 10 to 12 participants) as opposed to individuals (ranging between 10 to 13 participants) and conventional (ranging between 8 to 11 participants) where nearly more than half were not permitted to vote. The gap between the institution participants and the individual and conventional groups of participants, with regards to those permitted to vote and not permitted to vote, appears to be similar. From the comments noted from individuals, it is those with significantly large investments that were able to vote, mainly either through having a board representation (as a result of the size of the investment) or due to having been able to obtain such ability through an agreement prior to committing the investment. Individual participants that were not as fortunate and it was noted that they knew of the FI making decisions on mandates, including exit, but that they had no say in the matter. While another participant mentioned that on matters such as exit, the FI had informally asked in which direction they wanted to go.

Of the conventional (individual) participants, 3 did not select a response. Of which two commented that it depends on the investment and that when co-investing, yes, and when investing through LP or vehicle co-investment structures, voting rights were limited to none. The third conventional individual remarked that in investments where they had board seat representation, they had full voting, and in those where they did not, they were not permitted to vote on anything. While one conventional individual that was permitted to vote noted that he was permitted to vote on the matters listed, except on the removal of the manager, and was able to do so through signing side letters that are subject to some preconditions and special votes for those letters to be executed/triggered. The side letters covered matters such as: special management fees, carry provisions, co-investment options, and additional board seats. The conventional (institution) that selected voted on “Other” matters was on matters related to investment decisions such as loans and capital increase. Moreover, a conventional (institution) investing in the LP form noted that although in such investments a blanket power of authority is given to the GP, when it came to changes to the LP agreement terms, they were able to vote.

**Table 6.27 - Investor Type and Voting on Key Issues**

Key Issues	Investor Time	Descriptive Statistics	Permitted		Weighted Score-a	Median
			To Vote	Not Vote		
<b>Amendment of Agreement</b>	Individuals	Count	7	11	1.39	1.00
	Institutions	Count	11	6	1.65	2.00
	Conventional	Count	6	9	1.40	1.00
Pearson Chi-Square Test			Value	df	<i>p</i>	<i>V</i>
			2.884	2	0.236	0.240
Number of Valid Cases			50			
<b>Dissolution before end of Investment Period</b>	Individuals	Count	8	10	1.44	1.00
	Institutions	Count	12	5	1.71	2.00
	Conventional	Count	6	9	1.40	1.00
Pearson Chi-Square Test			Value	df	<i>p</i>	<i>V</i>
			3.630	2	0.163	0.269
Number of Valid Cases			50			
<b>Extension of Investment Period</b>	Individuals	Count	8	10	1.44	1.00
	Institutions	Count	11	6	1.65	2.00
	Conventional	Count	7	8	1.47	1.00
Pearson Chi-Square Test			Value	df	<i>p</i>	<i>V</i>
			1.682	2	0.431	0.183
Number of Valid Cases			50			
<b>Issues of Conflict of Interest</b>	Individuals	Count	5	13	1.28	1.00
	Institutions	Count	10	7	1.59	2.00
	Conventional	Count	6	9	1.40	1.00
Pearson Chi-Square Test			Value	df	<i>p</i>	<i>V</i>
			3.494	2	0.174	0.264
Number of Valid Cases			50			
<b>Removal of Investment Manager</b>	Individuals	Count	5	13	1.28	1.00
	Institutions	Count	10	7	1.59	2.00
	Conventional	Count	4	11	1.27	1.00
Pearson Chi-Square Test			Value	df	<i>p</i> #	<i>V</i>
			4.745	2	0.093	0.308
Number of Valid Cases			50			
<b>Other Matters</b>	Individuals	Count	2	11	1.15	1.00
	Institutions	Count	1	8	1.11	2.00
	Conventional	Count	6	3	1.67	2.00
Kruskal Wallis *					H (2)	<i>p</i>
					2.155	0.341
Number of Valid Cases					31**	

a-To calculate the weighted score, scores were allocated 2 to "To Vote" and 1 to "Not Vote".

# At 10% significant level

\* The Kruskal Wallis was conducted and not the Chi-Square test, due to the the count in some groups

\*\* These 31 cases represent participants who had either stated that they were permitted to vote on other matters (other than the list of options provided) or stated that they were not permitted to vote on any other matter not listed. The rest of the 20 investors had stated their responses (permitted not permitted) to the list of options of matters, and so Others were not applicable to them.

The Chi-square test for independence was performed on all key issues, and the results indicated that (with the exception of Removal of Manager) there is no significant association between investor type and permission to vote on any of the key issues, as can be seen in Table 6.27. The test on Removal of Manager, at the 10% significance level ( $p < 0.1$ ) indicated that voting on Removal of Manager was statistically significant, with a moderately large size effect<sup>181</sup>,  $X^2(2) = 4.745$ ,  $p = 0.093$ ,  $V = 0.308$ . However, the post hoc comparison analysis that was performed revealed there to be no pairwise relationship between the groups.

### 6.5.3 FI Frequency of Updates

This section looks into the frequency with which the FI updates the investors and the investors' thoughts on the matter. Table 6.28 below displays the FI frequency in getting in touch with the investors. The participants had to select the frequency in terms of "Frequent", "Occasional" or "None" and accordingly the weighted scores were calculated. Two conventional participants did not select a response. With regards to the individual participants, most of them were between having received frequently (16.33%) and occasionally (16.33%). Only 2 participants (4.08%) had not received any updates. While with the institutional investors all of them had received updates. The majority of the institutional (24.49%) had received frequent updates and the remaining 10.20% received occasional ones. The conventional participants were similar to institutions in that all participants received updates: 20.41% received them frequently and 8.16% received them occasionally. The range of frequency of updating was from quarterly, semi-annually to annually. The Kruskal-Wallis H test on the distribution of how often the FI got in touch for all groups of investors indicated that there was no statistically significant difference in frequency of the FI getting in touch with the three groups of investors at the 5% level of significance,  $H(2) = 4.067$ ,  $p = 0.131$ .

---

<sup>181</sup> The standard for interpreting Cramer's V as proposed by Cohen (1988) for df (2): 0.07=small effect, 0.21=medium effect, and 0.35=large effect.

**Table 6.28 - Investor Type and How Often FI Gets in Touch**

Investor Type	Descriptive Statistics	How Often IFI Gets in Touch			Weighted Score-a	Median
		Frequent	Occasional	None		
<b>Individuals</b>	Count	8	8	2	2.33	2.00
	% of Total	16.33%	16.33%	4.08%		
<b>Institutions</b>	Count	12	5	0	2.71	3.00
	% of Total	24.49%	10.20%	0.00%		
<b>Conventional</b>	Count	10	4	0	2.71	3.00
	% of Total	20.41%	8.16%	0.00%		
Kruskal-Wallis					H (2)	p
					4.067	0.131

a-T to calculate the weighted score, scores were allocated 3 to "Frequent", 2 to "Occasional" and 1 to "None".

The participants who answered “Occasional” and “None” to how often the FI got in touch were then asked about their opinion on the reason for the FI’s behaviour. Those applicable to respond were 10 individuals, 5 institutions, and 4 conventional, of which one applicable individual did not provide a response, and so was not included in the total count. In addition, two of the applicable conventional did not provide a response and so were not included in the total count. However, the total count includes all participants who responded to the question (those applicable and not applicable). The participants’ opinions are displayed in Table 6.29 below. The participants had to rank the reasons for FI’s behaviour, choosing from: jeopardises the FI’s/GP’s information advantage (Information Advantage), endangers their (FI) position (Endanger Position); undermines their (FI) authority (Undermine Authority); too costly (Cost), and other. To facilitate in the scoring, the responses were scaled into 5 groups of importance, as can be seen in Table 6.29 below. The majority of the eligible participants of all three groups appear to consider these reasons as “Not Important” reasons for the FI not updating them frequently. Of those that did consider those to be a reason, Information Advantage was the main one (3 - individuals, 3 - institutions, 4 - conventional), followed by Endanger Position (3 - individuals, 0 - institutions, 2 - conventional). Only 2 individuals considered Undermine Authority to be a reason, and 3 participants (2 - institutions, 1 - conventional) considered it to be due to Cost. The Kruskal-Wallis H test that was conducted at the 10% significance level confirmed that there was a statistically significant difference between the three groups of investors in Information Advantage,  $H(2) = 4.678$ ,  $p = 0.096$ . However, a post hoc test on the pairwise analysis revealed there to be no pairwise relationship between the groups.

Of the individual participants, who considered that it was very highly important to jeopardise the FI’s information advantage, one participant noted that the FI failed to report on fair value, either because



they did not have an appropriate set up to do so or because the FI did not want to show that it was not doing well. While some of the individual investors selected “Others”, to them the reason for the FI’s lack of getting in touch was: the FI lacks responsibility in addition to that the FI does not want to report negative news as it affects its reputation, which was also a comment made by a conventional (individual) participant. Furthermore, one individual participant commented that with regards to reporting, it depends on the investment and he did not consider that most PE required quarterly updates. Moreover, according to the institutional participant who selected “Other”, it was that the FI’s main concern was just getting their fees and nothing else.

**Table 6.29 - Investor Type and Reason For Not Getting in Touch**

Reason For Not Getting In Touch	Investor Type	Descriptive Statistics	Opinion on Not Getting In Touch					Weighted Score-a	Median
			Not Important	Low Important	Important	Highly Important	Very Highly Important		
Information Advantage	Individuals	Count	6	0	0	2	1	2.11	1.00
	Institutions	Count	2	0	0	0	3	3.40	5.00
	Conventional	Count	0	0	0	2	2	4.50	4.50
Kruskal-Wallis							H (2)	p*	
							4.678	0.096	
Endanger Position	Individuals	Count	5	0	1	0	3	2.56	1.00
	Institutions	Count	5	0	0	0	0	1.00	1.00
	Conventional	Count	1	0	1	1	1	3.25	3.50
Kruskal-Wallis							H (2)	p	
							4.432	0.109	
Undermine Authority	Individuals	Count	5	0	2	2	0	2.11	1.00
	Institutions	Count	5	0	0	0	0	1.00	1.00
	Conventional	Count	2	1	1	0	0	1.75	1.50
Kruskal-Wallis							H (2)	p	
							3.172	0.205	
Too Costly	Individuals	Count	7	2	0	0	0	1.22	1.00
	Institutions	Count	3	0	0	0	2	2.60	1.00
	Conventional	Count	2	1	0	0	1	2.25	1.50
Kruskal-Wallis							H (2)	p	
							1.622	0.444	
Other	Individuals	Count	5	0	0	0	4	2.78	1.00
	Institutions	Count	3	0	0	1	1	2.40	1.00
	Conventional	Count	2	0	1	0	1	2.50	2.00
Kruskal-Wallis							H (2)	p	
							0.190	0.910	

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 5 with a score of 1 to “Not Important” to 5 “Very Highly Important”.

\*At 10% level of significance.

In addition to questioning the participants on the reason for the FI’s behaviour in keeping in touch, they were also asked the effect that receiving information would have on them as investors. The options of responses offered and their selection have been summarised in Table 6.30 below. Three conventional

participants did not select a response and were not included in the total count. In addition, one individual commented “None” to the selection of responses provided, as the information received might all be negative, and so was also not included in the total count. In most cases the effect was similar in all groups, with the most popular response being that it would enhance the trust in the GP/FI (25.53% - individuals, 27.66% - institutions, 25.53% - conventional) and reduce the need to monitor (17.02% - individuals, 17.02% - institutions, 12.77% - conventional). In addition, the institutional participants were willing to inject more capital.

**Table 6.30 - Investor Type and the Effect of Information/Report Received on Investors**

Investor Type	Descriptive Statistics	Effect of Information/Report Received			Total
		Reduces the Need to Monitor	Enhances Trust in FI GP	Willing to Inject Capital	
<b>Individuals</b>	Count	8	12	4	17
	% of Total	17.02%	25.53%	8.51%	36.17%
<b>Institutions</b>	Count	8	13	7	17
	% of Total	17.02%	27.66%	14.89%	36.17%
<b>Conventional</b>	Count	6	12	3	13
	% of Total	12.77%	25.53%	6.38%	27.66%
<b>Total</b>	Count	22	37	14	47
	% of Total	46.81%	78.72%	29.79%	100.00%

Furthermore, the participants were asked what form the provision to report and to provide feedback by the FI was in, and whether it was part of the formal agreement they had with the FI, or part of an informal agreement, or something else. As can be seen in Table 6.31 below, the responses from the three groups were similar. Whereas to the majority of the participants it formed part of the formal agreement (11 - individuals, 12 - institutions, 10 - conventional), and for 5 participants from each of the three groups, it formed part of the informal agreement. An institution participant who selected it was part of the informal agreement noted that although there was nothing mentioned in the agreement on reporting, it is a common practice that the FI has to report to the investor. While an individual who selected informal agreement noted that it was a way by which the IFI keeps its relationship with the investor, to attract the investor into another investment. Furthermore, a conventional (individual) participant, who selected it was part of an informal agreement, noted that it was imposed by the regulators/agencies that govern the institutions they deal with. Of the institutional participants who selected that reporting back was part of the formal agreement, they commented that reporting requirements are always specified to some extent in all private equity investments. Moreover, two

individual participants selected “Other”. One of the individuals had no idea with regards to this matter, and the other did not specify anything.

**Table 6.31 - Investor Type and Reporting Provision Part of Formal/Informal Agreement**

Investor Type	Descriptive Statistics	Report back Formal/Informal Agreement		Weighted Score-a	Median
		Part of Formal Agreement	Part of Informal Agreement		
<b>Individuals</b>	Count	11	5	1.69	2.00
	% of Total	22.92%	10.42%		
<b>Institutions</b>	Count	12	5	1.71	2.00
	% of Total	25.00%	10.42%		
<b>Conventional</b>	Count	10	5	1.67	2.00
	% of Total	20.83%	10.42%		
Total	Count	33	15	48	
	% of Total	68.75%	31.25%	100.00%	
Kruskal-Wallis				H (2)	<i>p</i>
				0.658	0.719

a-To calculate the weighted score, scores were allocated with 1 to "Part of Formal Agreement", 2 to "Part of Informal Agreement", and 3 to "Other".

A cross-tabulation was performed between reporting back being part of a formal/informal agreement and the form through which the investment was carried out when invested in private equity (Table 6.32 below). It appears that close to 70% in each group stated that reporting back formed part of the formal agreement. With individuals, the most popular forms were direct equity investment, followed by LP where reporting back was part of the formal agreement (54.55% - Direct Equity, 45.45% - LP). While with institutions, it was also direct equity investment (75.00%), but this was followed by indirect equity (58.33%). And for to conventional participants, it was also direct equity investment (80.00%), but this was followed by both indirect equity investment (70.00%) and LP (70.00%).

**Table 6.32 - Reporting Back Part of Formal/Informal Agreement and Investment Carried Out**

Investor Type	Reporting Back Formal/Informal Agreement	Descriptive Statistics	Investment Carried out Through				Total Formal/Informal Agreement
			Direct Equity Investment	Indierct Equity Investment	Private Equity Fund of Fund	Limited Partnership	
Individuals	Part of Formal Agreement	Count	6	4	4	5	11
		% of Total within	54.55%	36.36%	36.36%	45.45%	68.75%
	Part of Informal Agreement	Count	4	2	0	1	5
		% of Total within	80.00%	40.00%	0.00%	20.00%	31.25%
	Total	Count	10	6	4	6	16
Institutional	Part of Formal Agreement	Count	9	7	3	2	12
		% of Total within	75.00%	58.33%	25.00%	16.67%	70.59%
	Part of Informal Agreement	Count	4	2	1	2	5
		% of Total within	80.00%	40.00%	20.00%	40.00%	29.41%
	Total	Count	13	9	4	4	17
Conventional	Part of Formal Agreement	Count	8	7	4	7	10
		% of Total	80.00%	70.00%	40.00%	70.00%	66.67%
	Part of Informal Agreement	Count	3	4	1	2	5
		% of Total within	60.00%	80.00%	20.00%	40.00%	33.33%
	Total	Count	11	11	5	9	15

Percentages and totals are based on respondents: 16 total Individuals responses, 17 total Institutions responses, 15 total Conventional responses.

### 6.5.4 FI Method of Updates

Participants were asked about whether it was easy to analyse the information received from FI with the industry performance. They were given a four-scale option to select from, as can be seen in Table 6.33 below. It appears that the majority of investors were in the range of “Somewhat easy” to “Not So Easy”, as reflected in the weighted score. To individuals (18.00%) and conventional (18.00%) it was more “Somewhat Easy”, while to institutions (14.00%) it was more “Not So Easy”. Furthermore, 4 participants from each group of individual and institution investors and one conventional considered the information received to being easy to analyse. The Kruskal-Wallis H test that was conducted showed that the distribution of the ease of analysis of the information received for the three groups of investors was similar. It also showed that there was no statistically significant difference in the ease of analysing the information received,  $H(2) = 0.471, p = 0.790$ .

**Table 6.33 - Investor Type and Information Received Easily Analysed**

Investor Type	Descriptive Statistics	Information Received Easily Analysed				Weighted Score-a	Median
		Easily Analyzed	Somewhat Easy	Not So Easy	Not at All Easy		
<b>Individuals</b>	Count	4	9	3	2	2.83	3.00
	% of Total	8.00%	18.00%	6.00%	4.00%		
<b>Institutions</b>	Count	4	6	7	0	2.82	3.00
	% of Total	8.00%	12.00%	14.00%	0.00%		
<b>Conventional</b>	Count	1	9	4	1	2.67	3.00
	% of Total	2.00%	18.00%	8.00%	2.00%		
Total	Count	9	24	14	3		
	% of Total	18.00%	48.00%	28.00%	6.00%		
Kruskal Wallis						H (2)	p
						0.471	0.790

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 4 with a score of 1 to "Not at All Easy" to 4 "Easily Analyzed".

Participants were also questioned on the method of reporting, whether it was standardised, the same from one period to another, and if the information that was reported was not only the same, but was also consistent and that it allowed for comparison from one period to the next. Table 6.34 below summarises their responses. Most of the investors in the three groups found the method of reporting standardised and consistent for them to compare: individuals (11), institutions (15) and conventional (9). The Kruskal-Wallis H test that was conducted showed that the distribution of the method of reporting for all three investor groups was similar. The test indicated that there was no statistically significant difference in frequency of how the three groups of investors found the method of reporting,  $H(2) = 3.568, p = 0.168$ .

**Table 6.34 - Investor Type and Method of Reporting**

Investor Type	Descriptive Statistics	Method of Reporting		Weighted Score-a	Median
		Standardized Consistent for Comparison	Not Standardized		
<b>Individuals</b>	Count	11	7	1.61	2.00
	% of Total	22.45%	14.29%		
<b>Institutions</b>	Count	15	2	1.88	2.00
	% of Total	30.61%	4.08%		
<b>Conventional</b>	Count	9	5	1.64	2.00
	% of Total	18.37%	10.20%		
Total	Count	35	14		
	% of Total	71.43%	28.57%		
Kruskal Wallis				H (2)	p
				3.568	0.168

a-To calculate the weighted score, scores were allocated 1 to "Standardized Consistent for Comparison" and 2 to "Not Standardized".

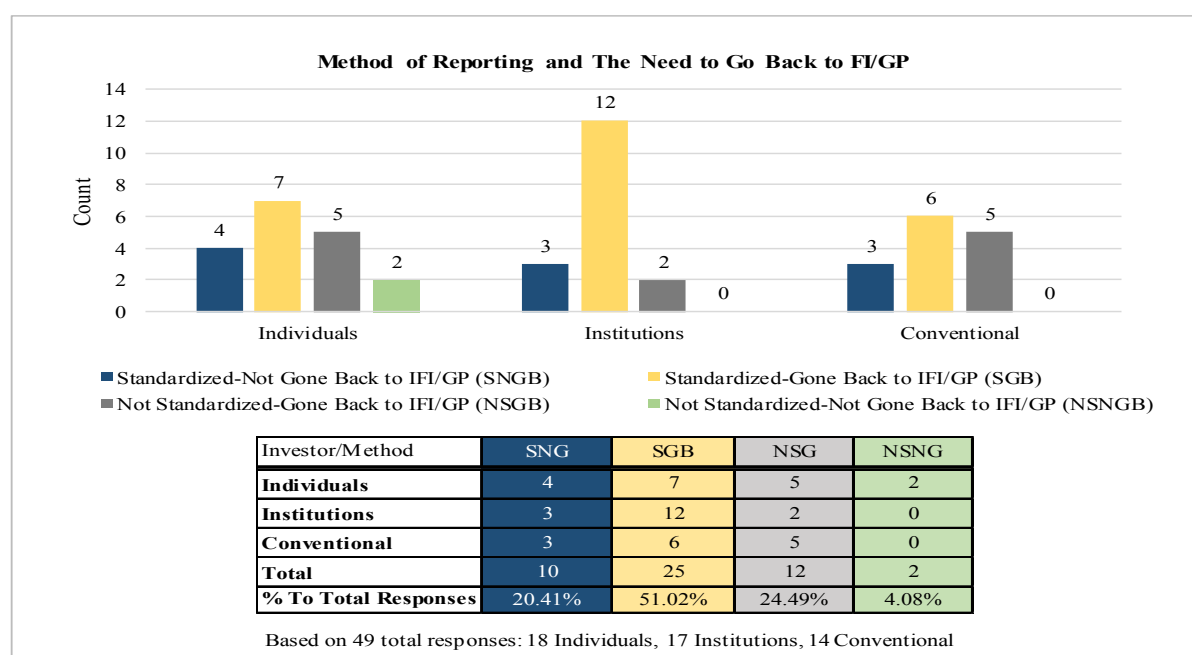
Participants were also asked whether they needed to go back to the GP/FI for any further information or questions. Figure 6.13 below provides a breakdown of those participants (investor type wise) who did not find the information received sufficient enough and needed to go back for more information, and categorised this in line with the method of reporting of the information. 25 of the 35<sup>182</sup> participants who considered the informational update that they received as standard, had to go back for more information. Of which 7 participants were individuals, 12 were institutions and the remaining 6 participants were conventional. While nearly all of the participants (12 of the 14<sup>183</sup> participants) who considered the information they received was not standardised had to go back for more information. Unlike expected, both institutions and conventional did not appear to go back for further information when the reports received were not standard. The comments given by the participants that invested in IPE mainly revolved around the information received being too general or standard and that it did not provide enough details, clarification, and sufficiency to evaluate performance. To some it was more on the progress of the investment or that it did not match the forecast. In addition, some of the comments were that they had to go back and follow-up with the FI/GP because there were delays in the reporting. While the comments made by those who invested in CPE, in addition to obtaining further clarification on performance/forecast, as in IPE, they had to go back for further clarifications on some clauses that were not enforceable in certain jurisdictions.

---

<sup>182</sup> See Table 6.34. Total count of participants who found reporting method standardised and consistent for comparison.

<sup>183</sup> See Table 6.34. Total count of participants who found reporting method not standardised or consistent for comparison.

Figure 6.13 - The Method of Reporting and The Need to Go Back to FI/GP With Questions or Further Information



An open-ended question was then put to the participants with regards to what information they would like to see being reported.<sup>184</sup> Table 6.35 below summarises the responses. The responses have been grouped into the categories seen in Table 6.35. Ten of the 51 participants (5 - individuals, 1 - institution, 4 - conventional) did not provide a response.

Table 6.35 - Investor Type and Information Liked to be Reported

Investor Type	Descriptive Statistics	Information liked to be Reported									Total
		Financials-Ratios-Valuation	Market-Economy-Industry-Sector	Investment - Exit	Risk-Return	Management	Litigations	Shari'ah Compliant	Operational	Social	
<b>Individuals</b>	Count	11	6	7	2	1	0	0	1	0	13
	% of Total	26.83%	14.63%	17.07%	4.88%	2.44%	0.00%	0.00%	2.44%	0.00%	31.71%
<b>Institutional</b>	Count	15	6	9	3	3	2	3	6	3	16
	% of Total	36.59%	14.63%	21.95%	7.32%	7.32%	4.88%	7.32%	14.63%	7.32%	39.02%
<b>Conventional</b>	Count	10	5	10	0	0	1	0	0	0	12
	% of Total	24.39%	12.20%	24.39%	0.00%	0.00%	2.44%	0.00%	0.00%	0.00%	29.27%
<b>Total</b>	Count	36	17	26	5	4	3	3	7	3	41
	% of Total	87.80%	41.46%	63.41%	12.20%	9.76%	7.32%	7.32%	17.07%	7.32%	100.00%

Participants were interested in timely, regular performance updates on the investment. The top three groups of information that participating investors were interested in appear to be the same for all types

<sup>184</sup> Part of research questions A.

of investors. They were in the following order: Financials & Valuation, Investment & Exit, and Market-Economy-Industry-Sector Performance. Institutions (36.59%) gave greater weight to financials than individuals (26.83%) and conventional (24.39%). The details of the top three groups of information updates that they are interested in are listed in Table 6.36 below. Moreover, institutional investors were also interested in receiving information updates on: Risk & Return, Management, Operational, *Shari'ah* Compliance, Litigation, and Social Updates. While individuals were only further interested in: Risk & Return, Management, and Litigation. On the other hand, with conventional investors, other than the top three mentioned above, they were only interested in Litigation; the remaining types of information do not appear to be of interest. With regards to those investing in IPE, it is interesting to note that overall interest among investors in information on *Shari'ah* compliance was low, and was only institutions (3).

**Table 6.36 - Details of The Top 3 Information Updates Liked to be Reported**

Financials & Valuations	Market-Economy- Industry-Sector Performance	Investment & Exit
Performance progress & Comparative analysis	Macro industry overview	Investment status/update
Quarterly financials	Macroeconomic overview	Progress report Vs Planned
Annual Audited financials	Market analysis & status	Any delays
Cost overruns	Market trend & outlook	Capital redemption
Explanation of non-performing assets	Similar project comparison	Exit plan/process
GP fee structure		Future investments /activities
Fees and expenses charge to investors		Corporate Governance
Calculation Methodology & Valuation		Board meetings/minutes
		Investment risks

### 6.5.5 Risk in Private Equity

Risks are expected in all investments; hence, participants were asked if they had any concerns with regards to investing in IPE/PE. Table 6.36 summarises their responses. It appears that nearly all (47) participants see that there are risks. The participants were asked if those risks were addressed in the documents that they were provided. They commented that the risks, when addressed, were in general terms. Of the 47 participating (who responded to the risk question - Table 6.37 below), 46 provided a response to whether it was addressed in the document (Table 6.38 below). Of those 46 responses, 29 participants said yes, while the remaining 15 did not think the documents had covered the risk, as can be seen in Table 6.38 below. Of the 5 participants that did not provide a response, two did not respond to having any risk concerns in the previous question. The Mann-Whitney test that was conducted showed that the distribution of the documents addressing risk is similar across categories of



concern of PE risk and that there is no statistically significant difference between those that have concern and those that have none,  $U = 29.000$ ,  $z = -0.995$ ,  $p = 0.320$ .

**Table 6.37 - Investor Type and Concern PE Risk**

Investor Type	Descriptive Statistics	Concern PE Risk		Total
		None	Have Risk of Concern	
Individuals	Count	1	17	18
	% of Total	1.96%	33.33%	35.29%
Institutions	Count	2	15	17
	% of Total	3.92%	29.41%	33.33%
Conventional	Count	1	15	16
	% of Total	1.96%	29.41%	31.37%
Total	Count	4	47	51
	% of Total	7.84%	92.16%	100.00%

**Table 6.38 - Concern PE Risk and Document Addressed Risk**

Concern PE Risk	Descriptive Statistics	Document Addressed Risk		Total	Median
		No	Yes		
None	Count	0	2	2	2.00
	% of Total	0.00%	4.35%	4.35%	
Have Risk of Concern	Count	15	29	44	2.00
	% of Total	32.61%	63.04%	95.65%	
Total	Count	15	31	46	
	% of Total	32.61%	67.39%	100.00%	
Mann-Whitney		U	Z	p	
		29.000	-0.995	0.320	

Overall, the comments made were that the type of risk depends on the type and nature of the investment. The common risks of concern between the conventional individuals and conventional institutions were: liquidity risk, business risk, market conditions and exit. Conventional individuals had concerns, especially with investing in PE in the MENA region. The concerns that were stated, in addition to the above, were: valuation at entry and exit, the carry forward paid to managers, sectorial/global allocation, transparency, disclosure of conflicts, minority position (and FI/GP being selective with investors), financial manipulation, lack of alignment of interest, lack of operating experience of GP, governance and corruption/fraud. While conventional institutions, in addition to the above, stated: financial structure, management, operation, legal, and regulation.

With regards to the investors that invested in IPE, individual and institutions, they noted that most of the risks in IPE are similar to the conventional PE investment, such as market, liquidity, management, legal, financial, credit, profitability and geographical risks. They had some further observations with regards to it being *Shari'ah* compliant and that there were also such risks as risk shifting, ownership, lack of transparency, concealing and shifting funds between investments, inexperienced individuals in *Shari'ah*, governance (misconduct of management and negligence), alignment and conflict of interest. They also had some concerns with regards to regulatory and jurisdiction issues. The main concerns with regards to regulatory risk were the lack of regulations in this area of investment and the ineffective/lack of regulatory enforcement (especially when it came to overdue investment term). While with regards to jurisdictional issues, they were obtaining the required authorisation, operating in non-Islamic countries

and the implementation of *Shari'ah* rulings. This was in addition to the possible risk of breach of the agreement and the cost of having to take up the matter legally.<sup>185</sup>

## 6.5.6 Investing in Islamic Private Equity

Furthermore, those that had invested in IPE were asked some questions with regards to *Shari'ah* investing: the importance of *Shari'ah* risk, and *Shari'ah* definition and compliance. Note that *Shari'ah* related issues are not relevant to conventional investors.

### 6.5.6.1 *Shari'ah* Risk

The IPE participants (individual and institution groups) were also asked how important *Shari'ah* risk was to them. The response options on the level of importance scaled from “Very Important” to “Not Important”, as can be seen in Table 6.39 below. For about 68.57% of the participants (24 participants) *Shari'ah* risk appears to be of high importance (Important-Very Important), of which about 11 participants were institutions and 13 participants were individuals. It was interesting to see that to some *Shari'ah* risk was not of importance, and more so to individuals than institutions (5 - Individuals and 2 - Institutional). The Mann-Whitney test that was conducted showed that the distribution was similar and that there was no statistically significant difference in the ease of analysing the information received with the two groups of investors,  $U = 135.500$ ,  $z = -0.608$ ,  $p = 0.544$ .

**Table 6.39 - Investor Type and Importance of *Shari'ah* Risk**

Investor Type	Descriptive Statistics	Importance of <i>Shari'ah</i> Risk				Weighted Score-a	Median
		Very Important	Important	Somewhat Important	Not Important		
<b>Individuals</b>	Count	6	7	0	5	2.78	3.00
<b>Institutions</b>	Count	8	3	4	2	3.00	3.00
Total	Count	14	10	4	7	35	
	% of Total	40.00%	28.57%	11.43%	20.00%	100.00%	
Mann-Whitney					U	Z	p
					135.500	-0.608	0.544

a-To calculate the weighted score, scores were allocated in ascending order with 1 to “Not Important” and 4 to “Very Important”.

<sup>185</sup> Reference was made to the GCC Arbitration Centre, and the initial administrative cost in taking up the case at the Centre was expensive.

### 6.5.6.2 *Shari'ah* Definition and Compliance

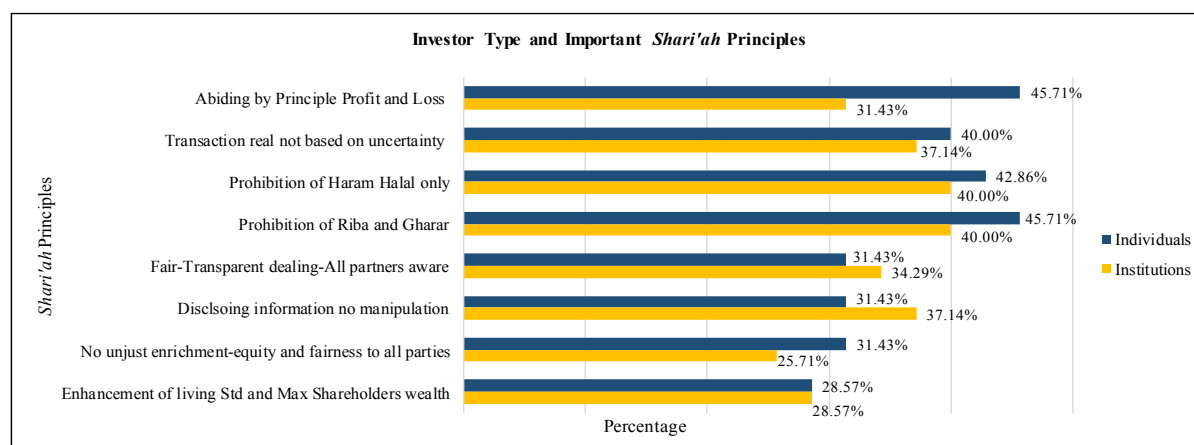
In order to obtain the investors' view of *Shari'ah* compliance, their understanding of what they defined as being *Shari'ah* compliant was first sought. This was an open question and Table 6.40 below summarises their responses. The responses provided were grouped into different categories as can be seen in the table. A few had a holistic/spiritual view and were not into the technical aspects and to some the technical aspects were part of their definition. While others provided a very broad definition in that it had to be in line with the *Shari'ah* principles, laws and standards. It is interesting to see that the financial/ratio matter was more part of the individual participants' definition than that of the institutions. However, the majority (8 - individuals, 7 - institutions) relied on the *Shari'ah* Supervisory Board's (SSB) approval, and as commented by a participant, once the *Fatwa* is given, it was not disputed and they did not go into the details. Moreover, with regards to dependence on the SSB, an institutional participant observed that even though they relied on the SSB, at times, the English version of the *Fatwa* differed from the Arabic version. Moreover, the individual participants who had a holistic view thought that since the whole economy was based on *riba*, it would be unavoidable, especially when finance/leverage is required to maintain the technical/ratio aspect. Furthermore, two of the participants who provided a broad definition also commented on the side that anything *Shari'ah* is usually related to excessive fees and margins and is more related to the benefit of the structuring entity than the investor.

**Table 6.40 - Investor Type and Investor *Shari'ah* Definition**

Investor Type	Descriptive Statistics	<i>Shari'ah</i> Definition as per Investor							Total
		Holistic Non-Technical/ <i>Sharia'h</i> Spirit/Ethical	Four Prohibits- Riba, Haram, Gharar, Gambling	Financial-Ratio & Profit/Loss	Islamic Product	Social-Adds Value	<i>Shari'ah</i> Supervisory Board Approval/Overseen	<i>Shari'ah</i> Principles/ Law/ Standards (did not elaborate)	
Individuals	Count	3	2	5	1	2	8	5	18
	% of Total	8.57%	5.71%	14.29%	2.86%	5.71%	22.86%	14.29%	51.43%
Institutions	Count	1	3	1	0	1	7	7	17
	% of Total	2.86%	8.57%	2.86%	0.00%	2.86%	20.00%	20.00%	48.57%
Total	Count	4	5	6	1	3	15	12	35
	% of Total	11.43%	14.29%	17.14%	2.86%	8.57%	42.86%	34.29%	100.00%

Participants were given a set of *Shari'ah* principles and had to select the most important *Shari'ah* principle(s) from their point of view. The list of principles provided are those represented in the vertical axis in Figure 6.14 below. The views of both groups are mostly similar, with a slight variation on some of the principles. The major difference was in abiding to the principle of profit and loss (the sharing principle) and the prohibition of *Riba*, which appears to be a more important principle to the institutional participants. While to the individual participants, transparency and all partners being aware of their rights, along with disclosure, was slightly more important to them.

**Figure 6.14 - Important *Shari'ah* Principles as per Investor's Point of View**



Before looking into how the participants follow-up on whether the investments are *Shari'ah* compliant, they were asked what happens when the IPE investment is no longer *Shari'ah* compliant. It was an open-ended question and the responses were gathered and grouped into categories, as can be seen in Table 6.41 below. Four of the participants did not respond to this question: two from each group of investors. There appears to be a difference in thoughts between the two groups of participating investors. The institutional participants' thoughts were mainly between giving the FI a chance to correct the non-compliance and/or exiting the investment (8 participants) and referring to the SSB for advice (5 participants). While the individual participants' thoughts were between no action (6 participants), and exiting and purifying the income (4 participants). Some of the participants opting for exiting and purifying commented that they expected their investment principle to be returned. Furthermore, some of those who thought of no action were of the view that they are unable to do anything on their own, and would need the support of other LPs, while others felt they were locked in until the end of the investment period. While some considered that they had entered with the intention of it being *Shari'ah* compliant and so would continue. In addition, for some participants it did not matter since they were conventional investors and the profitability of the business was more important.

**Table 6.41 - Investor Type and What Happens When *Shari'ah* Non-Compliant**

Investor Type	Descriptive Statistics	What happens when shari'ah non-compliant					Total
		Correct and Exit- Exit	Exit and Purify income	SSB advice	No action-Just means non-compliant	No idea	
<b>Individuals</b>	Count	2	4	2	6	1	15
	% of Total	6.45%	12.90%	6.45%	19.35%	3.23%	48.39%
<b>Institutions</b>	Count	8	3	5	1	0	16
	% of Total	25.81%	9.68%	16.13%	3.23%	0.00%	51.61%
Total	Count	10	7	7	7	1	31
	% of Total	32.26%	22.58%	22.58%	22.58%	3.23%	100.00%

Participants were then asked about how they ensure *Shari'ah* compliance throughout the investment. This was an open-ended question and the responses were grouped as can be seen in Table 6.42 below. One individual participant did not provide a response. It appears that the majority of participants (70.59%) relied on the SSB and/or the *Shari'ah* audit report. However, quite a few individual participants (14.71%) claimed that they did not receive the *Shari'ah* report and for some it was not possible to follow up on the *Shari'ah* compliance matter and they relied on the SSB of the investee or the FI's management. Some also relied on both the SSB and the FI's management (one institution and one individual). With regards to others, it was that the participant relied on the fact that since the FI was licensed as Islamic it would only invest in *Shari'ah* compliant investments, or that once the initial *Shari'ah* screening was done prior to investing it was not followed up thereafter. In another case, the participant relied on the instructions/policies in ensuring *Shari'ah* compliance, set by the FI at the time of investment. While to another participant, there was no set method as it depends on the investment instrument. Moreover, even when *Shari'ah* reports were not received, one individual participant indicated that being a direct investor, the investment manager was able to monitor compliance due to the form of partnership.

**Table 6.42 - Investor Type and Ensuring Maintaining *Shari'ah* Compliance**

Investor Type	Descriptive Statistics	Ensure Maintaining <i>Shari'ah</i> Compliance					Total
		SSB and or <i>Shari'ah</i> Audit Report	Relay on IFI Management	Follow-up From Time to Time on Operational Activities	Don't get Audit reports	Other	
<b>Individuals</b>	Count	11	6	0	5	3	17
	% of Total	32.35%	17.65%	0.00%	14.71%	8.82%	50.00%
<b>Institutions</b>	Count	13	2	2	0	2	17
	% of Total	38.24%	5.88%	5.88%	0.00%	5.88%	50.00%
Total	Count	24	8	2	5	5	34
	% of Total	70.59%	23.53%	5.88%	14.71%	14.71%	100.00%

The participants were then asked if they were aware that the investment is overseen by a SSB and also if they had perceived at any time during the investment that the investment project faced any ethical and/or legal issues. Their responses to both questions were cross tabulated and summarised in Table 6.43 below. The majority of the participants (71.43% or 25 participants) were fully aware that the investment was overseen by a SSB. Of those only 14.29% (5 of the 25 fully aware participants) perceived that the investment had faced some unethical issues and 8.57% (3 of the 25 fully aware participants) are of the view that the investment might have undergone both unethical and legal issues. While some participants (22.86% or 8 participants) were somewhat aware that the investment was overseen by a SSB, of which a few had seen either unethical issues (2 of the 8 somewhat aware participants), or illegal issues (1 of the 8 somewhat aware participants), or both (2 of the 8 somewhat aware participants). There was one participant who was not aware of whether SSB was overseeing the investment and another had no idea. Furthermore, although the participant was unaware about the supervision of SSB, he perceived during the investment that it faced some unethical issues. With regards to the issues that the participants had perceived as being unethical/illegal, they noted that there were some cases when the FI was taking excessive risks in some IPE products; while some noted that due to lack of investments, some invested businesses were not following entirely Islamic principles (such as carrying conventional debt, non-halal products on the premises). There were those that considered it unethical that the FI had not disclosed the charges it had charged the investors (which they had discovered after investing), and that they were excessive in value and taken upfront, regardless of whether the investment was successful or not. Furthermore, a comment was also made by a participant that at times the SSB, after having initially signed off the investment, was not aware of what happened to the investment thereafter.

**Table 6.43 - Aware Investment Overseen by SSB and Perceptive to Ethical and/or Legal Issues**

Aware Investment Overseen By SSB	Descriptive Statistics	Perceptive to Ethical and/or Legal Issues				Total
		Unethical Issues	Illegal Issues	Both	None	
<b>Fully Aware</b>	Count	5	0	3	17	25
	% of Total	14.29%	0.00%	8.57%	48.57%	71.43%
<b>Somewhat Aware</b>	Count	2	1	2	3	8
	% of Total	5.71%	2.86%	5.71%	8.57%	22.86%
<b>Not Aware</b>	Count	1	0	0	0	1
	% of Total	2.86%	0.00%	0.00%	0.00%	2.86%
<b>No Idea</b>	Count	0	0	0	1	1
	% of Total	0.00%	0.00%	0.00%	2.86%	2.86%
<b>Total</b>	Count	8	1	5	21	35
	% of Total	22.86%	2.86%	14.29%	60.00%	100.00%

## 6.6 REGULATORY REQUIREMENTS

In order to get an idea of the participants' awareness of the regulatory requirements<sup>186</sup> and their opinion on the level of enforcement, the participants (of all three groups) were asked if they were aware if the FI/GP had any requirements to meet. The outcome of their responses has been summarised in Table 6.44 below. A 3-point Likert scale was provided and the weighted score was calculated. It appears that 50.00% are "Fully Aware" and 30.00% of the participants are "Somewhat Aware", with the institutional participants being more aware than the individual and conventional participants (11 - institutional, 7 - individual, 7 - conventional). Close to half of the individuals (7 participants) were "Not Aware" of any regulatory requirements, while only one institution and two conventional were not aware. The Kruskal-Wallis H test that was conducted showed that there was no statistically significant difference in the awareness of the regulatory requirements that the FI had to meet, between the three groups of investors,  $H(2) = 4.228, p = 0.121$ .

**Table 6.44 - Investor Type and Awareness of Whether FI have Regulatory Requirements**

Investor Type	Descriptive Statistics	FI have Regulatory Requirements			Weighted Score-a	Median
		Fully Aware	Somewhat Aware	Not Aware		
<b>Individuals</b>	Count	7	4	7	2.00	2.00
<b>Institutions</b>	Count	11	5	1	2.59	3.00
<b>Conventional</b>	Count	7	6	2	2.33	2.00
Total	Count	25	15	10		
	% Total	50.00%	30.00%	20.00%		
Kruskal Wallis					H (2)	p
					4.228	0.121

a-To calculate the weighted score, scores were allocated in descending order from 3 to 1 with 3 to "Fully Aware" to 1 "Not Aware".

None of those who invested in CPE made any comments. Of those that invested in IPE, one of the participants, although not aware, thought that since the FI is a financial institution it must fall under the supervision of the Central Bank. Another noted that there were no regulations as such, as some regulators look at matters from a commercial perspective rather than a regulatory perspective, and other regulators might pretend to have regulatory requirements, but actually they do not. While another participant, who stated full awareness, commented that there were no Islamic requirements (those related to *Shair'ah* compliance) for the GP to meet, but there were other regulatory requirements.

<sup>186</sup> Part of research questions A.

Participants were then asked about their views on how effectively the regulatory requirements were enforced. There responses were summarised in Table 6.45 below. Three participants did not provide a response. The responses were based on a 3-point Likert scale and the weighted score was calculated. It appears that the individuals and conventional have similar views “Somewhat Enforced” with a count of 6 and 7 respectively. While institutions (9) are of the view that they are “Fully Enforced”. Furthermore, almost half of the individual (8) participants did not have an idea, while only 2 institutions and one conventional did not have an idea if the regulations were effectively enforced. A comment made by one of the individual “Somewhat Enforced” group of participants was that they relied on the auditor’s report. In the sense that if the auditor’s report had been given clearance then it is the assumption that they have fully gone through the requirements indicating enforcement. The Kruskal-Wallis H test that was performed revealed that there is a statistically significant difference in the views on effective enforcement score between the three groups of investors  $H(2) = 6.13, p = 0.047$ .

**Table 6.45 - Investor Type and Regulatory Requirements Effectively Enforced**

Investor Type	Descriptive Statistics	Regulatory Requirements Effectively Enforced				Weighted Score-a	Median
		Fully Enforced	Somewhat Enforced	Not Enforced	No Idea		
<b>Individuals</b>	Count	4	6	0	8	2.33	3.00
<b>Institutions</b>	Count	9	5	0	2	3.31	4.00
<b>Conventional</b>	Count	4	7	2	1	3.00	3.00
Total	Count	17	18	2	11	48	
	% of Total	35.42%	37.50%	4.17%	22.92%	100.00%	
Kruskal Wallis						H (2)	p
						6.129	0.047

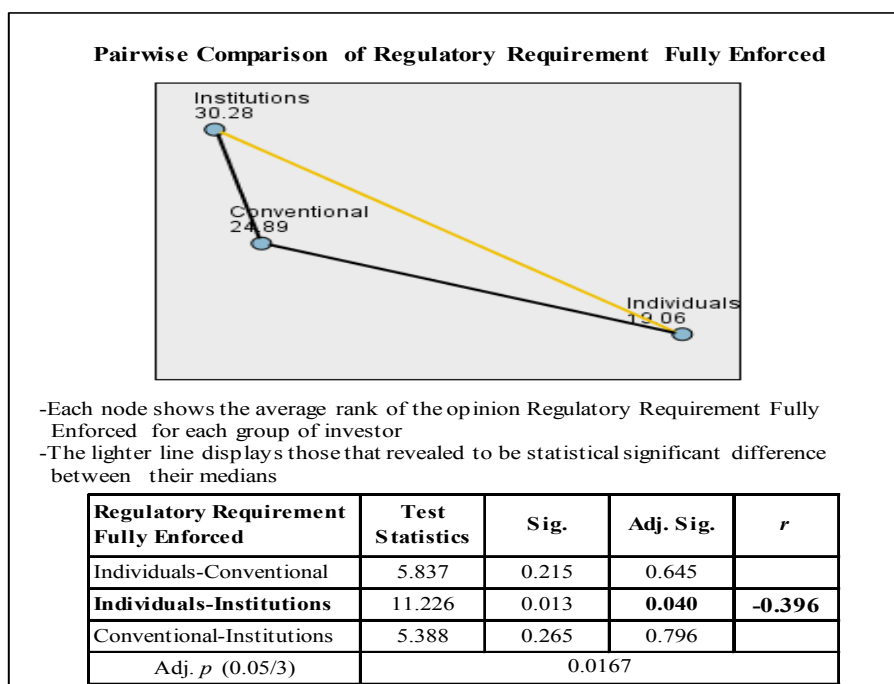
a-To calculate the weighted score, scores were allocated in decesndng order from 4 to 1 with 4 to "Fully Enforced" to 1"“No Idea”.

Accordingly, a post hoc pairwise comparison analysis was performed (Figure 6.15), using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons. Statistical significance was accepted at the  $p < 0.0167$ . This post hoc analysis revealed there to be a difference in the median of individuals (3.00) and institutions (4.00), with a medium size effect<sup>187</sup>, ( $p = 0.040, r = -0.396$ ). However, it was not statistically accepted,  $p > 0.0167$ .

<sup>187</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.



Figure 6.15 - Post Hoc Test on Regulatory Requirement Fully Enforced



Participants were also asked if there were any regulatory requirements they had to meet/abide by. This was an open question, and the responses (three participants did not respond) were grouped as can be seen in Table 6.46 below. (31.25%) of the participants reported that there were no requirements. Of the individual participants (whether invested in IPE or CPE) that had, they were mainly “Know Your Client” (KYC), Anti-Money Laundering (AML), Tax (FATCA), and Citizenship requirements. While with regards to the institutions (whether invested in IPE or CPE), as an institution their requirement varied depending on the jurisdiction and the regulator of that jurisdiction and what industry they were in. Examples of Entity Verifications<sup>188</sup> were: entity registration, articles of associations, and board resolutions to invest.

<sup>188</sup> This is background verification on the entity entering the investment (similar to KYC on individual).

**Table 6.46 - Investor Type and Regulatory Requirement on Investor**

Investor Type	Descriptive Statistics	Regulatory Requirement on Investor				Total
		KYC-AML-Tax-Citizenship	Regulator-Jurisdiction-Industry	Entity Verifications	Nothing	
<b>Individuals</b>	Count	8	2	1	8	18
	% of Total	16.67%	4.17%	2.08%	16.67%	37.50%
<b>Institutions</b>	Count	2	6	3	6	17
	% of Total	4.17%	12.50%	6.25%	12.50%	35.42%
<b>Conventional</b>	Count	9	5	1	1	13
	% of Total	18.75%	10.42%	2.08%	2.08%	27.08%
<b>Total</b>	Count	19	13	5	15	48
	% of Total	39.58%	27.08%	10.42%	31.25%	100.00%

## 6.7 MEETING EXPECTATIONS AND FUTURE PLANS

Participants were asked if their experience of investing in PE had met their expectations in the following areas: on the procedures and FI approach, on the risk and returns, on the trust in the FI/GP, and on the *Shari'ah* purposes and *Shari'ah* compliance (for those that invested in IPE). Table 6.47 below summarises their responses. The range of responses provided to participants for each category were: “All”, “Some”, “Few” and “None” had met their expectations. As per the weighted score calculated, the average for the Procedures-Approach category is the same for all groups of investors (approx. 3 or “Some”). The expectations of participants of individuals appear to be spread across “All” to “None” on risk/return, while institutions (7) were more to “Few” and conventional were more inclined to “Some” (9). However, they seem to differ slightly when it comes to FI/GP trust. The institutional participants’ expectations (6) appear to be greater than the individuals’ (4), while the conventional (6) were more on Few. Moreover, no institutional participant selected “None”, indicating that at least some of their expectations were met. While this was not the case with the individual and conventional participants. There were 2 to 4 individual participants, and one conventional that said their expectations were not met at all (in all categories for individuals and on FI/GP trust for conventional). With regards to expectations meeting *Shari'ah* purposes/compliance, it appears to mostly range between “All” (9 - individual, 9 - institutions) to “Some” (5 - individuals, 7 - institutions). Although *Shari'ah* compliance appears to have met over half of the participants’ expectations, it is not something that they obsess about and rely on the assurance of the SSB and the SSB’s conscience as commented by an individual participant. The Kruskal-Wallis H test that was conducted showed that there was no statistically significant difference in the expectations between the three (two for *Shari'ah*) groups of investors in all of the categories. The results are tabulated in Table 6.47.

**Table 6.47 - Investor Type and Investment Meeting Expectations**

Investment Meet Expectation on	Investor Type	Descriptive Statistics	Investment Meet Expectations on Procedures-Approach				Weighted Score-a	Median
			All	Some	Few	None		
Procedures-Approach	Individuals	Count	4	9	3	2	2.83	3.00
		% of Total	7.84%	17.65%	5.88%	3.92%		
	Institutions	Count	4	8	5	0	2.94	3.00
		% of Total	7.84%	15.69%	9.80%	0.00%		
	Conventional	Count	4	7	5	0	2.94	3.00
		% of Total	7.84%	13.73%	9.80%	0.00%		
Total		Count	12	24	13	2	51	
		% of Total	23.53%	47.06%	25.49%	3.92%	100.00%	
Kruskal Wallis						H (2)	p	
						0.033	0.984	
Risk-Return	Individuals	Count	4	5	5	4	2.50	2.50
		% of Total	7.84%	9.80%	9.80%	7.84%		
	Institutions	Count	5	5	7	0	2.88	3.00
		% of Total	9.80%	9.80%	13.73%	0.00%		
	Conventional	Count	4	8	4	0	3.00	3.00
		% of Total	7.84%	15.69%	7.84%	0.00%		
Total		Count	13	18	16	4	51	
		% of Total	25.49%	35.29%	31.37%	7.84%	100.00%	
Kruskal Wallis						H (2)	p	
						2.153	0.341	
IFI-GP Trust	Individuals	Count	4	8	3	3	2.72	3.00
		% of Total	7.84%	15.69%	5.88%	5.88%		
	Institutions	Count	6	5	6	0	3.00	3.00
		% of Total	11.76%	9.80%	11.76%	0.00%		
	Conventional	Count	4	5	6	1	2.75	3.00
		% of Total	7.84%	9.80%	11.76%	1.96%		
Total		Count	14	18	15	4	51	
		% of Total	27.45%	35.29%	29.41%	7.84%	100.00%	
Kruskal Wallis						H (2)	p	
						0.688	0.709	
Shari'ah Purpose-Compliance	Individuals	Count	9	5	1	3	3.11	3.50
		% of Total	25.71%	14.29%	2.86%	8.57%		
	Institutions	Count	9	7	1	0	3.47	4.00
		% of Total	25.71%	20.00%	2.86%	0.00%		
Total		Count	18	12	2	3	35	
		% of Total	51.43%	34.29%	5.71%	8.57%	100.00%	
Kruskal Wallis						H (1)	p	
						0.405	0.524	

a-To calculate the weighted score, scores were allocated in decesding order from 4 to 1 with 4 to "All" to 1 "None".

Participants were then asked if they would continue to invest in IPE and were given the following choices to select from: "Plan to Continue", "Undecided" and "No Plans to Continue". As can be seen

in Table 6.48 below, more than half (72.55% collectively: 19.61% - individuals and 25.50% institutions, 27.45% - conventional) plan to continue investing in IPE/CPE. There are those that are undecided; more individual participants (5) than the institutional (3) and conventional (2) participants. While 3 individuals and one institution do not plan to continue.

Many of the participants that invested in IPE (individual and institutions group) and that plan to continue had commented that IPE: offers an alternative form of investment, is an ethical way of investment and for some it is their core business. Those that were undecided observed that whether they would continue or not depends on the market, sector, and industry conditions. Some others would continue with smaller allocations and be more selective in the investment opportunities. Of those that do not plan to continue, they noted that they felt that the regulations and the legal system were not supportive enough from their experience. One of the participants considers that although the regulations might be in line with international standards, they do not provide the support needed to the investment environment, the economy or the investor. While those that invested in CPE (conventional group) and plan to continue commented that PE is a lucrative business, with a lot of potential, and the returns are superior compared to other asset classes, in addition to it offering greater flexibility in structuring the investment. One commented that although the results were mixed, the key to getting good rewards in PE is that the investments are made in a structured and systematic way. While another remarked that within the MENA region the only form of investment will be where he was a controlling shareholder, and he will not invest in any regional GP/LP investments. He will only consider GP/LP outside the region, with recognised GPs, with top performance and procedures. All comments made by the conventional group were by individuals, and by those who plan to continue.

**Table 6.48 - Investor Type and Going Forward Expect to Continue**

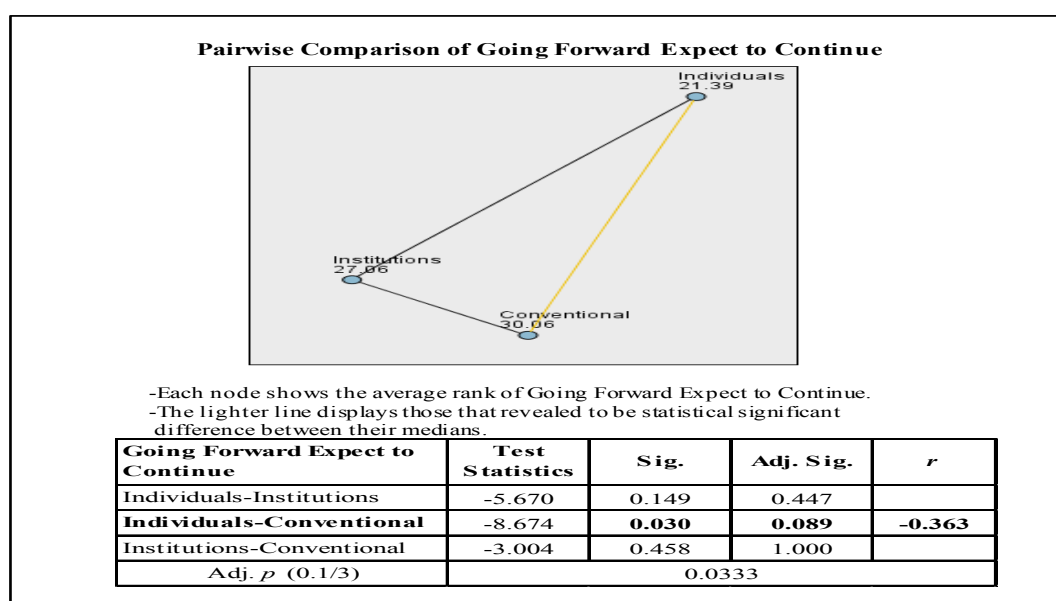
Investor Type	Descriptive Statistics	Going Forward Expect to Continue			Weighted Score-a	Median
		Plan to Continue	Undecided	No Plans to Continue		
<b>Individuals</b>	Count	10	5	3	2.39	3.00
	% of Total	19.61%	9.80%	5.88%		
<b>Institutions</b>	Count	13	3	1	2.71	3.00
	% of Total	25.49%	5.88%	1.96%		
<b>Conventional</b>	Count	14	2	0	2.88	3.00
	% of Total	27.45%	3.92%	0.00%		
Total	Count	37	10	4	51	
	% of Total	72.55%	19.61%	7.84%	100.00%	
Kruskal Wallis					H (2)	<i>p</i> *
					4.936	0.085

a-To calculate the weighted score, scores were allocated 3 to "Plan to Continue", 2 to "Undecided", and 1 to "No Plans to Continue".

\* At 10% Significant level

The Kruskal-Wallis H test that was performed revealed there to be a statistically significant difference in "Going Forward Expect to Continue" between the three groups of investors, at the 10% significance level,  $H(2) = 4.936, p = 0.085$ . Accordingly, a post hoc pairwise comparison was conducted (Figure 6.16), using Dunn's (1964) procedure with a Bonferroni correction for multiple comparisons. Statistical significance was accepted at  $p < 0.0333$ . Although, the post hoc analysis revealed there to be a difference between individuals (3.00) and conventional (3.00), with a medium size effect ( $p = 0.089, r = -0.363$ ), it was not statistically significantly accepted as  $p > 0.1$ .

**Figure 6.16 - Post Hoc on Going Forward Expect to Continue**



### 6.7.1 Pairwise of Meeting Expectations and Future Plans

With the above findings, it was decided to conduct a pairwise comparison of going forward plans with the investment meeting the participants' expectations of the four categories. In order to conduct a pairwise analysis, a Kruskal-Wallis H test was initially performed to determine if there were differences between the three options of future plans in continuing to invest, and in the investments meeting expectations. Then, the pairwise analysis was performed on those that resulted in there appearing to be a statistically significant difference between the medians of "Meeting Expectation" and "Going Forward Expect to Continue", to find out which option(s) was different from the other, by running a post hoc test.

Investment meeting expectation on "Procedures-Approaches", on "Risk-Return" and "*Shari'ah* Purpose-Compliance", across the options of "Going Forward Expect to Continue", showed there to be differences in the medians, across the 3 groups of investors. While there were no differences in the medians, in the investment meeting expectations on "FI-GP Trust". Thus, a post hoc test was run on those that showed differences.

#### a. Pairwise of Meeting Expectations on Procedures-Approach and Future Plans

The Kruskal-Wallis H test that was run revealed that the distribution of investment meeting expectations on "Procedures-Approach" was similar for all groups, and the "Going Forward Expect to Continue" median scores were statistically significantly different between groups,  $H(2) = 7.844, p = 0.020$ . As such, pairwise comparisons were then performed using Dunn's (1964) procedure with a Bonferroni correction for multiple comparisons (Figure 6.17). Statistical significance was accepted at the  $p < 0.0167$ .<sup>189</sup> Although the post hoc analysis revealed there to be a difference in the median of expecting to continue scores between the "No Plan to Continue" (1.50) and "Plan to Continue" (3.00), with a medium size effect<sup>190</sup> ( $p = 0.028, 0.382$ ) of the expecting to continue groups, yet it was not statistically significantly accepted,  $p > 0.0167$ .<sup>191</sup>

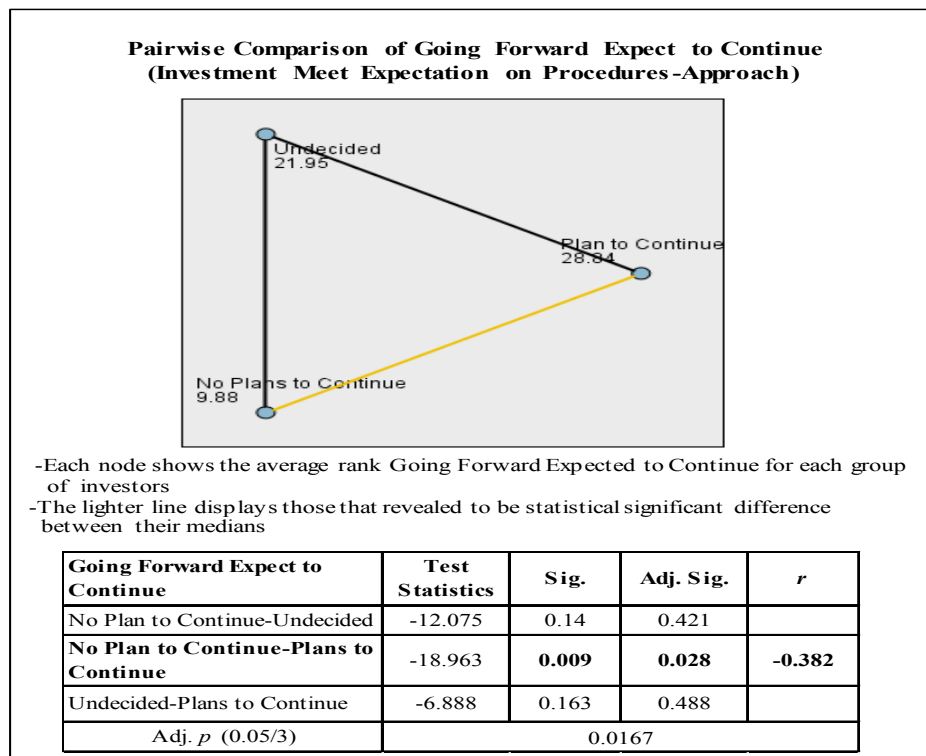
---

<sup>189</sup>  $P$  is adjusted for multiple comparisons. Hence in this case there are 3 groups, so  $p = 0.05/3 = 0.0167$ .

<sup>190</sup> Using Cohen's (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

<sup>191</sup> The difference between Plan to Continue and No Plans to Continue ( $p = 0.028, r = 0.382$ ) could be accepted at 10% significance,  $p < 0.0333$ .

**Figure 6.17 - Post Hoc Test on the Distribution of Investment Meets Expectations on Procedures-Approach Across the Categories of Going Forward Expect to Continue**



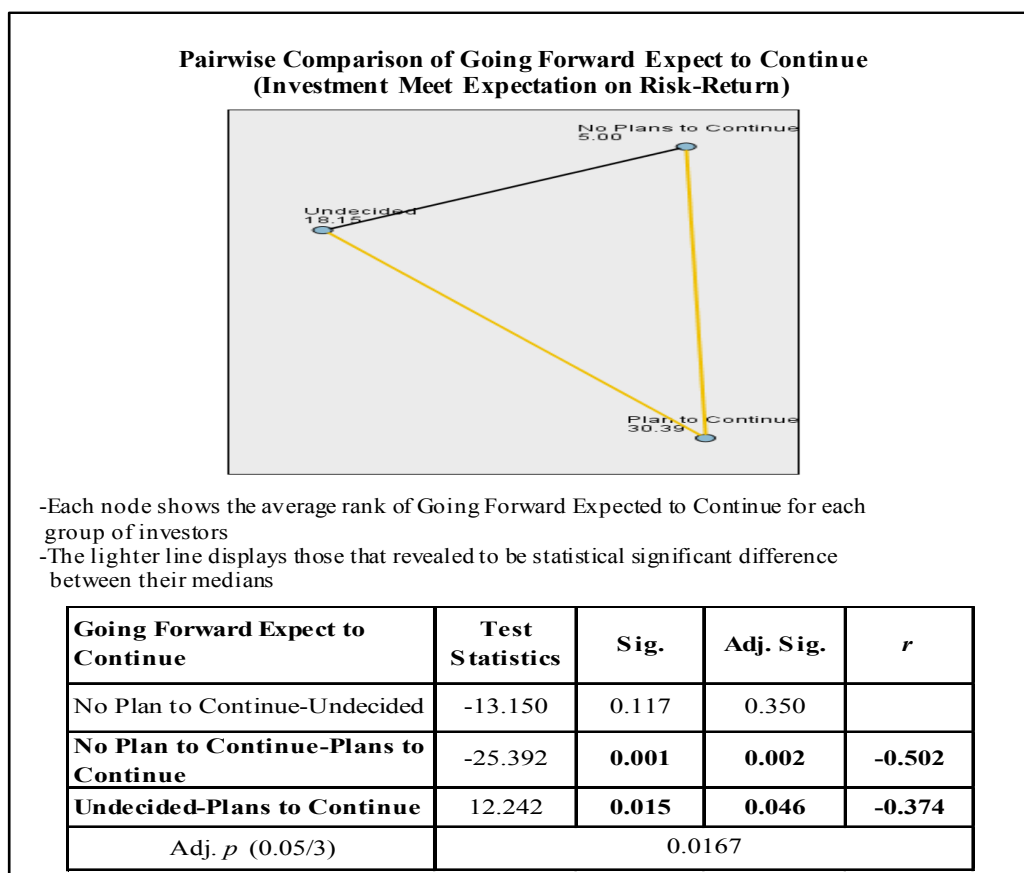
### b. Pairwise of Meeting Expectations on Risk-Return and Future Plans

The Kruskal-Wallis H test that was run revealed that the distribution of investment meeting expectations on “Risk-Return” was similar for all groups, and the “Going Forward Expect to Continue” median scores were statistically significantly different between groups,  $H(2) = 15.410$ ,  $p < 0.0005$ .

As such, pairwise comparisons were then performed using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons (Figure 6.18). Statistical significance was accepted at the  $p < 0.0167$ . This post hoc analysis revealed there to be a difference in the median of expecting to continue scores between the “No Plan to Continue” (1.00) and “Plan to Continue” (3.00), with a large size effect<sup>192</sup> ( $p = 0.002$ ,  $r = -0.502$ ) and “Undecided” (2.00), with a medium size effect ( $p = 0.046$ ,  $r = -0.374$ ) of the expecting to continue groups, but not between the “Undecided” group (2.00) or any other group combination. However, only the difference between “No Plan to Continue” and “Plans to Continue” was statistically significantly accepted,  $p < 0.0167$ .

<sup>192</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

Figure 6.18 - Post Hoc Test on the Distribution of Investment Meets Expectations on Risk-Return Across the Categories Going Forward Expect to Continue



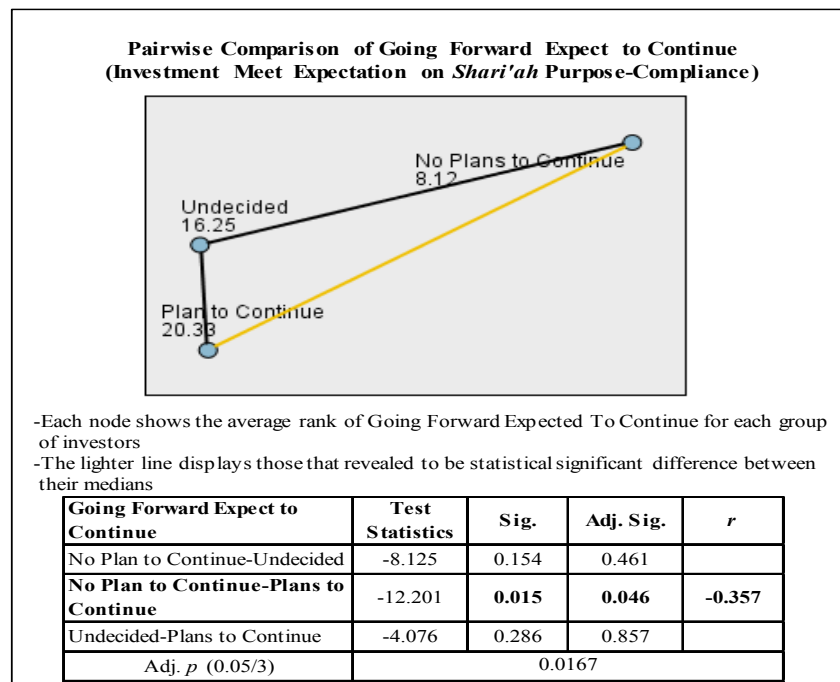
### c. Pairwise of Meeting Expectations on Shari’ah Purpose-Compliance and Future Plans

The Kruskal-Wallis H test that was run revealed that the distribution of investment meeting expectations on “Shari’ah Purpose-Compliance” was similar for all groups, and the “Going Forward Expect to Continue” median scores were statistically significantly different between groups,  $H(2) = 6.233, p = 0.044$ . As such, pairwise comparisons were then performed using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons (Figure 6.19). Statistical significance was accepted at the  $p < 0.0167$ . This post hoc analysis revealed there was a difference in the median of expecting to continue scores between the “No Plan to Continue” (1.00) and “Plan to Continue” (4.00), with a medium size effect<sup>193</sup> ( $p = 0.046, r = -0.357$ ) of the expecting to continue groups, however, it was not statistically significant,  $p > 0.0167$ .

<sup>193</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.



**Figure 6.19 - Post Hoc Test on the Distribution of Investment Meets Expectations on *Shari'ah* Purpose-Compliance Across the Categories Going Forward Expect to Continue**



### 6.7.2. Form of Investment Going Forward

Participants were asked going forward, what their preferred form of investment would be. The options of responses provided were the same as those put forward at the beginning of the questionnaire, to identify the form of investment they had carried out when they invested in IPE/CPE. Some participants selected more than one form of investment. The responses are summarised in Table 6.49 below. It appears that all groups of investors have a similar order of preference: “Direct Equity” (11 - individuals, 15 - institutions, 11 - conventional), followed by “Indirect Equity” (7 - individuals, 6 - institutions, 9 - conventional), followed by “Limited Partnership (LP)” (6 - individuals, 1 - institutions, 5 - conventional). However, individual participating investors seem to be more inclined towards LP, and conventional more towards “Funds of Funds”, while institutions are more towards Direct Equity. Funds of Funds was the least preferred for both individual and institution groups. Moreover, one individual does not plan to invest going forward but all conventional and institutions plan to do so. As one institutional investor commented, it is part of their business.

**Table 6.49 - Investment Initially Carried Through and Investment Going Forward Cross-tabulation Across Type of Investor**

Investment Carried Through Initially	Investor Type	Descriptive Statistics	Investment Going Forward					Total Investment Carried Through Initially	% of Going Forward Form to Investment Carried Through Initially
			Direct Equity Investment-Fwd	Indirect Equity Investment-Fwd	Private Equity Funds of Funds-Fwd	Limited Partnership-Fwd	Not investing-Fwd		
Direct Equity Investment	Individuals	Count	8	5	0	5	1	12	
	Institutions	Count	11	5	1	1	0	13	
	Conventional	Count	11	8	3	3	0	12	
	Total	Count	30	18	4	9	1	37	81.08%
Indirect Equity Investment	Individuals	Count	4	6	0	5		8	
	Institutions	Count	8	3	1	1		9	
	Conventional	Count	9	9	4	3		12	
	Total	Count	21	18	5	9		29	62.07%
Private Equity Fund of Fund	Individuals	Count	1	1	2	2		4	
	Institutions	Count	3	2	1	1		4	
	Conventional	Count	4	4	3	3		5	
	Total	Count	8	7	6	6		13	46.15%
Limited Partnership	Individuals	Count	4	4	0	5		6	
	Institutions	Count	3	2	1	0		4	
	Conventional	Count	6	5	3	5		9	
	Total	Count	13	11	4	10		19	52.63%
	Total Investment Going Forward	Total	37	22	7	12	1	Total Investor	
	Individuals	Count	11	7	2	6	1		18
	Institutions	Count	15	6	1	1	0		17
	Conventional	Count	11	9	4	5	0		16

A comparison was done between the form of investment the participating investors carried out for their investment earlier and their going forward preference for investment. Table 6.49 (above) summarises the outcome of the cross-tabulation. It appears that of the 37 participants that invested initially in Direct Equity, 30 of them plan to continue investing in the same way, while others plan to invest in other forms and one individual has no intention of investing in Direct Equity going forward. With regards to Indirect Equity investment (investing through SPV), 18 of the initial 29 (62.07%) participants plan to continue in the same way, while only 10 of the 19 initial participants (52.63%) plan to continue investing in the LP form. And only 6 of the initial 13 participants (46.15%) of the Funds of Funds plan to continue in the same form of investment.

As per the comments made by IPE investors (individuals and institutions groups), the majority of the preference is towards direct and indirect investments. Preference towards these investments provides them with some form of control over the investment and they get to see where their money is going. It was more of a say in the decision making rather than managing the business. Especially for those who did not have a *Shari'ah* investment team, or when their investment team was small, or the business of investment requires specific knowledge. Many of the Institutions were interested in partnering with

founders, to share the risk and help them grow, which will help build an effective Islamic investment industry and thus create more choices within the Islamic family of investments. While others, due to their size, wanted to share the risk but did not want to pay the large fees and thus prefer to invest directly. While for an institution, it was clear that as an investor they preferred to invest directly, but when it came to offering it to their clients they preferred to offer it indirectly. Moreover, the comments made by CPE investors (conventional) were, in addition to the control over direct and indirect forms of investment offered, that these forms of investment were also better in fee structure than in investing in the funds of funds. Furthermore, one investor noted (as mentioned earlier) that investing in the region would be direct through a controlling stake, and his interest in LP lies outside the MENA region.

## **6.8 PRIVATE EQUITY INDUSTRY GOING FORWARD**

This section looks into the investors' views on the private equity (PE) industry in general and how to take IPE/CPE forward. Their views on whether investing in PE had any public consequences and if it had any indirect systemic impact were sought. Their thoughts on what they saw as the key issues facing IPE/CPE were also questioned. In addition to what they thought, going forward, would be the best way to handle the IPE/CPE industry.

### **6.8.1 Private Equity Impact on the Market**

Participants were provided with a selection of responses to select from. Table 6.50 summarises the participating investors' views. Some selected more than one option, and one participant (conventional) did not respond. As can be seen from the table below, most of the participants thought that the PE form of investment had some kind of effect on the market and hence the economy. The main consequence was that it was another form of providing liquidity/finance to the market parallel to banks and market exchanges with 28.00% of the individual participants and 30.00% of each of the institution and conventional participants having that view. The next consequence was that the shortfall in the protection of investors and investor losses in PE could affect the liquidity in the market. More individual (28.00%) and conventional (22.00%) participants than institutions (18.00%) had such a view. The participants (20.00% of individuals, 18.00% of institutions, and 20.00% conventional) also thought that investors' losses through PE investment could indirectly affect individual savers and the wider public. Only one institution did not think that investing in PE had any consequences for the market.

Of those participants that selected “Other”, the comments made by the IPE group of investors was that it was another way of creating money and that PE was an appropriate asset class for start-ups and developing companies as well as longer-term business models, such as real estate projects. This is true, especially since they did not have the constraint to report quarterly earnings, as listed companies have to. The only issue was the governance in PE companies is not as good as that in listed companies. It was suggested that this could be improved through imposing regulations, or be self-imposed by the company itself, or imposed by the PE investors. While the conventional (individual) participant that selected “Other” (in addition to having selected the other consequences) commented that with careful, prudent and ethical management, PE can improve the functioning of markets and economies and if not prudently and ethically done, it can have negative consequences and destroy economies.

**Table 6.50 - Investor Type and PE Impact**

Investor Type	Descriptive Statistics	PE Indirectly Systemic Impact					Total
		Another Form of providing Liquidity-Finance	Shortfall Investor Protection and Losses Imapcts Liquidity	Investor Losses Indirectly Effects Individual Saver and Public	None	Other indirect Systemic Impact	
<b>Individuals</b>	Count	14	14	10	0	1	18
	% of Total	28.00%	28.00%	20.00%	0.00%	2.00%	36.00%
<b>Institutions</b>	Count	15	9	9	1	1	17
	% of Total	30.00%	18.00%	18.00%	2.00%	2.00%	34.00%
<b>Conventional</b>	Count	15	11	10	0	1	15
	% of Total	30.00%	22.00%	20.00%	0.00%	2.00%	30.00%
Total	Count	44	34	29	1	3	50
	% of Total	88.00%	68.00%	58.00%	2.00%	6.00%	100.00%

## 6.8.2 Key Issues in IPE/CPE

Participants were asked what they thought the key issues were that IPE/CPE faced. For the analysis, the responses were ranked using a 4-point Likert scale from “Low Importance” to “Very Highly Important”, as can be seen in Table 6.51 below. For ease of identifying the importance between the three groups, the levels of importance were totalled (i.e. those with low importance and not important were not included in the total of importance) and the percentage was calculated based on the total responses for each group of investors under each key issue category. All key issues were considered important to all groups, achieving at least over 50% of the total responses for each key issue. However, the conventional participants appear to have achieved a higher percentage of importance than the institutional and individual participants in the following key issues: Transparency and Investor Communication (93.75%), Fees-Alignment of Interest (81.25%), and Economic Environment (81.25%). While the

institutional participants appear to have achieved a higher percentage of importance than individuals on the following key issues: Fees-Alignment of Interest (76.47%), FI/GP Management (76.47%), Liquidity (70.47%), Transparency and Investor Communication (70.59%), Regulations (70.59%), and Economic Environment (64.71%). While individuals' (83.33%) importance exceeded institutions' (64.71%) on the issue of valuation.

Of the eight participants that selected "Other", six participants (2 - individuals, 2 - institutions, 2 -conventional) also selected from the list of key issues provided. While only two (2 - individuals) selected only "Other" and nothing from the list of key issues. The other issues that were noted by the IPE group (individuals and institutions) were: resistance to *Shari'ah* compliance; ability to source sound deals in the region; limited number of investment opportunities; investors' knowledge of understanding; market research/knowledge, and exit. While the CPE group (conventional) noted: growth prospects of the target company and reputation of the institution they would be dealing with. Many conventional investors mentioned exit when they selected liquidity and valuations and commented that many investments have failed to exit due to liquidity issues and because either the information on price is only available to a few, or to initially having paid a high value for acquisition, due to the FI being under pressure to deploy funds. They also had concerns with regards to GPs, and being in the dark (as one described it as the Black Box). Elaborating that the investor is investing in an SPV, not getting involved in the investment, and after 5-7 years the investment has not yet matured and has been extended for another 2 years; while during that time the investor is getting quarterly NAVs without being told why and when the exit will happen. This ended with there are no clear regulations for GPs and PE funds.

The Kruskal-Wallis H test that was conducted showed that the distributions were similar and that there was no statistically significant difference in the views between the three groups of investors in all the key issues (with the exception of FI/GP Management and Regulations). The results are tabulated in Table 6.51. However, although the distribution of the views on the key issue scores for the three groups were similar, the Kruskal-Wallis H test showed there to be a statistically significant difference in the "FI/GP Management" between the median for individuals (0.50) and institutions (2.00), at the 5% significance level,  $H(2) = 6.794, p = 0.033$ ; and in the "Regulations" between the median for individuals (1.50) and institutions (3.00), at the 10% significance level,  $H(2) = 5.585, p = 0.061$ .

**Table 6.51 - Investor Type and Key Issues in PE**

Key Issues	Investor Type	Descriptive Statistics	Not Important	Low Importance	Important	Highly Important	Very Highly Important	Total Responses	Total of Importance (Important to V.H. Important)	% Total of Importance to Total Responses	Weighted Score-a	Median
Economic Environment	Individuals	Count	8	1	2	2	5	18	9	50.00%	2.72	2.50
	Institutions	Count	3	3	4	3	4	17	11	64.71%	3.12	3.00
	Conventional	Count	2	1	3	4	6	16	13	81.25%	3.69	4.00
	Total	Count	13	5	9	9	15	51	33	64.71%		
Kruskal Wallis											H (2)	p
											2.861	0.239
Valuation	Individuals	Count	3	0	3	5	7	18	15	83.33%	3.72	4.00
	Institutions	Count	4	2	2	7	2	17	11	64.71%	3.06	4.00
	Conventional	Count	1	1	5	1	8	16	14	87.50%	3.88	4.50
	Total	Count	8	3	10	12	17	51	39	76.47%		
Kruskal Wallis											H (2)	p
											3.452	0.178
Fees-Alignment of Interest	Individuals	Count	8	0	3	3	4	18	10	55.56%	2.72	3.00
	Institutions	Count	3	1	7	1	5	17	13	76.47%	3.24	3.00
	Conventional	Count	1	2	5	4	4	16	13	81.25%	3.50	3.50
	Total	Count	12	3	15	8	13	51	36	70.59%		
Kruskal Wallis											H (2)	p
											1.914	0.384
FI/GP Management**	Individuals	Count	9	2	3	4	0	18	7	38.89%	2.11	1.50
	Institutions	Count	3	1	5	4	4	17	13	76.47%	3.29	3.00
	Conventional	Count	2	3	5	4	2	16	11	68.75%	3.06	3.00
	Total	Count	14	6	13	12	6	51	31	60.78%		
Kruskal Wallis											H (2)	p
											6.794	0.033
Liquidity	Individuals	Count	6	1	2	1	8	18	11	61.11%	3.22	3.50
	Institutions	Count	3	1	3	3	7	17	13	76.47%	3.59	4.00
	Conventional	Count	2	2	4	2	6	16	12	75.00%	3.50	3.50
	Total	Count	11	4	9	6	21	51	36	70.59%		
Kruskal Wallis											H (2)	p
											0.256	0.880
Transparency & Investor Communication	Individuals	Count	6	1	2	5	4	18	11	61.11%	3.00	3.50
	Institutions	Count	5	0	1	5	6	17	12	70.59%	3.41	4.00
	Conventional	Count	0	1	1	10	4	16	15	93.75%	4.06	4.00
	Total	Count	11	2	4	20	14	51	38	74.51%		
Kruskal Wallis											H (2)	p
											2.808	0.246
Regulations **	Individuals	Count	6	3	3	4	2	18	9	50.00%	2.61	2.50
	Institutions	Count	2	3	0	5	7	17	12	70.59%	3.71	4.00
	Conventional	Count	3	4	4	3	2	16	9	56.25%	2.81	3.00
	Total	Count	11	10	7	12	11	51	30	58.82%		
Kruskal Wallis											H (2)	p*
											5.585	0.061

a-To calculate the weighted score, scores were allocated in ascending order from 1 to 5 with 1 to "Not Important" to 5 "Very Highly Important".

\* At 10% Significant Level

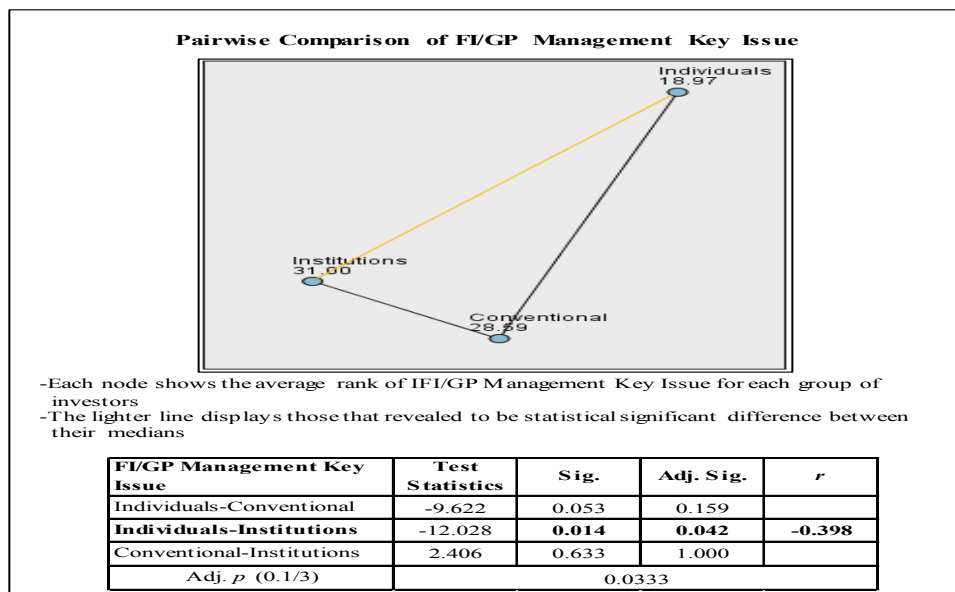
\*\* Although Kruskal Wallis Test conducted showed to there being a staisitcal significant difference, yet there appears to be no group of investors significantly different from the other.

Accordingly, post hoc pairwise comparisons were then performed using Dunn’s (1964) procedure with a Bonferroni correction for multiple comparisons (Figure 6.41 and Figure 6.42). Statistical significance was accepted at the  $p < 0.033$ .<sup>194</sup> The post hoc analysis revealed there to be a difference in the medians of “FI/GP Management” between individual (1.50) and institutions (3.00), with a medium size effect<sup>195</sup> ( $p = 0.042$ ,  $r = -0.398$ ), but the difference was not statistically significant,  $p > 0.033$  (Figure 6.20).

<sup>194</sup>  $P$  is adjusted for multiple comparisons. Hence in this case there are 3 groups at the 10% significance level, so  $p = 0.1/3 = 0.0167$ .

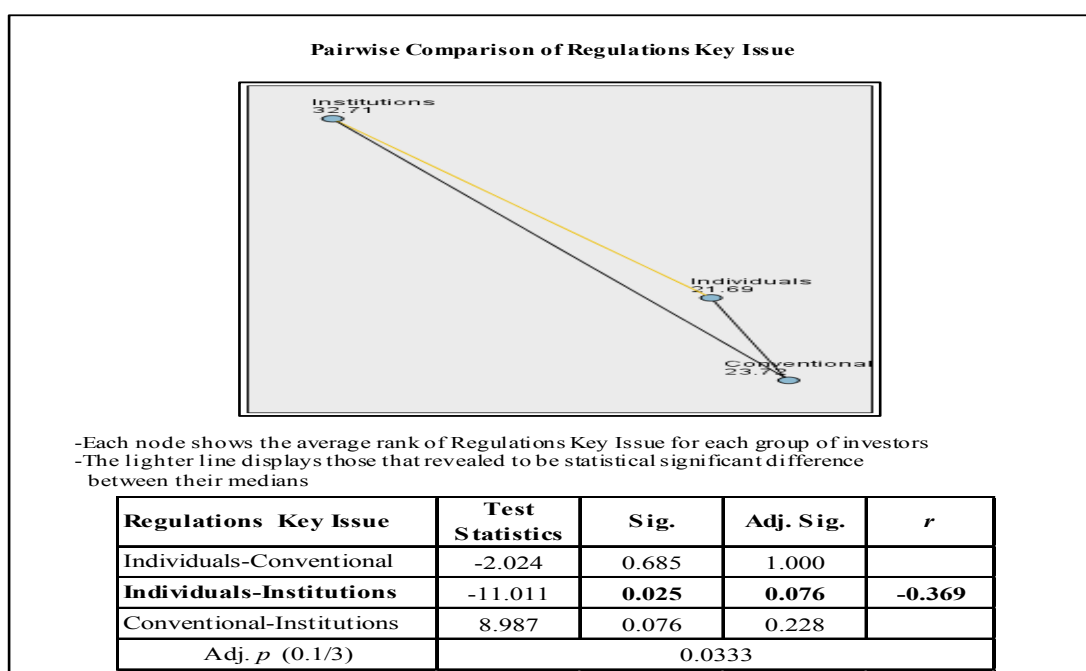
<sup>195</sup> Using Cohen’s (1988) criteria of 0.1=small effect, 0.3=medium effect, and 0.5=large effect.

Figure 6.20 - Post Hoc Test on the Distribution of FI/GP Management Key Issues



A similar outcome was revealed with pairwise analysis for “Regulations”. There was a difference in the medians between individuals (2.50) and institutions (4.00), with a medium size effect ( $p = 0.076$ ,  $r = -0.369$ ), but this was not statistically significant,  $p > 0.033$  (Figure 6.21).

Figure 6.21 - Post Hoc Test on the Distribution of Regulations Key Issue



### 6.8.3 Regulating IPE/CPE

Participants' views on how to handle the IPE/CPE market were sought by asking them whether it was beneficial to regulate the IPE/CPE market, who should regulate it and how to regulate it.<sup>196</sup>

#### 6.8.3.1 Beneficial to Regulate IPE/CPE Market

Participants were asked if they thought it was beneficial or not to regulate the IPE/CPE market prior to the investment stage and/or in the post-investment stage. Investors investing in IPE (individuals and institutions) were asked with regards to investing in the Islamic private equity market and the conventional investors were asked with regards to investing in the conventional private equity market. All the responses were collated into one table because the questions were basically the same. One conventional investor did not provide a response. Table 6.52 below summarises the participants' views. A cross-tabulation was performed to get an overall view of regulating pre- and post-investment. Overall, all groups appear to have a similar view, that it is beneficial to regulate pre- and post- investment.

**Table 6.52 - To Regulate Pre-Investment and To Regulate Post-Investment Cross-tabulation Across Investor Type**

To Regulate Post-investment	Individuals	Descriptive Statistics	To Regulate Pre-investment				Total	Weighted Score-a
			Beneficial to Industry	Not Beneficial to Industry	Unsure	No Idea		
<b>Beneficial to Industry</b>	Individuals	Count	12	0		1	13	3.77
	Institutions	Count	14	1		0	15	3.93
	Conventional	Count	10	0		0	10	4.00
	Total			36	1		1	38
<b>Not Beneficial to Industry</b>	Individuals	Count	2	0			2	4.00
	Institutions	Count	1	1			2	3.50
	Conventional	Count	0	3			3	3.00
	Total			3	4			7
<b>Unsure</b>	Individuals	Count		0	3		3	2.00
	Institutions	Count						
	Conventional	Count		1	1		2	2.50
	Total				1	4		5
<b>Total</b>	Individuals	Count	14	0	3	1	18	
	Institutions	Count	15	2	0	0	17	
	Conventional	Count	10	4	1	0	15	
	Total			39	6	4	1	50
Kruskal Wallis (To Regulate Pre-Investment)						H (2)	p	
						2.069	0.355	
Kruskal Wallis (To Regulate Post Investment)						H (2)	p	
						2.520	0.284	

a-To calculate the weighted score, scores were allocated 4 to "Beneficial to Industry", 3 to "Not Beneficial to Industry", 2 to "Unsure" and 1 to "No Idea".

<sup>196</sup> Part of research questions C.



Of the 39 participants (14 - individuals, 15 - institutions, 10 - conventional) who thought it was beneficial to regulate pre-investment, 38 (13 - individuals, 15 - institutions, 10 - conventional) of them also thought to was beneficial to regulate post-investment. It was interesting to see that all the pre-investment institutional and conventional investors also agreed on post-investment, unlike the individual participants, where they were more in favour of regulating pre-investment but not post-investment. There were also 4 unsure respondents (3 - individuals, 1 - conventional). Some of the individuals' hesitation was that it might be beneficial from the investors' perspective, but might not be in favour of the PE firms', which could lead them to re-locate to less regulated countries. Another issue was that having regulations could compromise the confidentiality of the firm's strategy. While one conventional (institution) was Unsure because PE investments are free from regulatory complications and to regulate contracts would be difficult as they vary in mandates and strategy.

Some of those investing in the IPE were of the opinion that if reporting was done clearly and quarterly, then there is no need to regulate post-investment. One participant, although they thought it was beneficial to regulate post-investment, had no idea with regards to pre-investment, in that the issue was not much about the agreement as it was the enforceability of post-agreement. In addition to being an effective monitoring system, it was not enough just to receive updates, and it is desirable that more is done by the regulator. On a similar concept, a participant thought that since each industry (of the investment opportunities) in itself is already regulated, pre-investment is not beneficial to regulate, while post is. There were those that thought regulations have to be balanced between regulating and the ease of doing business, and that too many regulations could negatively affect the growth of the industry. So it was beneficial to regulate pre-investment and leave post-investment to be regulated by having an effective enforcement, and a strong court and legal system. However, one of the participants commented that there appears to be a shortfall in the regulations, and the judicial system does not make up for it in both the courts and the arbitration system. Generally, those that were in favour of the regulations thought that it would have a positive effect on: investors' protection, investors' confidence, trust in the market, greater transparency, greater disclosure, more audit, reduce ambiguity, and bring in more controls/discipline to the market. They also thought that regulations were to be light, clear, address major issues and work towards standardisation. One of the participants who was in favour of regulating pre- and post-investment thought that although the investors of the IPE are supposed to be HNW and FI, the assumption is that they have the right knowledge to perform a proper risk assessment of the investment opportunities, which is not the case, especially in the GCC region. So having regulatory supervision and monitoring would assist in weeding out risky deals.

While those investing in CPE thought that it would comfort investors if they knew that best practices were being followed and issues related to investors' rights are appropriately addressed. However, there were conventional investors that did not think it was beneficial and commented that private equity transactions already require a significant amount of time and effort to execute and to regulate pre-investment would slow down the process, add cost and slow down the PE market. In addition to that, PE investments are offered to sophisticated investors and regulators do not have to worry with regards to protecting them as with retail consumers. Furthermore, the regulators cannot ensure the qualitative aspect of PE transactions, and if they could, it would mean that they are actually evaluating the transaction itself, which is beyond its scope and capabilities. They also had varying thoughts when it came to regulating post-investment. There were those that thought frontier markets need hand-holding as they develop and that regulations will add transparency, professionalism and maturity to the industry. While others thought the matter was more relevant to maintaining contractual obligations. Disclosure being the key factor, and to have requirements that regulate FI/GP on disclosing promptly and in the event that they do not do so, they could be subject to fraud. Such a system would require a clear and swift court process to deal with unjust cases. To those investors, it was not that to regulate what you can have or cannot have in the agreement, but to regulate to promote disclosure and to have an effective judicial system.

The Kruskal-Wallis H test that was performed showed that the distribution of to “Regulate Pre-investment” is the same across all investor groups and that there was no statistically significant difference between them,  $H(2) = 2.069, p = 0.355$ . The same outcome was for to “Regulate Post-investment”, whereby  $H(2) = 2.520, p = 0.284$ .

### **6.8.3.2 Who to Regulate IPE/CPE Market**

Participants were also asked who they thought should regulate: the Regulator, the Industry or Both. The responses were summarised in Table 6.53 below. One conventional investor did not provide a response. A cross-tabulation was performed to get an overall view of who is to regulate pre- and post- investment. It appears that they were in favour of regulating both stages; all had either the preference to have the Regulator regulate both stages or to have Both the Regulator and Industry regulate together, with the individual and conventional sentiments being more towards the Regulator and the institutions more towards the Industry. Seventeen participants (9 - individuals, 3 - institutions, 5 -conventional) thought that the Regulator should regulate both stages. While 15 participants (3 -individuals, 8 - institutions, 4 - conventional) thought that Both (Regulator and Industry) should regulate both stages. There were 5 participants (2 - individuals, 2 - institutions, 1 - conventional) who thought that the Regulator should

regulate pre-investment, and post-investment should be Both. There were 3 participants that were in favour of only regulating the pre-investment stage and not the post one, one individual was for the Regulator to regulate, and another individual was for Both, while one institution was for the Industry to regulate. There were 3 conventional that selected “None”, neither the Regulator nor the Industry.

**Table 6.53 - Who to Regulate Pre-investment and Who to Regulate Post-investment Cross-tabulation Across Investor Type**

Who to Regulate Post-investment	Investor Type	Descriptive Statistics	Who to Regulate Pre-investment				Total Who Regulate Post Investment	Weighted Score-a	
			Regulator	Industry	Both	None			
<b>Regulator</b>	Individuals	Count	9	0	1		10	3.80	
	Institutions	Count	3	1	0		4	3.75	
	Conventional	Count	5	0	0		5	4.00	
	Total			17	1	1		19	
	% of Total Who Regulate to Total Investor			34.00%	2.00%	2.00%	0.00%		
<b>Industry</b>	Individuals	Count	0	0	1	0	1	2.00	
	Institutions	Count	0	2	0	0	2	3.00	
	Conventional	Count	1	0	0	1	2	2.50	
	Total			1	2	1	1	5	
	% of Total Who Regulate to Total Investor			2.00%	4.00%	2.00%	2.00%		
<b>Both</b>	Individuals	Count	2		3		5	2.80	
	Institutions	Count	2		8		10	2.40	
	Conventional	Count	1		4		5	2.40	
	Total			5		15		20	
	% of Total Who Regulate to Total Investor			10.00%	0.00%	30.00%	0.00%		
<b>None</b>	Individuals	Count	1	0	1	0	2	3.00	
	Institutions	Count	0	1	0	0	1	3.00	
	Conventional	Count	0	0	0	3	3	1.00	
	Total			1	1	1	3	6	
	% of Total Who Regulate to Total Investor			2.00%	2.00%	2.00%	6.00%		
Total Who Regulate Post Investment	Individuals	Count	12	0	6	0	18		
	Institutions	Count	5	4	8	0	17		
	Conventional	Count	7	0	4	4	15		
	Total			24	4	18	4	50	
Kruskal Wallis (Who to Regulate Pre-Investment)						H (2)	P		
						3.488	0.175		
Kruskal Wallis (Who to Regulate Post Investment)						H (2)	P		
						2.270	0.321		

a-To calculate the weighted score, scores were allocated 4 to "Regulate", 3 to "Industry", 2 to "Both" and 1 to "None".

IPE investors who were for the Industry to be regulated thought that some form of supervision should be imposed on the Industry to ensure best practices and in addition, the Industry Associations might not have the power of enforcement. Those that were in favour of the Regulator had some reservations too. Although the preference is for the Regulator because it reduces the Industry’s capture<sup>197</sup>, the Regulator has to be efficient (which not all are, as commented on by the participants). The Regulators need to be qualified to monitor, guide and support, with effective enforcement, both the investment and the

<sup>197</sup> Reference is to if the industry was given full reign it would prioritise their specific concerns over the overall benefit of the sector/industry.

investors. They were also of the view that regulations are required, yet not to over regulate because it hinders creativity and development, or that the requirements prove to be costly for the managing entity. A note was also made that the relationship between the investor and the FI is based on a contractual agreement between both parties, based on clear terms, and what is required for the post-investment stage is effective enforcement of the regulation and proper court systems, in cases of a breach of contract.

While CPE investors that were for the Regulator to regulate pre-investment thought it would add assurance that the risk related to the legal structure of the investment and investor rights would effectively be addressed. There were others who thought there is a place for both government and industry associations to regulate, while some commented that Industry associations regulating post-investment would add a level of supervision without disturbing the flow of the deal, in addition to ensuring effective monitoring of the business risk related to portfolio companies.

With regards to the Industry regulating, a question was put forward to name the Industry associations that as participants they were aware of. The Industry associations that the IPE participants were aware of and mentioned were: ILPA (Institutional Limited Partners Association), MENA Private Equity, EVCA (European Private Equity and Venture Capital Association), PEGCC (Private Equity Growth Capital Council) and CIBAFI (General Council of Islamic Financial Institutions). Some also made reference to AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) an international accounting, auditing and *Shari'ah* standards setting body. While the CPE investors, in addition to ILPA, mentioned: NVCA (National Venture Capital Association), EMPEA (Emerging Market Private Equity Association and CFA Institute (Chartered Financial Analyst Institute).

### **6.8.3.3 How to Regulate IPE/CPE Market**

Participants were asked how the IPE/CPE market should be regulated. The choices of responses and the participants' responses have been summarised in Table 6.54 below.

**Table 6.54 - Investor Type and How Should They Regulate**

Investor Type	Descriptive Statistics	How should They Regulate				Total	Weighted Score-a
		Obligatory Compliance	Comply or Explain	Other	None		
<b>Individuals</b>	Count	9	7	1	1	18	3.33
<b>Institutions</b>	Count	9	7	0	1	17	3.41
<b>Conventional</b>	Count	6	4	3	2	15	2.93
<b>Total</b>	Count	24	18	4	4	50	

a-To calculate the weighted score, scores were allocated 1 to "None", 2 "Other", 3 to "Comply or Explain", and 4 to "Obligatory Compliance".

It appears that the majority were in favour of some form of compliance. Both the individuals and the institutions had similar numbers of participants under “Obligatory Compliance” (9 - individuals, 9 - institutions), and “Comply or Explain” (7 - individuals, 7 - institutions). While 6 conventional were for “Obligatory Compliance” and 4 for “Comply or Explain”. The IPE participant responding “Other” was of the view that it should be both methods and not only one or the other. One participant was of the view that in order to regulate the Regulator would need to be on the board of the investee company to ensure that investors’ rights are protected, rather than regulating through the comply/explain or obligatory compliance. Those of the comply or explain view have commented that, although compliance is required to help discipline in the market, in order not to defeat the purpose of it being a private equity market, it needs to be on an explanation basis. Moreover, not every industry understands Islamic principles, so at times some explanations are needed, with regards to being able to comply. Furthermore, it was also noted that enforcement needs to be efficient and effective for the comply or explain basis to be an effective method. While for the CPE participants with the view of “Other”: two were of the view of having clear rules and regulations on the disclosure of all information and conflict of interest was sufficient and one thought that funds should be reported to the regulators of each country.

With regards to how to regulate, the participants were also asked about having an Investors (LP) Advisory Committee (IAC) that represents the investors in the investment to voice the investors, focus on substantial issues, and meet with FI (GP) regularly to discuss time-sensitive important matters. The participants’ responses range from “Very Much Agree” to “Not Agree” or “Rather be Independent” and handled matters on their own, which are summarised in Table 6.55 below. It appears that participants are more in agreement than not. More than half of the participants (52.00%) “Very Much Agree” to having an IAC, more so individuals (11 participants) than institutions (8), and conventional (7). There were more institutional participants (4 - Somewhat Agree, 3 - Agree) that were of the view of “Somewhat Agree” and “Agree”, than individuals (2 - Somewhat Agree, 2 - Agree). While conventional were more for “Agree” (4) than “Somewhat Agree” (2). It was interesting to see that it was the individual participating investors (3) who preferred to be independent more so than the institutional and

conventional participants, none of whom seem to want to be independent. Two participants from each of the institutions and conventional groups did not agree to having an IAC.

The Kruskal-Wallis H test that was performed showed that the distribution of having an IAC is the same across all investor groups and that there was no statistically significant difference between the medians of the three groups,  $H(2) = 0.339, p = 0.844$ .

**Table 6.55 - Investor Type and Have an Investor Advisory Committee Representative**

Investor Type	Descriptive Statistics	Have an Investor Advisory Committee Representative					Total	% of Total Agree (V.M Agree-SW Agree-Agree) to Total Investors	Weighted Score-a	Median
		Very Much Agree	Somewhat Agree	Agree	Not Agree	Rather be Independent				
Individuals	Count	11	2	2	0	3	18	30.00%	4.00	5.00
	% of Total	22.00%	4.00%	4.00%	0.00%	6.00%	36.00%			
Institutions	Count	8	4	3	2	0	17	30.00%	4.06	4.00
	% of Total	16.00%	8.00%	6.00%	4.00%	0.00%	34.00%			
Conventional	Count	7	2	4	2	0	15	26.00%	3.93	4.00
	% of Total	14.00%	4.00%	8.00%	4.00%	0.00%	30.00%			
Total	Count	26	8	9	4	3	50	100.00%		
	% of Total	52.00%	16.00%	18.00%	8.00%	6.00%	100.00%			
Kruskal Wallis								H (2)	p	
								0.339	0.844	

a-To calculate the weighted score, scores were allocated in descending order with 5 to "Very Much Agree" to 1 "Rather be Independent".

## 6.9 CONCLUDING REMARKS

The current chapter attempted to address the research questions from the investors' perspective in investing Islamic equity finance. And in doing so it attempted to compare their experience with the experience of investors who invested in the conventional private equity market. It looked into the investors' experience in investing in IPE/CPE, their relationship with the FI, their investment decision factors and their level of awareness of IPE/CPE. In addition to the issues they faced and foresee in such an industry and their recommendations on improving the IPE/CPE market. The methodology that was conducted to seek the investors' input was the quantitative method, based on a questionnaire that was presented to the participating investors. In conducting the analysis, the participating investors were grouped into three groups<sup>198</sup>: individuals, institutions (representing IPE) and conventional (representing CPE) and their responses were analysed using mainly descriptive analysis. Inferential non-parametric

<sup>198</sup> Further explanation on such grouping is provided in the Research and Methodology Chapter 5, section 5.4.2.2.

analysis was performed with regards to seeing if there was any independence between the groups in their responses.

Overall, for the investors, following their experience in investing in IPE/CPE, many of them plan to continue investing in IPE. However, the preference was more towards the form of investment where they would be more aware of what is happening; and they were less concerned with being involved in the management. Greater preference was towards direct and indirect forms of investment, rather than funds of funds or a limited partnership. Moreover, although the investors are all considered to be accredited sophisticated investors, there is a difference with regards to certain matters, where the size of investment has an effect on the relationship with the FI. Matters included discussing the alignment of interest matters, the pre-agreement on the handling of conflict of interest issues, the ability to negotiate prior to signing, and the ability to vote or provide input on the direction of decision making on material matters. When it comes to the *Shari'ah* compliance aspect, there appears to be a great amount of reliability on the *Shari'ah* Supervisory Board (SSB). The investor expects to be investing in an Islamic investment and relies on the *Shari'ah* due diligence being performed and is not given priority when performing his own due diligence. This is in addition to forgoing not receiving the *Shari'ah* audit report, and placing full dependence on the SSB performing its role of supervision and audit.

Investors were in favour in bringing in some form of regulation to the IPE/CPE market, yet not to over regulate it. The aim is to bring more discipline into the market and enhance the level of disclosure and transparency. Furthermore, as the relationship between the investor and FI when investing in IPE/CPE is a contractual one, enforcement of the contract/agreement in times of breach is of great importance, which currently appears to be weak, especially in the region. Any shortfall in the legal system affects the investors' protection and reduces the investors' confidence in the market.

## Chapter Seven:

### IFI APPROACHES TO ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND ANALYSIS

#### 7.1 INTRODUCTION

This chapter looks into the results of the semi-structured interviews conducted with 15 Islamic Financial Institutions (IFI<sup>199</sup>) from across the GCC<sup>200</sup>, with regards to their investment approaches during the pre- and post-investment stages, the transparency and due diligence process and *Shari'ah* compliance governance system. The results were analysed using content and thematic analysis. Initially the responses were transcribed by the researcher and then imported into Nvivo software. This software was used to assist in collating the responses and coding them. After which Excel software was used to analyse the content and derive the themes with regards to the IFI's investment approach, post-investment relationship and the IFI's handling of due diligence, transparency and governance. The *Shari'ah* compliance and *Shari'ah* Supervisory Board matters were performed manually after the initial Nvivo coding.

The data analysis will first look at the general themes arrived at, which are then further explained by focus coding and looking into the subthemes. The results on each subtheme are supported by the related interviewee responses and quotations from different respondents.

#### 7.2 INVESTMENT APPROACH

The set of questions under the investment approach were mainly to determine who and how the IFI approached potential investors. Table 7.71 summarises the various approaches undertaken, while Table 7.4 summarises how the IFI approached investors.

---

<sup>199</sup> In presenting the results, the IFI interviews will be represented in code form (IFI-01, IFI-02, etc.) to preserve the confidentiality and the identity of the IFI. While the IFI cannot be identified due to confidentiality, the basic characteristics of them are given in Appendix 4.

<sup>200</sup> GCC - Gulf Cooperation Council countries.



## 7.2.1 Investors being approached

Table 7.1 to Table 7.3 summarises the responses of IFI with regards to who they approached and how they selected their potential investors.

**Table 7.1 - Investors Being Approached**

Interview Question	How do you approach your potential investors? How do you decide which investor to approach?
Focused Coding	Subtheme/remarks
1	Internal database
2	Immediate circle of contacts
Concluding Theme	Investors' selection was mainly based on friends, Board of Directors (BOD) members, shareholders and the internal data that was created of records of investors' information created and maintained from regular visits.

Over a period of time, IFIs have created an internal database of investors; created from regular visits and maintaining a record of investor information (appetite/sector of interest). Investors are usually acquaintances of the immediate circle of shareholders, BODs, and contacts and relationships that they have maintained through networking.

**Table 7.2 - Focused Coding 1 For Investors Being Approached**

Subtheme	Internal Database
Interviewees	Remarks
IFI-01, IFI-04, IFI-08, IFI-09, IFI-12, IFI-13, IFI-14, IFI-15	Created by regular visits and maintaining a record of investor information

Investor relationships are maintained by the IFI, mainly by the investment relationship officer or the marketing/sales, or business development officers' regular visits to investors, *"We have a data base. We have investment relationship officers and they have maintained for the last 8 years, that they have developed, I mean they have a very good relationship with the investors"* (IFI-10). The database maintains a record of investors, their appetite and sector of interest, *"We build our database, we profile our investors, so that when I have the right opportunity, then I know which investors to approach and which investors not to approach"* (IFI-08). Many of them have had prior investments and are regular investors, *"We know our investors...we have been dealing with them for years"* (IFI-04).

**Table 7.3 - Focused Coding 2 For Investors Being Approached**

Subtheme	Immediate Circle of Contacts
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-03, IFI-07	Friends, relationships, contacts
IFI-01	Board of Directors (BOD) members
IFI-08, IFI-10	Shareholders
IFI-10	Strategic partners

Usually, IFIs start with their immediate circle, this being shareholders and the BODs of the IFI, *“We start with our immediate circle, which is our shareholders, then we go to the wider circle of other investors in the region...”* (IFI-08) and their friends *“...friends and people that sit on our board. People that are part of our bank”* (IFI-01). When it comes to large investments, usually the preference is to approach friends, those who they have had a good investing experience with. *“If there is a large ticket size, we just call up our friends”* (IFI-07).

The investors being targeted were sophisticated accredited investors: institutions and individuals, *“We used to put categories for the clients: institutions and individuals. Individuals if they were High Net Worth (HNW) or individuals or salary person, for all investments”* (IFI-03); *“Our target is financial institutions, HNWs and family offices these who they are. A mix of both”* (IFI-05). In most cases the preference was for individuals, as individuals were quicker to respond than institutions, as Interviewee IFI-08 asserts; *“It is a combination [individuals and institutional investors], but there is a slight bias towards individuals... an individual is much faster than institution...time deadlines to make the investment...so you get the feedback much faster and the process is quicker.”* Individuals also would bring more individuals (family and friends), as IFI-06 notes; *“he [individual] used to bring for you a lot of people [family members of the individual that signs a subscription]...”*

### **7.2.2 IFI Approach**

The tables below summarise the responses of IFIs with regards to how they approached investors and how and what information they provided them with.

**Table 7.4 - How IFI Approach Investors**

Interview Question	How do you approach your potential investors?
Focused Coding	Subtheme/Remarks
1	Approach was conducted in 2-3 stages
2	Information was provided in 3 stages
3	Private Placement Memorandum (PPM) and Executive Summary
Concluding Theme	Some approached investors to test their interest first, before providing them with detailed information. In some cases, a Non-Disclosure Agreement (NDA) was signed, prior to providing information. Others provided the PPM and executive summary along with a presentation.

Some IFIs' initial approach was to visit and test the waters prior to going into details of the investment, while others would approach the investors with the investment, by providing the PPM and executive summary.

**Table 7.5 - Focused Coding 1 For How IFI Approach Investors**

<b>Subtheme</b>	<b>Approach was conducted in 2-3 stages</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-08, IFI-15	Courtesy visit and testing interest (after which targeted investor is selected). Offer/sell the product, provide detailed information, cooling off period before signing.
IFI-10, IFI-11, IFI-14	Presentation, after which the document is provided/forwarded, sits and discusses, cooling off period before signing.

The above IFI's approach was to first visit the investors and assess their interest "*we start, we approach a wide range of investors first to gage the appetite and then once we have the initial feedback, we narrow down to our target investors*" (IFI-08); and their understanding of the type of investment, "*Courtesy visit, offer our profile, brief him on organisation structure, business, or history...Second visit, we offer him the product. The first visit is to understand the client; he is an investor or not? He knows private equity or not? So, we have to understand the client to see under which category he falls*" (IFI-15). After which they would provide further information on the investment, "*and then we provide them with a second layer of information. Once that second step is over, then we go to meetings, in order to basically go into details and depth about this transaction and answer all questions they might have*" (IFI-08). "*Then based on that we work, because we have funds. ... When you go on the second visit offer*

them PPM, executive summary, teaser<sup>201</sup> about the project we are offering him” (IFI-15). There are IFIs that present the investment through a presentation and provide the PPM thereafter, “We don’t go to investors with a PPM on a slide show, because the PPM is very narrative. The PPM would be in the document that we provide the client may be at the end of the presentation or we can send it to them afterwards by e-mail or hard copy as they might wish...he takes his time, he asks...he runs it by his internal approval process... He sits with you 3 times...convinced, signs with us” (IFI-13).

In some jurisdictions, once the potential investors have been identified, the IFI would submit the potential list to the Regulator (if less than 60 investors) and seek the Regulator’s approval on the offering document (PPM) before providing the investor, “We meet with them [investors] initially, explain the idea. Let’s say, the strategy of the company, where the company might be in the next couple of years. ... If they are interested, then we submit to the [Regulator] and get approval on the private placement offer. We will go back to them [investors] with the complete offering package and offering documents ...” (IFI-12).

**Table 7.6 - Focused Coding 2 For How IFI Approached Investors**

Subtheme	Information was provided in 2 stages
Interviewee	Remarks
IFI-01	Seek interest present with teaser
	Sign Non-Disclosure Agreement
	Provide more details

In some instances, the IFI does not disclose details of the investment to the potential investor before he signs a Non-Disclosure Agreement. So in the event that he does not invest, once he sees the details, the investor maintains confidentiality and does not disclose the details of the investment/project as IFI-01 notes; “First at the initial stage we give them a brief, a teaser, showing them the opportunity high level, if they would like to explore further, we sign a NDA (non-disclosure agreement) and send them the information that we have got.”.

<sup>201</sup> A document/sheet circulated to potential investors for a specific offer of an investment that contains some information on the offer that might entice the potential investor.

**Table 7.7 - Focused Coding 3 For How IFI Approached Investors**

Subtheme	Information provided by PPM and Executive Summary
Interviewees	Remarks
IFI-07, IFI-11	PPM and Executive Summary

There are IFIs that in their first meeting provide the investor with a PPM and Executive Summary, “*As a start the investment memorandum and the executive summary. Will start with giving a background of the institution itself...then we go and move to the investment itself... then at the end, sometimes there are some answering questions*” (IFI-07). Once the investor is approached, they are given time to review and decide, “*Providing the PPM...we open up the data room for our clients. We answer all the questions and then basically give them a window within the PPM that they could be anywhere from one to three months for a closing date where they have to basically say if they are interested or committed*” (IFI-11).

Moreover, there were instances where it was the investors that approached the IFI rather than the IFI approaching the investor. Some investors followed the herd as they say and were very eager to enter the investment, in that they were approaching IFIs to take them on board on the investments. They were kept on a waiting list, because there was a cap on the amount of capital being raised. This list would be approached if the capital to be raised was increased or if there was a no show by other investors. According to IFI-03; “*People would come, I wouldn’t say begging, but please get me in this placement....They wanted to enter the investment and were asking favours to do so. There was a waiting list for the placement. I would tell him your number is five*”. This interest from investors aroused the interest of the IFI’s management and the possibility of making greater gains through management fees, if they were to take those interested investors on board. As such, at times they took the risk and raised the cap on the amount to be raised as IFI explains; “*Say I had put a target of 15m, those that had registered 18m. Now come management: I take fees say 10%, on the 3m [additional amount from investors’ interest], there is initial 300,000 per quarter in a year. So, ... started to see how much the gain from the placement, and since people were coming, why lose it, I’ll [the management of IFI] take it [the gain to be made by taking the investors on board]. There was a liability from all levels; whether it was investors or placement officer*”.

When IFIs approached the investors, they provided the information that they knew the investors were seeking and interested in hearing in order to get the investors' attention. Table 7.8 summarises what IFIs discussed and on what investors based their investment decisions according to the IFIs.

**Table 7.8 - Basis of Investors' Investment Decision**

Interview Question	What is discussed in the meeting? I.e. Investors invested based on:
Focused Coding	Subtheme/Remarks
1	Mainly interested in the exit and returns
2	Mainly based on trust than information, reading and doing their DD
Concluding Theme	Investors were mainly concerned with the exit and the returns to be generated, and the IFI focused on this in their approach. Investors also based their decision making on the trust in IFI rather than reading the documents in detail and performing their DD on the investment.

The IFI provides the investor with what it believes would help the investor's decision making. The IFI simplified its presentation to the investor so they could easily understand the investment, especially when the investment structure is complicated such as when the setup was comprised of multi-level/multi SPVs. IFI-08 confirms; *"Sometimes structures are so complicated that honestly there is no added value if you keep it in there, in the presentation. It is going to cause more confusion rather than help them understand. So, we try to simplify the structure and show it to the investors"*. The IFI simplified its promoting of the investment as "take, list and exit" rather than there being any risk involved. *"When you go to people, who are talking about looking at the investment, they are not seeing the establishing companies, as per investment understanding it's riskier than listed companies. But it's been marketed to the people as take, list and exit"* (IFI-03). The IFIs provided the investors with what they wanted to hear, such as the returns to be generated.

**Table 7.9 - Focused Coding 1 For Investors Invested Based On**

Subtheme	Decision Based on Returns
Interviewees	Remarks
IFI-03, IFI-06	Mainly interested in the exit and the returns

Many investors, although the IFI representatives would try to give them a briefing on all aspects of the investments, their main concerns were when they would exit and what the returns were. As IFI-03 noted; *"we used to say to the client that this is the risk factor; that this is the return, that's the investment. We*

*also give them that's the advantage; that's the disadvantages... The placement [officer] would do all the work, but the investor won't look at it. The main question of the investor: what is the date of exit? What is the return? Not more than that."* When it came to the returns, the investors looked at the figure/the number of the percentage, as a return rate, disregarding what kind of rate it actually represented. Based on that, the investors would choose the investment with the higher percentage figure, disregarding whether the rate was the rate of return (ROI) or the internal rate of return (IRR). The ROI, although it shows a higher percentage figure/number, it only gives the investor an overall, simplified picture of the gains; while the IRR (with a smaller percentage figure/number) is a more complicated and comprehensive rate that takes into consideration not only the value to be gained, but also the dividends and time of payment. Hence, some IFI used this to their advantage and lured investors by stating the ROI on their documents/the PPMs. This caused some confusion among investors, and even though some of the IFI representatives tried to explain/clarify it to investors, the investors were not convinced and would go for the higher rate. As IFI-06 explains; *"Some of the banks they write on the PPM, ROI 30%. Some of the banks used to write IRR 15%. The investor then says how are you 15%? See this person he's giving me 30%, 35%. Come explain to him. Tell him IRR it depends on the exit period and so forth. He sees 35%, tells you, you don't know [being the IFI representative does not understand what he is saying]. I [investor] will go with them [the IFI offering higher rate]"*

**Table 7.10 - Focused Coding 2 For Investors Invested Based On Trust**

<b>Subtheme</b>	<b>Decision Based on Trust</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-06, IFI-07	Mainly based on trust than information, reading and doing their due diligence

Regionally, many rely on trust rather than expecting to be well informed, *"In the West it is like taken as given. There will be some sort of information, but ...here in the region, trust"* (IFI-07). As such, investors in addition to basing their investment decisions on returns to be generated, they also based it on trust in the IFI; a kind of hand shake deal rather than on their due diligence (DD) and reading the documents in detail. IFI-06 notes; *"But that was the kind of deal, a kind of shake hand. I [the investor] am here to make money. How you do it, I [the investor] trust you guys [the IFI]"*.

## 7.3 TRANSPARENCY AND GOVERNANCE

This section looks into whether the investors' interests/rights are considered in return for investing his funds. This is viewed through the IFI's participation in the investment and sharing in the risk, and the voting rights that investors have in decision making.

### 7.3.1. IFI Participation

Table 7.11 summarises the factors that influence the IFI's decision on its level of participation in the investment. How much will they be investing alongside their investors?

**Table 7.11 - Factors Affecting IFI's Participation in the Investment**

Interview Question	What are the criteria used by the institution to make investment decisions?
Focused Coding	Subtheme/remarks
1	Regulatory cap/exposure
2	Factor of capital
3	Asked by investors/gain investors' confidence
4	Investment department/allocation policy
Concluding Theme	Decision is mainly based on regulatory requirements and the investment policy of the IFI alongside gaining the investors' confidence in the investment.

It appears that the regulatory requirement is the main factor that indirectly affects the IFI's participation percentage. It limits the IFI's exposure, and depending on the capital base of the IFI and its investment policy allocation, the participating percentage is determined. While the investors' preference was to have the IFI participate with them in the investment, to give them reassurance about the feasibility of the investment.

**Table 7.12 - Focused Coding 1 For Factors Affecting IFI's Participation in the Investment**

<b>Subtheme</b>	<b>Regulatory factor</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-02, IFI-07, IFI-08, IFI-15	Regulatory cap/exposure



The IFI is restricted with regards to its exposure limits that are set by the regulators of the financial institutions. Accordingly, this regulatory cap affects how much an IFI can invest; *“We are capped by the [Regulator] regulations. We start from there...”* (IFI-08). The regulatory cap sets a minimum, upon which the IFI can invest in any investments, *“...that is a minimum. I expect it is set by the [Regulator]”* (IFI-02).

**Table 7.13 - Focused Coding 2 For Factors Affecting IFI's Participation in the Investment**

Subtheme	Capital Factor
Interviewees	Remarks
IFI-08, IFI-13	Factor of capital

Linked to the regulatory cap/percentage is the paid up capital of the financial institution. Hence, each institution capital is different and thus the amount available for investment differs, as IFI-08 notes; *“It is always a function of our capital base. So that is a limit of, I believe, it is 15% of the capital base. It is the maximum at any point in time”*; and IFI-13 goes on to elaborate *“We see how much we can afford taking into consideration the number of investments we want to get in and how much we want to diversify out books. Because our book is limited, is more or less, the capital of the company. But most of it is coming from the investor along with ours”*.

**Table 7.14 - Focused Coding 3 For Factors Affecting IFI's Participation in the Investment**

Subtheme	Investment Policy
Interviewees	Remarks
IFI-10, IFI-13, IFI-14, IFI-15	Investment department/allocation policy

There are various investments to make and IFI’s investment policy and investment department set the amount of investment for each investment. It depends on the extent of exposure/risk they are willing to take, and how much they want to diversify; *“We have risk matrix for evaluation, they would go through it. It has all the criteria. Based on that matrix, we will assess, then based on the assessment model we will decide... We have a policy that we don’t go more than 10%, so that to diversify”* (IFI-15). The sector in which to invest in, *“Depending on the sector, we have an investment policy here. You know already which sector to invest in...”* (IFI-19). The capital allocated; *“it depends on capital allocation. Let’s say I have 30% for real estate, 20% oil and gas, 50% for whatever...”* (IFI-02). The IFI at times are restricted by the amount of funds available and budgeted; *“Sometimes we have a budget. Because our*

company would decline. We offer them the budget, this is a great investment, would you please join, they would run it by investment, if they have enough budget to invest, they would definitely invest” (IFI-13).

**Table 7.15 - Focused Coding 4 For Factors Affecting IFI's Participation in the Investment**

Subtheme	Investor's Confidence
Interviewees	Remarks
IFI-02, IFI-04, IFI-13	Asked by investors/gain investors' confidence

In order to gain the investor's confidence, some IFI invest alongside the investors; “we typically re-invest, co-invest, just to give investors the confidence, that we are committed” (IFI-02). While there are times when it is not the IFI who is putting forth the commitment willingly, but the investor that is asking for it; “We have at least 5% [stake in the investment]. Sometimes 10%. We are not required to, but we are asked by investors” (IFI-04).

**Table 7.16 - What is the IFI Participation Amount?**

Interview Question	What is the process of deciding on the investment participation of your institution? I.e. what is your participation in the investment?
Focused Coding	Subtheme/remarks
1	5%-10%
2	10%-20%
Concluding Theme	IFI investment ranges from 5% to 20%

Most of the IFI participation ranges from 5% to 10%. There are those that go higher to 20%.

**Table 7.17 - Focused Coding 1 For What Decides the IFI Participation Amount in the Investment?**

Subtheme	IFI Participation
Interviewees	Remarks
IFI-04, IFI-07, IFI-15	5%-10%

Several IFI participate between 5% to 10% in the projects they offer the investors; “*We have at least 5%, sometimes we invest 10%*” (IFI-04); “*We will not commit more than 10% in this fund...*” (IFI-07).

**Table 7.18 - Focused Coding 2 For What Decides the IFI Participation Amount in the Investment?**

Subtheme	IFI Participation
Interviewee	Remarks
IFI-06	10%-20%

While others participate between 10% and 20%, “*But the rule of thumb was 20% or \$20m as a max*” (IFI-06).

However, since there is no minimum requirement for the amount an IFI has to make alongside the investment it offers its investors, the IFI is not obliged to do so. Hence, depending on the criteria mentioned above (Table 7.11), the IFI will determine the amount, which at times could be zero, as IFI-15 notes; “*There is no minimum, some projects we end up holding nothing*”.

Now while it is usually considered that the IFI participation is financial participation, in that the IFI is actually injecting cash, this is not usually the case. The IFI would take the amount that they plan to contribute with from the premium that they had placed on the value of the offer they made to the investor. Their portion of capital contribution would be taken from the arranging and promoting fee that is embedded in the price, as their portion of the capital, as explained by IFI-15; “*Always they do it in kind. Across the board, all banks so far. In kind. What they do? We value the company at 90m, we our share [in the investment] is 10m, it [being the offer price] becomes 100m. So, we sell [the investment to investors at] 100m. We sell out of this, so our share [how much IFI contributed in cash] like nothing*”.

### 7.3.2 Investors’ Voting Rights

This section looks into the investors’ interest and how it is handled by the IFI. Table 7.19 summarises how the IFI maintains the investors’ interest and voting rights.

**Table 7. 19 – How Do You Maintain the Investors’ Interest and Voting Rights?**

Interview Questions	How do you maintain investors’ rights and deal with/mitigate conflict of interest?
Focused Coding	Subtheme/remarks
1	Proxy taken
2	Different rights due to having different classes of shares
3	Different rights due to different stake/percentage of ownership
4	Different rights due to investment structure set-up
Concluding Theme	Overall proxy is taken for the IFI to act on behalf of the investor. Matters such as ownership, class of share and investment structure affected the investors’ power to vote/participate in the decision making.

The IFI’s preference was to take proxy on voting for decisions to be made on the investment, post-investment, especially when there are many small ticket size individual investors who are not so familiar with the investment. It gives the IFI the ability to make the decisions and maintain control over the investments. However, this was not so when the investment only involved two to three large ticket size investors. The large investors would at times make it to being board members in the investee company, as IFI-06 explains; *“Because we were going to a lot of investors, not sophisticated<sup>202</sup>, it didn’t make sense to give them voting rights... There were a couple of transactions where there were only 2 investors or 3 and all were big funds and such thing, they can come on board, they can have certain decision, etc. But when I go to 50, 100 each has half a million, one million, 3m and I have 100 of them, what can I do? I had to do that solution [of diluting the investors’ voting power]”*.

**Table 7. 20 - Focused Coding 1 For How Do You Maintain the Investors' Interest and Voting Rights?**

Subtheme	Proxy Taken
Interviewees	Remarks
IFI-01, IFI-06, IFI-08	Act on their behalf
IFI-07, IFI-12	By protecting company rights investors’ rights are protected

In the majority of cases the investor is a passive investor. The IFI does most of the decision-making. This is along the lines that since the IFI has done all the work and due diligence on the investment, the IFI is more aware of the industry and is in a better position to be on the board of the investment company and to make decisions on behalf of the investors. To this IFI-12 elaborates; *“they already did a lot of*

<sup>202</sup> “Not sophisticated”, not from the aspect of having a certain level of wealth, but in the sense of not being familiar or knowledgeable about the investments/finance.

work before actually coming to this point, where they got the license and stuff like that. So basically, they are saying, since we have done all this work, we are more into this industry, we understand it very well. Therefore, we are going to be members of the board for the first term...”. To some, it is considered a fiduciary duty of the IFI to protect the investor and act on his behalf, as expressed by IFI-01; “they have proxies given to the board members. The board members [that represent the investors] they are from the executive committee. The executive committee basically protects the interest of all other shareholders, it is a fiduciary duty at the end of the day”. Moreover, the IFI is given proxy to manage the investment on behalf of the investor. The IFI finds it easier and more practical to do so, especially when quick decisions need to be made, as IFI-08 notes; “We are merely managing this investment on their behalf...because of quickness of the decision making and the practicality, we get the proxy and manage throughout the life of the transaction”.

**Table 7. 21 - Focused Coding 2 For How Do You Maintain the Investors' Interest?**

Subtheme	IFI Participation
Interviewee	Remarks
IFI-06	Different rights due to having different classes of shares

Based on the concept mentioned above, and that the IFI is more aware of the investment (due to the work and effort made) and as such is more entitled to the decision making, some IFI worked on maintaining such rights by having a different class of shares with different voting rights; “we don’t want investors those who we give shares to, tomorrow they interfere in the decisions here ... we need to create 2 class of shares. Shares classes A and shares classes B. Class A is voting shares, class B non-voting” (IFI-06).

**Table 7. 22 - Focused Coding 3 For How Do You Maintain the Investors' Interest?**

Subtheme	IFI Participation
Interviewees	Remarks
IFI-01, IFI-07, IFI-06, IFI-08, IFI-09, IFI-12	Stake/percentage of ownership

Ownership affected the level of representation, whether it be the investor or the IFI, IFI-12 confirms; “Depending on how much percentage you are going to own, you have certain rights. You have voting rights, like 20% 25%... Basically, your ownership plays a role on the proxy. The larger you own the more influence you have”. Investors’ percentage of ownership also had an influence on whether they

would be able to be on the board of the investment/target company rather than the SPV and hence be able to participate directly in the decision-making. The SPV is an intermediary layer in the investment set-up/structure. A special purpose vehicle, a legal entity created to pool the investors’ funds into it, and that one legal entity (the SPV), rather than many investors, would invest in the investment/target company, which had a board of its own; *“We have jointly teamed with other families... and acquired assets. We did not bring them at the SPV level; they are core investors with us [meaning that they were on the board of the investment company]”* (IFI-01). While as IFI-07 explains, smaller investors were considered passive investors *“unless you are a co-investor sitting with us on the board table, any smaller ticket sizes they be completely passive”* (IFI-07). Ownership also affected attendance at the Annual General Meeting, *“if you invest more than 10% you will be able to come to the AGM or EGM, which should be happening once a year”* (IFI-09).

**Table 7. 23 - Focused Coding 4 For How Do You Maintain the Investors' Interest?**

Subtheme	IFI Participation
Interviewees	Remarks
IFI-06, IFI-13	Investment structure set-up

Some IFI in an attempt to maintain control took up different investment structures. One of which was to pool the capital collected into a fund structure rather than directly into a company structure, *“Usually when we talk fund versus private placement. The beauty of the fund, it gives the fund manager the say in controlling the fund money and the fund voting rights on whatever company, even without having a majority equity. And this is the difference between creating a fund or creating a company”* (IFI-13). Another was to dilute the investor’s ownership across several companies within the investment structure. This is confirmed by IFI-06 who states; *“They used to make 5 to 6 companies for the investor, and spread. For example, you put \$10m in one company, you could be 10%, you are big for voting. But if we spread the \$10m in 5 companies [companies that have been created as part of the investment structure], in every company you receive different percentage, so you become irrelevant”*.

**Table 7. 24 - Do You Ever Go Back to the Investor on Any Decisions to be Made?**

Interview Question	When given proxy, do you ever go back to the investor on any decisions to be made?
Focused Coding	Subtheme/Remarks
1	Goes back to investor
2	Doesn't go back to investor
Concluding Theme	In normal cases the IFI does not go back to the investors, but there are instances when it does.

Since the IFI is given proxy, it does not consider that it needs to go back to the investors on any decision to be made, as long as it is within what has been stated in the PPM.

**Table 7. 25 - Focused Coding 1 For Do You Ever Go Back to the Investor on Any Decisions to be Made?**

Subtheme	Goes Back to Investor
Interviewees	Remarks
IFI-01, IFI-08, IFI-13, IFI-14	On strategic/material decisions
IFI-05, IFI-10	If it affects the capital/legal structure
IFI-02, IFI-13	If not stated in the terms and conditions of the PPM
IFI-09	If in conflict with the interest of the board representative

The IFI goes back to investors when strategic decisions such as exiting the investment are to be taken; *“we cannot exit by ourselves, we have to get the approval from them [the investor] on exit” (IFI-01)*. Moreover, if anything that affects the legal structure of the company; *“Usually we don't go back to the investors for every single decision, unless it is related to liquidation or some change in structure legal framework...” (IFI-10)*; or the capital structure *“If there is for example capital reduction, capital increase, distribution of dividend, acquisition, sale of asset, big assets of the company, you know liquidation, whatever, issuing of bond, something that will affect the capital structure of the company. But I think you cannot [go back to the investor], for example, if every time you want to make an acquisition” (IFI-05)*. Any decision to be made that is not within the terms and conditions of the PPM (which encloses the investment criteria and is the binding document between the IFI and the investor), is also a case when some IFI would go back to the investor; *“if we are about to change the strategy of the fund to what we disclosed in the PPM. If we are considering something different, ok, we have to seek their approval. We have to stay on the same page. But only for material decisions, we seek their*

approval. Like extending the fund term, changing something with the strategy. Doing something that will increase the risk” (IFI-13). As the board representative represents the interests of the investors, in the event the interests of both parties are not aligned, the IFI would consult with the investors; “When issues being discussed are in conflict with the board representative” (IFI-09).

**Table 7. 26 - Focused Coding 2 For Do You Ever Go Back to the Investor on Any Decisions to be Made?**

Subtheme	Doesn't go Back to Investor
Interviewees	Remarks
IFI-04	Due to having different goals
IFI-02, IFI-14	Within the agreed terms/investment criteria
IFI-06, IFI-15	Due to being given proxy and being updated

On the other hand, some IFI do not consider going back to the investor with regards to any decisions to be made, as the goals of all the investors in the investments are different and it would not be practical to do so; “No, because the reason being clients may have different goals. Some clients wouldn't mind holding the investment for 20 years, some clients want 5 years. If you do that [that being to go back to the investor] you can't please everyone” (IFI-04). Moreover, there is no need to seek the investors' decision on issues that the investors have agreed on beforehand. When the investor decided to enter the investment, he had done so based on certain terms and conditions, hence, anything within those conditions, the IFI is free to make his own decision; “As long as it is within the boundaries of the fund management role has been agreed, then it [it being the decision] is done by the fund manager” (IFI-14). While some IFI consider that since proxy was given, they do not see the need to seek the investors' input on any decisions to be made about the investment, as IFI-15 notes; “Normally we don't consult...because we had proxy”.

#### **7.4 POST-INVESTMENT RELATIONSHIP**

This section looks into how the IFI maintained its relationship post-investment with the investor. It summarises the format of disclosure, the frequency of updates, and the level of disclosure.



### 7.4.1 Format of communication between the IFI and the investor

This looks into how the IFI maintained communication with the investor once the funds were collected from the investor and invested into the investment/project.

**Table 7. 27 - How is the Communication Maintained Post-Investment?**

Interview Question	How is communication maintained between the institution and the investor post-investment? Do visits take place or just reporting?
Focused Coding	Subtheme/remarks
1	Reports and visits
2	Conferences/group sessions
3	Presentation
Concluding Theme	Communication maintained through updates made by reports, visits and at times conferences and group sessions

Some form of communication was maintained, whether it was through reports or visits, and in some cases conferences were conducted for big clients at the IFI’s expense. However, there was a period at the start of the financial crisis (2008-2010) where everyone was in the dark, including the IFI itself, and it did not know what to report to its clients, *“in 2008, 2009 the market dropped, the update reduced, because what to tell them. We had to be careful what to say, what not to say... here from 2008 to 2010/2011 the investor felt that as if he is sitting in a dark room. He can’t see anything. No clue what is my investment doing? ... It was a shock for everyone; bankers as well as investors. Everybody was lost; didn’t know what to do... No one knowing what is happening, what is the plan. So, it was a little mess... Until afterwards the banks, took some time, adjusted themselves, started communicating with investors...”* (IFI-06).

**Table 7.28 - Focused Coding 1 For How is the Communication Maintained Post-investment?**

Subtheme	Reports and Visits
Interviewees	Remarks
IFI-03, IFI-04, IFI-05, IFI-08, IFI-11, IFI-14	Reports and visits to all their investors
IFI-15	Reports and visits only to major/big investors

In general, the IFI would produce reports of updates to the investor. There were some that would follow-up the reports with a visit. However, there are some IFI that made visits to their big clients only, *“especial clients, big clients we have frequent visits. At least either a call or at least every 3 months we have to update them”* (IFI-15). At times visits depended on the relationship manager and the client, and whether there was a need for a visit, *“...for the meeting there is no set formula for it. It depends on the relationship manager and on the client. Sometimes they [investors] don’t really have the need to meet. Sometimes they request meetings; sometimes they call [phone call rather than a visit/meeting] with the questions. It is really tailored to the client”* (IFI-04). IFI also visited investors, not only to update them on their current investments but also to update them on future investments, *“So we visit them. We make sure that they are aware of any developments or if they have any certain requests and plus we give them update of any potential investments in the future”* (IFI-08).

**Table 7.29 - Focused Coding 2 For How is the Communication Maintained Post-investment?**

Subtheme	Conferences
Interviewees	Remarks
IFI-03, IFI-06, IFI-13, IFI-15	Conferences/group sessions

There were IFIs that made an event for the update. Some arranged conferences, whereby big clients were invited to the event, at the IFI’s expenses, for a few days in some city, where there would be some important speakers invited to talk, in addition to being updated on the performance of the investment, *“invite the big investors... we would invite them on the bank’s expenses, 2 to 3 days ...at a nice place, nice hotel and give them an update on the bank, on the market. We bring someone famous to talk about politics. The investor feels important, pampering him basically. So, it was good in that one on one with the investor. We would build relationship; we know what’s on their mind; what is his plan, etc.”* (IFI-06); *“We did 2 conferences in..., invited clients for around 4 days and showed them presentation of investments they had entered, what is the performance...”* (IFI-03). Investors were selected due to the size of their investment and as such are to be treated differently, *“if somebody investing above certain amount like 5m and above, different than somebody investing 100,000. So these big investors because they are holding certain percentage so we invite them.”* (IFI-15). And there were those that invited their investors, but not to such a large set-up but more of a group gathering, where they would update them on the investment and the market, *“we sometimes do sessions, where we invite our investors for summary or executive sessions and we bring our market expertise to present the market conditions in these areas”* (IFI-13).

**Table 7.30 - Focused Coding 3 For How is the Communication Maintained Post-investment?**

Subtheme	Presentations
Interviewees	Remarks
IFI-14	Presentations to the board of directors, executive committee or management of the IFI’s institutional investors

There are investors, institutional investors, that request the IFI to come and present and update the institutional investor’s management on an annual basis, rather than just a visit made to the investment team, as noted by IFI-14.

## 7.4.2 Frequency and Format of Disclosure

The section below looks into the frequency and format of communication that the IFI maintained with its investors.

### 7.4.2.1 Frequency of Disclosure

Table 7.31 summarises the frequency of information/updates provided by the IFI to its investors. Overall, while reporting involved a lot of work in gathering the information, frequency depended on the nature of the investment; on whether there were any updates to report (some of these investee companies did not produce reports), if the IFI wanted to call/draw down capital, and maintaining relationships for future investments, *“it would be to our benefit because we would want to maintain it is more of a relationship type that I would want this co-investor to again come with us in another deal. So, I think because of that try and maintain full dialogue, keep them happy, keep the information flow open”* (IFI-07).

**Table 7.31 - What is the Frequency of the Information Provided to the Investor?**

Interview Question	What is the frequency of the information provided to the investor?
Focused Coding	Subtheme/remarks
1	More than once a year
2	Once a year
Concluding Theme	Reporting frequency varied, depending on the IFI and type of investment

Updates were mainly quarterly or semi-annually. It depended on the type of asset class of the investments and if there was information to update. IFI tried to maintain regular updates, but it was not easy to do so. This is confirmed by IFI-06, *“some of the banks had regularly every 3 months or regularly every 6 months, but it was a lot of work. But once a year had to be there at a minimum”*. Although some IFI reported monthly, they were mainly reports to their clients on their portfolio of investments with the IFI, rather than updates on the performance of the investment/project, *“Each month we send him a statement of account that he is holding, and we send him updates quarterly”* (IFI-15).

**Table 7.32 - Focused Coding 1 For What is the Frequency of the Information Provided to the Investor?**

Subtheme	More than once a year
Interviewees	Remarks
IFI-04, IFI-11, IFI-13, IFI-13, IFI-15	Quarterly
IFI-11, IFI-14	Semi-annually

Some IFIs on a quarterly basis send an update to their investors on the latest developments since the last report, *“Every quarter we are supposed to send a refreshment, progress report”* (IFI-13); *“there is a chart... Event chart saying ...infrastructure in that period of time. So if there is a delay on one of them, we do quarterly reports we will update the investor, based on the PPM or based on the project”* (IFI-15).

Those IFIs that do not do quarterly updates would do so semi-annually, *“so we do that on a regular semi-annual basis.”* (IFI-11); *“But when it comes to performance we do it semi-annual and annual”* (IFI-14).

**Table 7.33 - Focused Coding 2 For What is the Frequency of the Information Provided to the Investor?**

Subtheme	Once a year
Interviewees	Remarks
IFI-06, IFI-13, IFI-14	Annually

Quite a few IFIs provide updates based on when the investee company produces its reports, *“We do invest updates annually and they are post-management accounts or post-audited accounts. Depending on when the financial audited statements come out for the investee company, that the investors invested in”* (IFI-11); *“at the end of each year we issue for them like audited financial and final report for each year”* (IFI-13).

#### 7.4.2.2 Format of Disclosure

Table 7.34 to Table 7.37 below look into the format of disclosure. What information there was and how it was provided to the investor. Institutional investors and individual investors initially received the same information, *“we prepare one standard report, which goes the same time, the same format to all investors”* (IFI-15). But usually, institutional investors, along with individuals (family offices that have a professional team) would request further information, upon which they were provided with, *“it [the information] is the same in theory, but financial institutions usually ask, because they have auditors...whereas an individual investor doesn’t really ask for that. They don’t have auditors”* (IFI-04). However, the issue arises with reporting on investments that the IFI have exited. The information/update provided could vary from one investor to another, due to the investors having entered the investment at different prices. The difference in entry price affects the turnover generated for each investor at exit, as IFI-08 explains:

*“Sometimes we feel from experience that the more information the investors are given in certain elements, such as fees and exit, especially exit. They tend to start comparing and ... they get into too much detail and we lose the big picture ...so we provide them the minimum possible information ... Especially if you made any investment before 2008. There was a very high level of premium that had been charged at the time, across the banking industry...So if your investments were still outstanding from that era, you will probably have investors coming in at very different price levels. So obviously, at exit, for some it could be a loss and for others it could be a profit. So then you have to be careful how to display that information”.*

**Table 7.34 - What Information is Provided to the Investor?**

Interview Question	What information is provided to the investor?
Focused Coding	Subtheme/remarks
1	Simple update
2	Comparable updates
3	Updates and projections
Concluding Theme	Updates were mainly on the performance of the investment to date and there were those that compared the investment performance to the market environment at the time. In addition to some disclosing major decisions made and to be made, along with future forecasts.

Progress reports/updates were provided to the investors, based on a set template that the IFI has on each asset/investment class.

**Table 7.35 - Focused Coding 1 For What Information is Provided to the Investor?**

Subtheme	Simple updates
<b>Interviewees</b>	<b>Remarks</b>
IFI-05, IFI-07, IFI-09, IFI-10, IFI-11, IFI-13	Updates on performance, the financial and operations aspects of the investment itself

Some of the IFI’s updates mainly concentrated on the investment itself and its performance, *“We always communicate with them, on a quarterly basis. At the end of each year we issue for them like audited financial and final report for each year, which explains to them fully what happened during the year. So they are aware of what is happening, what’s going on. This is how we capture the whole story”* (IFI-13).

**Table 7.36 - Focused Coding 2 For What Information is Provided to the Investor?**

Subtheme	Comparable updates
<b>Interviewees</b>	<b>Remarks</b>
IFI-06, IFI-08, IFI-15	Project update, market report, project in comparison to market and highlight any risk

While other IFIs compared the investment performance to the market environment, *“It will show him the project itself, how it’s doing, how it is doing compared to the market. So then finally in terms of risk, we will highlight. There is a delay in structure. So normally we will update him with that”* (IFI-15).

**Table 7.37 - Focused Coding 3 For What Information is Provided to the Investor?**

Subtheme	Updates and projections
Interviewee	Remarks
IFI-10	Update, along with major decisions taken during the period and financial forecast

In addition, some IFIs would also provide a forecast along with any major decisions taken by management during the reporting period, *“The development from the past, last report, you know, what happened and the expected plan and the future, kind of forecast and the financials...if there are any major decisions to be taken then or has already been taken by management or the board of the respected company”* (IFI-10).

Usually the updates would be an executive summary in the form of a report, *“between 5 pages to 10 pages max. update executive summary, 2 nice pages, some photos...then 2 to 3 paragraphs on the business, 2 to 3 paragraphs on the market environment. A table, financial summary... sales, cost of goods sold, EBDA, net income, a little balance sheet, assets, liabilities...all summarised; we didn’t give audited accounts”* (IFI-06). Elaboration would be on any good events, while any undesirable events/performance would be toned down, *“when we go for a weak point, maybe we don’t zoom on it, 2 to 3 points. But if there is a good comment, we will tell a story about it”* (IFI-03); *“Again, because formal communication is on a quarterly basis...if the information comes within the quarter, so we wait till the end of the quarter. If it is not resolved, then obviously it would be part of the quarterly. If it gets resolved, we may refer to it in the report, but then the tone you would be using is obviously different because the situation has already been resolved, rather than you now causing unnecessary panic to the investor”* (IFI-08).

In some instances, the IFI agrees upfront with the investor on the type of information that the IFI will be providing him with, as IFI-07 notes, *“What we agreed on upfront. That I will provide him with financials...there will be a bit of commentary from the CEO on what is happening in the business, business update. If there is anything like negative, negative news to pass on”*.

While in some IFIs, although they provide the investor with updates, the content is kept to a minimum, “What was the minimum required. Always management will go with the minimum requirement of disclosure as per regulatory. They try to minimise it” (IFI-03).

## 7.5 DUE DILIGENCE

This section summarises how the due diligence was undertaken by the IFIs.

**Table 7.38 - Due Diligence Process Undertaken**

Interview Question	What does your due diligence process cover? I.e. how is the DD process undertaken?
Focused Coding	Subtheme/remarks
1	Due diligence in stages
2	Due diligence performed by different parties
3	Due diligence rarely performed
Concluding Theme	Most of the common due diligence was undertaken

Due diligence (DD) is performed by all the IFI. The main ones were *Shari’ah*, financial and legal/regulatory, in addition to investment risk, management, commercial and market due diligence. Table 7.39 to Table 7.41 below look at how the due diligence process is undertaken.

**Table 7.39 - Focused Coding 1 For How is the Due Diligence Process Undertaken?**

<b>Subtheme</b>	<b>Due diligence in stages</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-04, IFI-05, IFI-12	Initial due diligence followed by in depth due diligence

Most of the IFIs start with an initial due diligence on the potential investment, mainly *Shari’ah* screen/concept and simple financial/operational due diligence. With the initial due diligence performed they would test the waters, seek the investors’ interest, after which, if the investors’ interest was high and attractive they would then take the due diligence a step further and perform a more comprehensive



assessment on the investment, “you don’t want to incur time and effort. So usually, it would be come at a later stage after submission of a letter of intent” (IFI-05).

**Table 7.40 - Focused Coding 2 For How is the Due Diligence Process Undertaken?**

Subtheme	Due diligence performed by different parties
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-02, IFI-04, IFI-07, IFI-12, IFI-14	Internal and external due diligence

Some IFI performed part of the due diligence internally and part of it externally. Generally, when it came to a specific specialised industry/market they would seek an external professional assessment, “*In real estate, we have the legal due diligence, financial... This we do in house. And the structural take place, we hire engineering firms, we hire environmental engineers as well. It gets carried out by professionals, because we don’t have the experience...*” (IFI-02). While others outsourced the due diligence process fully, “*When we originate a transaction, we go through full third party due diligence...So all those parties and those reports, we combine them, put them in a PPM form...*” (IFI-12).

**Table 7.41 - Focused Coding 3 For How is the Due Diligence Process Undertaken?**

Subtheme	Due diligence exceptional
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-05, IFI-07, IFI-08, IFI-13	Social and/or environmental due diligence rarely performed

While most of the common due diligence, such as *Shari’ah*, financial, legal, management, commercial investment risk is undertaken, social and environmental were not as common, “*But as a day-to-day due diligence check list, we don’t specifically do social or environmental*” (IFI-07). Some IFI consider it as a personal issue and it is left to the investor to take into consideration, “*On the social issue, it is the client’s call. It isn’t our call*” (IFI-05). While to others it is a derivative of *Shari’ah* due diligence, “*To be fair we strictly more concern with the Shari’ah than let’s say social impact and most of the time Shari’ah impact is always interlinked with the social effect...it comes within the umbrella of Shari’ah*” (IFI-08). Although it is not performed initially at the outset, there are times when it is required at a later stage, or in cases such as meeting overseas/international requirements in order to take on board foreign

investors that macro environment and social impact due diligence are performed, “*Those issues [environmental and social] we face basically post the investment. I’m not going to lie to you and tell you we covered those social diligences ahead of time. But sometimes when you face them you have to deal with them*” (IFI-01); “*We don’t do it. Yet, but I have seen it being done in the country... especially when there is an international investor coming in. Because they have some guidelines, they have to go through in the funds they are coming from...*” (IFI-13).

## 7.6 SHARIA’H COMPLIANCE AND SHARI’AH SUPERVISORY BOARD

This section looks into the *Shari’ah* governance system within the IFIs. It looks into the *Shair’ah* set up, with regards to having a specific department and to having a *Shari’ah* Supervisory Board (SSB), the process of approval and the *Shari’ah* review that is undertaken post-approval.

### 7.6.1 *Shari’ah* Compliance

Table 7.42 summarises the IFI’s responses with regards to having a *Shari’ah* department and a *Shari’ah* compliance officer.

**Table 7.42 - *Shari’ah* Department and *Shari’ah* Compliance Officer**

Interview Question	Is there a <i>Shari’ah</i> department/unit within the institution? Is there a <i>Shari’ah</i> compliance officer?
Focused Coding	Subtheme/remarks
1	<i>Shari’ah</i> department and <i>Shari’ah</i> compliance officer
2	No <i>Shari’ah</i> department but <i>Shari’ah</i> compliance co-ordinator
Concluding Theme	Even though IFI had someone handling the <i>Shari’ah</i> compliance, not all IFIs had a <i>Shari’ah</i> department

Overall, there was some form of association with undertaking *Shari’ah* compliance by the IFIs, whether it be directly, by having an internal *Shari’ah* mechanism, or indirectly, by outsourcing the service. For those that had an internal mechanism, it did not necessarily mean that they had independent compliance for *Shari’ah* specifically, but it was taken care of through the general compliance of the institute or by someone from the investment team.

**Table 7.43 - Focused Coding 1 For Is There a *Shari'ah* Department/Unit Within the Institution? Is There a *Shari'ah* Compliance Officer?**

Subtheme	<i>Shari'ah</i> department
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-06, IFI-08, IFI-10, IFI-14, IFI-15	<i>Shari'ah</i> department at institutional level and a <i>Shari'ah</i> team/ <i>Shari'ah</i> compliance officer
IFI-02, IFI-04, IFI-12, IFI-13	<i>Shari'ah</i> department at headquarters and <i>Shari'ah</i> supervisor/officer at institutional level

Some of the IFIs had a *Shari'ah* department at the institutional level, “Yes [to *Shari'ah* department unit], it is independent of the business team...there is a *Shari'ah* compliance officer...” (IFI-01). There were some IFIs that had a *Shari'ah* department at the headquarters level, of which they made use of their services at the branch level, “We have *Shari'ah* supervisors...At the bank level there is a whole department. But us at the company level we don't have. We have *Shari'ah* supervisors” (IFI-02); “we have an SLA [Service Level Agreement] with [parent institution] and that SLA includes the *Shari'ah* services... whenever we need *Shari'ah* we used to go the *Shari'ah*...of bank” (IFI-12).

**Table 7.44 - Focused Coding 2 For Is There a *Shari'ah* Department/Unit Within the Institution? Is There a *Shari'ah* Compliance Officer?**

Subtheme	No <i>Shari'ah</i> department
<b>Interviewees</b>	<b>Remarks</b>
IFI-03, IFI-05, IFI-07	IFI employee acts as coordinator with the <i>Shari'ah</i> Supervisory Board (SBB)
IFI-09	Outsourced

In some IFIs they did not have a *Shari'ah* department and employees of other departments would be handling the *Shari'ah* compliance matters. In some it is the investment team that follows up on maintaining *Shari'ah* compliance and a member of their team co-ordinates with the SSB. In such instances, the members of the investment team have some *Shari'ah* knowledge, either through experience and through having worked previously in a *Shari'ah* department or they have *Shari'ah* guidelines provided by the SSB that they follow, as IFI-07 comments, “We do have someone from the investment team. It is only because ...he worked in *Shari'ah* department in [another bank] beforehand...The coordinator”. While in some IFIs it is a member of the legal team (that also performs

the compliance for the IFI) that keeps track during the year of *Shari'ah* compliance, “*Usually it depends on the size of the fund. Usually the compliance people, the legal people*” (IFI-05). While some carried out their *Shari'ah* compliance through the IFI compliance department and not specifically having a *Shari'ah* department as such, “*Our head of compliance also our head of MLRO [Money Laundering Regulatory Officer]*” (IFI-11). Moreover, some IFIs outsource the whole *Shari'ah* matter, “*No [to Shari'ah department or unit], we don't...but we do when we come up with an investment opportunity. We have Shari'ah company or Sharia'h board that we use*” (IFI-09).

Now for those IFIs that said they had a *Shari'ah* department; it is usually the head of the *Shari'ah* department that acts as the *Shari'ah* compliance/supervisor officer/head and liaises with the SSB and those below the head perform the *Shari'ah* audit, upon which the *Shari'ah* compliance report is based. The role of the head is more supervisory/advisory on matters related to the pre-execution of the transaction: provide input on new proposals to IFI's departments, reviews and prepares documentation on new investments to the SSB. While those below undertake the role of auditing executed investments/transactions. This matter was clarified by getting in touch with the *Shari'ah* officers (SCO) of two IFIs. The *Shari'ah* department has two roles. The first is supervisory and is undertaken by the head of the *Shari'ah* department; he is considered the link between the IFI and SSB. His role, as explained by SCO-01<sup>203</sup> is: “*Shari'ah supervision is the phase prior to the execution of the agreements ...transactions and main agreements; all these fall under the supervision prior to execution. We make sure the structure is correct and is in line with the standards. Make sure that it is acceptable by the Shari'ah Supervision Board. Make sure that its clauses do not have any terms that go against the Shari'ah standards or against the Shari'ah fatwas. Also provide advice to the executive management.*” The second is *Shari'ah* audit which is undertaken by the *Shari'ah* team within the *Shari'ah* department. Whereby their role is post-execution of the transaction, as confirmed by SCO-02<sup>204</sup>: “*The Shari'ah auditor goes out into the field to look at the bank's executed transactions, and prepares all the audit paperwork and forms and so forth.... the Shari'ah's supervisor reports are submitted to the Shari'ah Supervision Board*”.

On another note, when enquiring about the *Shari'ah* compliance officer's independence, (since the *Shari'ah* compliance officer administratively falls under the IFI, yet technical performance is monitored by the SSB), as SCO-02 noted “*...administratively: performance appraisal, promotion, bonuses of the Shari'ah supervisor is considered part of the bank's employees' appraisal. The Shari'ah Supervision Board view is taken on his technical performance, but the final say is on the bank*”, and in some cases the IFI did not consider that there was any influence from the IFI management on the *Shari'ah* compliance officer's decision making. To this IFI-06 comments, “*No, it was always war...The CEO*

---

<sup>203</sup> The interview was conducted in Arabic and the quote has been transcribed and translated by the researcher.

<sup>204</sup> The interview was conducted in Arabic and the quote has been transcribed and translated by the researcher.

used to be convinced with the deal, board of directors convinced, the guy [being the Shari'ah compliance officer] doesn't...He [the Shari'ah compliance officer would say] I don't care. You have a problem go to the Shari'ah board"). While other IFIs did consider that it affected the Shari'ah compliance officer's independence in the decision making, as IFI-15 explains, "In theory he is independent. In reality, whatever the CEO wants, he will do...in most of the banks, normally they say he is reporting [to the SSB], he is not reporting to [to referring to the CEO]. This is where you get concern [being administered by the IFI has some affect on the Shari'ah compliance officer's independence]. I haven't seen so far, any internal Shari'ah will not do what the CEO wants" (IFI-15).

## 7.6.2 Process of Shari'ah Approval and Shari'ah Review

The following section looks into the process of obtaining Shari'ah approval and performing the post-investment Shari'ah review/audit.

### 7.6.2.1 Process of Shari'ah Approval

Table 7.45 below summarises the process of obtaining Shari'ah approval.

**Table 7.45 - Approval Process**

Interview Question	What is the process in which the Shari'ah consultation/approval is obtained at your institution?
Focused Coding	Subtheme/remarks
1	Investment team interacts indirectly with SSB
2	Investment team interacts directly with SSB
Concluding Theme	To be able to invest, IFIs need to get the SSB's approval on the investment

In order to obtain approval, every related document is usually approved by SSB, "because we have to be Shari'ah compliant, so everything has to be approved by Shari'ah [Board]. Financing has to be approved by Shari'ah. The investment structure has to be approved by Shrai'ah. The investment itself has to be approved by Shari'ah. The tenants have to be approved, etc." (IFI-02); "any documentation, any legal documentation, whether as basic as a non-disclosure agreement to a signing of a SPA [Share Purchase Agreement], or to basically signing of any due diligence document; every single document has to be approved by our Shari'ah" (IFI-11). And in most cases, the Shari'ah team prepares the necessary for the SSB to review, they provide their input at times to the investment team, however, they

do not make the *Shari'ah* judgement, as IFI explains, “*The bank Shari'ah employees are not decision makers. They put together a file and they present it to the Shari'ah Board that meets periodically and takes a decision. Sometimes they have authority to take decisions on simpler points that are basic Islamic rules, which they can say yes or no to. But if there is something that allows subjectivity it goes up in the right sort of way...* ”.

The SSB members were the decision makers, and would provide feedback when required for amendments to be made, “*We provide them with the information then they provide the feedback, they have an opinion, they have a provision that needs to be removed from the agreement or amended. And we accordingly do the amendments based on the Shari'ah instructions. To ensure the compatibility*” (IFI-02). However, this was not always the case during earlier years, as the SSB members were not very familiar with the investment structures, and so their questions were limited. But over time, as their knowledge/understanding broadened, they started to question more. As IFI-06 explains, “*At the early days they [the SSB members] were not seeing much. Little by little, they learned. They wanted to see every single thing to the actual business. Not only Cayman [being the SPV, the intermediary level in the investment structure] also under the Cayman. There are also other companies on top of the Cayman ... A couple of times they used to examine/audit into the company*”.

**Table 7.46 - Focused Coding 1 For What is the Process in Which the *Shari'ah* Consultation/Approval is Obtained at Your Institution?**

Subtheme	Investment team interact indirectly with SSB
Interviewees	Remarks
IFI-01, IFI-02, IFI-08, IFI-10, IFI-12, IFI-14, IFI-15	Coordinates with <i>Shari'ah</i> Compliance/Head who has an active role
IFI-07	Coordinates with <i>Shari'ah</i> Compliance/Head who has a passive role

The process of consultation for approval in some IFIs starts right at the beginning. As the investment team has a new investment/project, they immediately get in touch with the *Shari'ah* team to work on the requirements. Usually, the *Shari'ah* team will review the documents/project files in detail and will provide a summary and present it to the SSB for approval. To that IFI-12 notes, “*we basically contact the Shari'ah compliance officer and he will set up the requirements, come back to us if he needs more information and then he will present it [the investment/project] to the board...They review, first of all the issuer, ok, is Shari'ah compliant, then they will review the PPM*”. Furthermore, IFI-10 elaborates

on the matter, “we do approach the Shari’ah whenever we have a new project with a memo... meeting is arranged with...Sometimes with the lawyers, sometimes with the investment officer, with the SSB, or the Shari’ah auditor. They discuss and they highlight the issues. Sometimes Shari’ah comes up with some queries to be answered by the initiator of the investment, or treasury and a decision is made based on that”. And with the approval of the initial concept, the investment team will work on preparing all the related documents for SSB approval; first on the structure, then on the underlying asset, “We start by getting Shari’ah approval on the concept. Once it is granted as concept, then later SSB approval on the structure of the investment. Then we get approval on the underlying assets and we are free to go” (IFI-02). Moreover, at times the investment team is able to go ahead having only obtained approval on the structure, as IFI-15 explains, “...after we structure the deal we present it to them [being the SSB]. If they approve then don’t have to go back to them”.

In other IFIs, the Shari’ah teams are not as active, and have a more passive role, merely co-ordinating meetings between the investment team and the SSB, “because this coordinator [the employee performing the Shari’ah compliance role] doesn’t really get involved in the deal. He is just meant to be the point of contact...communication channel, possibly makes it easier. But the Shari’ah Board talks directly to the team [being the investment team]. So, any clarification and issues they have ...I remember there was instance where we were in co-investor deal, Shari’ah scholars were asking us questions. They interact with the deal...” (IFI-07).

One of the issues IFI faced when complying with the documentation for approval was for it to be an all-round document that would satisfy all parties, “Shari’ah compliant was very easy by the way. [It is a matter of] Internal activities and such thing. The problem was in the documentation. How to document all this in to paper, that it will pass Shari’ah and lawyers were happy, etc., and the other party who was not Shari’ah compliant for him, when he reads it he feels it is like normal” (IFI-06).

**Table 7.47 - Focused Coding 2 For What is the Process in Which the Shari'ah Consultation/Approval is Obtained at Your Institution?**

Subtheme	Investment team interact directly with SSB
Interviewees	Remarks
IFI-05, IFI-13	Gets in touch directly with SSB

Some IFIs liaise directly with the SSB, “And when we send them the documents and the plans, etc. they review it. They invite us, they ask some questions and then they would approve it with framework. These

*are the criteria 1, 2, 3 any deviation come back to us; let's talk and discuss*" (IFI-13). In other IFIs where the investment team liaised directly with SSB, they would not go immediately as an opportunity came up. They will first perform the initial screening themselves, as per the guidelines given to them by SSB, after which they will go to obtain approval from the SSB, as IFI-05 notes: *"The SSB would give us guidelines ...You have to take the guidelines and say would these guidelines fit in this transaction .... so if I take a transaction I will not go to them [being the SSB] from the beginning, but if once it gets serious ... we are in the process of sending them a letter of intent ... At this stage..."*. In such cases, the investment team members will need to be trained to have some *Shari'ah* background, *"You need to train your staff, whereby they are educated with the minimum requirement, so they understand that they cannot do this transaction if these companies you cannot touch"* (IFI-05).

However, for *Shari'ah* team members, with regards to having an adequate *Shari'ah* background, it was not enough to only be *Shari'ah* knowledgeable. Unlike the SSB members, the *Shari'ah* department team members, although they held high qualifications (PhD in *Shari'ah*), they lacked experience and financial/investment knowledge, which affected their understanding of the investment opportunities being presented. Hence, some investment teams faced some difficulties when dealing with *Shari'ah* team members to understand the opportunities being put forward for approval. IFI-06 explains, *"...what I noticed, the level of education, sophistication, and experience for the in-house is usually [limited] yes... sees only one bank...some of them had PhD in Shari'ah, underlying something was totally different. So a lot of them are totally new. Just started 2 to 3 years ago. No experience. But when you sit with Shari'ah Board member, his experience is different"*.

The approval process would end with a certification letter produced by the SSB, *"The report will go to them [SSB] on the project and normally you will find most of them in one letter with one paragraph saying we have reviewed and... they have comment, they don't have comment"* (IFI-15).



### 7.6.2.2 Shari'ah Review

Table 7.48 summarises the process of a *Shari'ah* review performed post-investment.

**Table 7.48 - Shari'ah Review**

Interview Question	What is the institution's process of monitoring the consistency of its <i>Shari'ah</i> compliance and how does it manage any <i>Shari'ah</i> compliance risk that may arise over time?
Focused Coding	Subtheme/remarks
1	Performed internally
2	Performed externally
Concluding Theme	<i>Shari'ah</i> review was undertaken either internally or externally by a <i>Shari'ah</i> Advisory Firm

In most cases, a regular *Shari'ah* review<sup>205</sup> is performed throughout the year, usually quarterly, “as a minimum quarterly” (IFI-01). This then acts as the basis for the annual *Shari'ah* report that is produced by the SSB for the shareholders and presented at the Annual General Meeting (AGM).

**Table 7.49 - Focused Coding 1 For What is the Institution's Process of Monitoring the Consistency of its *Shari'ah* Compliance? How Does it Manage any *Shari'ah* Compliance Risk that May Arise Over Time?**

Subtheme	Performed internally
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-06	Investment report to <i>Shari'ah</i> audit
IFI-07	Investment team report to SSB
IFI-08, IFI-10, IFI-11, IFI-14, IFI-15	<i>Shari'ah</i> audit review

In some IFIs it is the investment team that provides the *Shari'ah* department with regular reports on the investment and based on the reports the *Shari'ah* team performs the *Shari'ah* audit, “we [being the investment team], give them [the *Shari'ah* team] monthly reporting and quarterly reporting and from time to time they go and physically check. .... they review the transaction from start, and they do the audit on the target companies. They produce a report ... they would highlight all the *Shari'ah* aspects ....

<sup>205</sup> The terms review and audit were used interchangeably with regards to *Shari'ah* compliance reporting.

*If they have raised any comments and how it is being dealt with...*” (IFI-01). While in other IFIs, it is the *Shari’ah* compliance members that meet on an annual basis with the investment team (rather than the investment team providing a report to the SCO), and along with all the documents and information he obtains he produces the *Shari’ah* audit report, which is submitted to the SSB. IFI-06 explains, “... *he takes documents, financials, meets with me [the investment team member], maybe a few of them used to visit... to see the business...Then he does a report and sends it to the Shari’ah Board. The Shari’ah Board looks at the report, all is well, signs and here is a Shari’ah certification for 2011, all is good...*”.

In some jurisdictions where AAOIFI standards were not compulsory, and as such the IFIs in those jurisdictions were not obliged to have a *Shari’ah* audit, “*You have to remember that we are Islamic, but there is no stipulation that we have to be audited as Islamic*” (IFI-07). In such IFIs and in the IFIs that did not have a *Shari’ah* department nor did they outsource it, they would directly report to the SSB. They would report to the SSB with regards to having maintained the conditions/parameters set by the SSB at the time of approval. IFI-07 goes on to explain, “*So they [the investment team] also see on a monthly basis what is happening with the company [the investment company]...on an annual basis we give an update, so any of the issues that were highlighted...where our Shari’ah Board said here is the timeline to make these changes. You are going to invest in this company, fine, but better kind of convert all the accounts within one year. Change this within 2 years. So it was with conditions. So then we would have to report back*”.

While in some IFIs it was the *Shari’ah* department that handled the whole *Shari’ah* audit review, “*Shari’ah audit/officer he will go and do on annual basis, project by project and they will check whether Shari’ah compliant not Shari’ah. complaint...*” (IFI-15).

**Table 7.50 - Focused Coding 2 For What is the Institution's Process of Monitoring the Consistency of its *Shari'ah* Compliance? How Does it Manage any *Shari'ah* Compliance Risk that May Arise Over Time?**

<b>Subtheme</b>	<b>Performed internally</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-02, IFI-04, IFI-12, IFI-13	Outsourced to headquarters
IFI-03, IFI-05, IFI-09	Outsourced to Shari’ah Advisory Firm

There are some IFIs that outsourced the post-investment *Shari'ah* audit review, either through a service agreement with their headquarters or contracted it to a *Shari'ah* Advisory Firm. The coordinator, whether it be from the general compliance team or a *Shari'ah* supervisor at the IFI level, reports to the headquarters, *“the general compliance officer in the company he is the person, point of contact to liaise between us in business and the Shari'ah who are residence at the bank...we have Shari'ah review every 6 months. They come and ask for the file, the deal and they just review the whole thing”* (IFI-13). When they come and check, they check that the implementation has taken place as per the decisions of the SSB, and that no deviation to the decision has occurred. Any deviation is then reported to the SSB. On this IFI-02 elaborates:

*“...Contracts, financing, procedures. To make sure that the procedures are correct and have been executed/implemented as per Shari'ah. Because if he discovers any violation, immediately he reports...to Shari'ah supervisors and supervisors report to SSB [at headquarters] ... They come and do random checks from time to time, on files, on investments. They go and visit the investments sometimes ... Like an audit”.*

In cases where the whole SSB is outsourced to a *Shari'ah* advisory firm, the firm would appoint a committee from its employees, who will perform the *Shari'ah* audit. IFI-05 confirms, *“The Shari'ah company they appoint a Shari'ah committee or an independent committee. Whereby on an annual basis you need to go through everything and make sure that you... followed these parameters. When the annual audit comes, you have to show them, you followed this”.*

In instances where the *Shari'ah* review is performed internally, the issues raised in the report generated are taken up with the IFI/the investment team to be resolved. In the event the issue is still outstanding by year end, it then gets reported in the *Shari'ah* annual report prepared by the SSB. As IFI-01 explains: *“They come back to us, resolve the issues. By year end...Whatever is outstanding ... they [SSB] would mention that this has been highlighted... and is still under the process... And they would say that they are comfortable, they have enough comfort that this would be resolved”.* However, there are times, as IFI-15 remarks, when the feedback on the *Shari'ah* audit report is not as efficient as would be preferred, whereby the IFI could have exited the investment, before the SSB gets back to them *“...most of the Shari'ah Board they don't have time... So, by the time the reports go to him and he reads it, sometimes we exited and still he didn't come back. The efficiency is not there”.*

At other times the investment team did not see eye to eye with the *Shari'ah* audit comments. To them, those that performed the *Shari'ah* audit, at times, wanted to review documents that they did not think needed it, as they did not think they were *Shari'ah* related. IFI-06 remarks, *“The confidentiality*

agreement, that I want to sign, the Shari'ah has to see it. It is legal document... There are things when he then used to do audit, he will tell us, why didn't show this document. It is a commercial agreement [in the opinion of the investment team member]. I [Shari'ah audit member] have to see it... ”.

### 7.6.3 Shari'ah Supervisory Board (SSB)

The following section looks into the IFI's key on the independence of the SSB members of their institution. Its independence is in relation to the IFI it supervises. The independence is viewed from two aspects. First, whether there is any relationship or link of any of the SSB members with the IFI, and second, who appoints the SSB.

#### 7.6.3.1 SSB Independence

Table 7.51 below summarises whether any of the SSB members have any relationship or link with the IFI they are supervising.

**Table 7.51 - Whether Any of the SSB Members Have Any Relationship or Link With the IFI They are Supervising**

Interview Question	Are any of the SSB members on the Board of Directors (BOD) or on the Board Committee, a client or a shareholder?
Focused Coding	Subtheme/remarks
1	SSB completely independent
2	SSB not fully independent (exception)
Concluding Theme	In most cases the SSB members are independent of the IFI they supervise

In the majority of cases, the SSB are independent with regards to not being a member of BOD, or the IFI's Board Committees or a client<sup>206</sup> of the IFI or a shareholder. This is also reflected in the line of reporting, where they report directly to the BOD, “*These members report to the BOD*” (IFI-01).

<sup>206</sup> With regards to not being a client of the IFI, although when interviewing the IFI, none had reported that any SSB members were a client (possibly due to the interviewee being from the investment team and so they were not aware), some *Shari'ah* scholars had admitted to being a client of the IFI. Moreover, in the cases when they were, they had disclosed this information.

**Table 7.52 - Focused Coding 1 For Are Any of the SSB Members on BOD, on Board Committees, a Client, or a Shareholder?**

Subtheme	SSB completely independent
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-02, IFI-06, IFI-07, IFI-08, IFI-11, IFI-14, IFI-15	IFI's own independent SSB
IFI-03, IFI-04, IFI-05, IFI-09, IFI-12, IFI-13	IFIs outsource independent SSB

There are two categories of *Shari'ah* supervision: old school which is where the IFI will have its own independent SSB, where it will appoint *Shari'ah* scholars; and new school, which is where the IFI outsources the function of *Shari'ah* supervision to a specialised firm, "You are talking of the SSB, there are 2 schools. The old school, every company has a SSB. They chose scholars and they give remunerations at the end of the year" (IFI-05). The new school of appointing a specialised firm is a new trend, and in some jurisdictions it is a new addition to their list of authorised auditors, as IFI-03 comments, "When the [Regulator] came they made new regulations on the Islamic companies that there must be *Shari'ah* Auditor registered at the [Regulator]. There weren't any companies earlier, now they have started to register. So, I can sign with them, ... as *Shari'ah* Supervisory or *Shari'ah* Body...".

In either case the SSB is totally independent (with the exception below) from the IFI, as IFI-02 confirms, "He [the SSB member] is from outside, not related to us. So there is no conflict and he stays independent and they report directly to the Board...They are highly independent".

**Table 7.53 - Focused Coding 2 For Are Any of the SSB Members on BOD, on Board Committees, a Client, or a Shareholder?**

Subtheme	SSB not fully independent (exception)
<b>Interviewee</b>	<b>Remarks</b>
IFI-10	SSB not fully independent (exception)

One of the IFIs was given an exception to the norm of SSB members being independent from the IFI. This was due to one of the three SSB members resigning due to health issues and so the IFI sought the regulator's approval for the *Shari'ah* compliance officer to replace the resigned member. On this

IFI-10 explains: “*Shaikh A<sup>207</sup> is now a member of the SSB and he is the internal Shari’ah compliance officer as well. He is a member on the board [SSB]... You can’t consider Shaikh A, as independent, but he does provide his opinion very independently. This is an exception*”.

### 7.6.3.2 Appointment of the SSB

The appointment of the SSB was looked at as part of the SSB function being independent. Table 7.54 below summarises who appoints the SSB.

**Table 7.54 - Appointment of SSB**

Interview Question	Who appoints the SSB?
Focused Coding	Subtheme/remarks
1	AGM appoint by name on recommendation BOD
2	AGM provide general approval open to BOD to select/appoint
3	Depends on the investment (in the case of outsourcing)
Concluding Theme	In general, it is the AGM, but it varies whether by name or general approval to appoint a SSB

Although in general the Annual General Meeting (AGM) made the decision either directly (deciding on the names) or indirectly (no specific names) with regards to the appointment of the SSB, the number of times that a SSB member could be re-elected/re-nominated was open. IFI-08 notes, “*So every year, we state the re-appointment of the Shari’ah board. We recommend as management, or the board recommends, to the shareholders and then they endorse the appointment...The simple answer to the question, they can be renewed indefinitely*”. This open-ended time of re-electing/re-appointing is a cause for concern with regards to the effect it can have on the scholar’s independence. Over time, the scholar becomes more familiar and closer to the IFI affecting his independence, and hence, is an area that needs improving, as IFI-15 comments, “*Open...if you go to some of the Islamic banks some of them have been since the inception of the bank. This is one area that the [Regulator] can learn and play a good role in*”.

<sup>207</sup> A - The identity of the *Shari’ah* scholar has not been revealed to maintain the confidentiality and identity of both the scholar and the IFI.

However, in some cases, the flexibility the IFI has in determining the term period of the SSB’s service has assisted them in controlling the performance of the SSB members. In some cases, they have used it as a mechanism to control the SSB members’ attendance, as IFI-10 explains:

*“There is no limit. Some banks they appoint them for 3 years. And they renew it. Here we renew on annual basis... We had changed to annually, to allow us to evaluate the SSB performance. Because somehow the 2 members initially they were not attending the meetings, and that is why [changed to annually], they [management] want to keep an eye on the performance of the SSB...that was the recommendations [being that of the Management], not regulations. The regulators are fine if you are appointing them for 3 years”.*

**Table 7.55 - Focused Coding 1 For Who Appoints the SSB?**

Subtheme	AGM appoint by name on recommendation of BOD
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-10, IFI-12, IFI-13, IFI-14	AGM by name on recommendation of BOD/management

In some IFIs the BOD nominates the *Shari’ah* scholars to the shareholders at the AGM for approval, *“The general meeting. A recommendation comes from the management, from the board and goes to the general shareholding meeting”* (IFI-10).

**Table 7.56 - Focused Coding 2 For Who Appoints the SSB?**

Subtheme	AGM provide general approval open to BOD to select
<b>Interviewees</b>	<b>Remarks</b>
IFI-02, IFI-07, IFI-08, IFI-11, IFI-15	AGM general approval open to BOD to select

In other instances, the SSB members are appointed based on the shareholders keeping it open to the BOD to select the *Shari’ah* scholar, as IFI-02 notes, *“The AGM approves them...No specific names”*. This open authorisation has allowed the IFI management to choose the *Shari’ah* scholars that they think will most likely accept their proposals, as IFI-15 explains, *“most of the Shari’ah members you will find that he is appointed by the board. Which suit them, which they can work with. So, you will find lots of bank will say, from which school is he [the Shari’ah scholar] and the one that easily accepts, they will choose”*. That being said, some IFI faced some difficult times in harmonising with some SSB members.

According to IFI-06, there are times when a scholar bases his opinion on the past without making allowances for the changes that have taken place in the business environment:

*“Honestly there were Shari’ah issues. He used to explain to me from his perspective... he shows me the AAOIFI and he shows me the text, I know what it means, but for me I am sitting on the other side. I try to explain to him. I try to make him understand that there is no discrepancy to Shari’ah opinion. ... he holds text on me. The text is history 1350 years...at the time, there were no companies that had working capital, nor companies’ capital’s that had rights issues or tier 1 capital, tier 2 ... what are the Shari’ah principles? Let’s understand the principles and we implement the principles on that basis. It was difficult.”*

That being said, although not all, there were some SSB members that did try to understand and assist to help find possible ways to conduct the investment as per *Shari’ah*, *“There are Shaikhs ...he understands. He gives you solutions...he gives and takes in dialogue”* (IFI-06).

**Table 7.57 - Focused Coding 3 For Who Appoints the SSB?**

Subtheme	Depends on the investment
Interviewee	Remarks
IFI-05	Depends on the investment

In some IFI (those that outsource the SSB function) it depends on the type of investment they are entering into, *“It depends if it is a public company or if it is a big project, of course it [being the SSB members] is appointed by the AGM. But if it is a project by itself, usually the fund manager appoints them or the project manager, who is running the process or the clients. ...Yes [to getting the client’s approval] if I am acting in a position on behalf of clients, I would tell them, hey listen we are appointing this and this and these are the fees, etc.”* (IFI-05). It also depends on the location of the investment and investors because it is inappropriate to appoint SSB from a jurisdiction other than where the investment is based or to whom it is offered, as IFI-05 explains:

*“It depends on demographics. It depends where you are... Because you need to make sure that also these people you bring on board are accepted by the local community that you are in. Some of them, the people for example, if I do a project today and I have a fund in Dubai/GCC and all my Shari’ah Board are from Malaysia, people will not take a look at that”.*



#### 7.6.4 Shari'ah Risk

*Shari'ah* risk is looked at from the perspective of what are the areas or possible matters that could affect the *Shari'ah* compliance of the transaction/project post-investment.

**Table 7.58 - Shari'ah Risk**

Interview Question	What do you consider as <i>Shari'ah</i> risk for Islamic Private Equity (IPE)?
Focused Coding	Subtheme/remarks
1	No risk
2	There is a risk of non-compliance
Concluding Theme	There are some matters that could affect the <i>Shari'ah</i> compliance of the investment

Some IFIs had identified there being some form of risk or another, while one IFI could not foresee any post-investment risk, if initially the process of *Shari'ah* screening was done diligently.

**Table 7.59 - Focused Coding 1 For What Do You Consider as Shari'ah Risk For Islamic Private Equity (IPE)?**

Subtheme	No risk
Interviewee	Remarks
IFI-02	No risk of <i>Shari'ah</i> non-compliance

In the opinion of one of the IFIs, if the initial work was done correctly, the IFI does not perceive there being any *Shari'ah* risk of deviating from the *Shari'ah* principles,

*"I don't see it as risk. If the work was done correctly at the beginning, there is no risk. If you are given the guidelines and you started the correct way, I don't see there being a problem. On the contrary, from the start your financing is correct, Shari'ah correct, the asset class you are dealing in is right, there are no restrictions. There are no Shari'ah preservation. Can't see anything risk associated"* (IFI-02).

**Table 7.60 - Focused Coding 2 For What Do You Consider as *Shari'ah* Risk For IPE?**

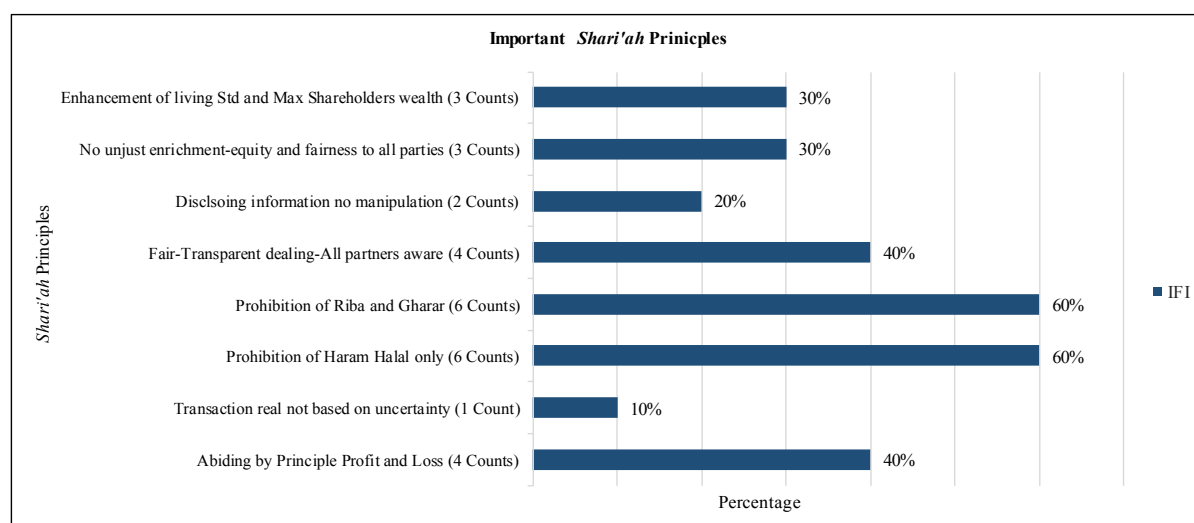
Subtheme	There is a risk of non-compliance
Interviewees	Remarks
IFI-05, IFI-07	Risk in maintaining ratio
IFI-05, IFI-08	Risk in business structure
IFI-03, IFI-09, IFI-10	Risk in <i>halal</i> (where and what/type) investment

Some IFIs thought that the risks from a *Shari'ah* perspective were with regards to maintaining the financial ratio (debt to equity), as IFI-05 explains, “*But sometimes, what will happen is some ratios might change for some reason or another, the debt/equity ratio. The portion of non-halal revenue and all that, if these change, then you are in trouble*”. While with others it is related to the underlying structure being *Shari'ah* compliant, especially those that are based on a conventional structure “*you have to be careful that the structure is within the Shari'ah guidelines and more importantly is the essence of Shari'ah in that transaction. You can try to change a conventional investment into a Shari'ah compliant one, but the underlying investment could basically be far from Shari'ah philosophy*” (IFI-08). Some also saw that the matter of *halal* is also a cause of *Shari'ah* risk because it depends on the size of the non-*Shari'ah* effect. Whether the amount of non-*halal* is relatively small in comparison to its value, as IFI-10 notes, “*sometimes he [SSB member] accepts... They are saying this is very minor compared to the total size of the price, but may be would have to come up with some formula to make purification at the end, at the time of exit*”.

When the IFI was questioned on the important *Shari'ah* principles, as per their responses (Figure 7.1 below) the majority of the responses<sup>208</sup> consider the prohibition of *haram* and only *halal* (60%), along with the prohibition of *riba* and *gharar* (60%), as the most important principles. This was followed by the principle of sharing in profit and loss (40%), along with the principle of fair and transparent and being aware of rights and obligations (40%). Enhancement of living and the welfare of community (30%), along with no unjust enrichment, equity and fairness to all (30%) followed suit. While clarity, disclosure of information and no manipulation ranked before the last (20%) and the principle of the transaction being real ranked last (10%).

<sup>208</sup> The responses cover 10 of the 15 IFIs that were interviewed.

**Figure 7.1 - IFI Perception on the Important *Shari'ah* Principles**



## 7.7 REGULATORY REQUIREMENTS

The following section looks into whether there are any regulatory requirements, prior to and post-investment, in Islamic Private Equity/Private Placement (IPE) offering and the IFIs' opinion on such regulations.

### 7.7.1 Pre-Regulatory Requirements

Table 7.61 below summarises whether the IFI have any pre-regulatory requirements when they offer IPE to investors.

**Table 7.61 - Pre-Regulatory Requirements**

Interview Question	Are there any regulatory requirements on your institution with regards to promoting and selling IPE?
Focused Coding	Subtheme/remarks
1	There are pre-requirements
Concluding Theme	All jurisdictions have pre-regulatory requirements in some form or another.

It depends on the jurisdiction where the IFI is located, and whether there are any pre-regulatory requirements that the IFI has to abide by prior to offering such investments to investors. When

approaching investors to invest in IPE, IFIs are required to approach accredited/sophisticated investors, and this requirement is taken as an expected fact on the type of investors that the IFI approaches. Some have to provide the regulator with a list of the investors post-investment and depending on the number of investors, if it is below a certain threshold, a list of potential investors would also need to be forwarded to the regulator prior to investing. IFI-12 explains:

*“There is the limited offer type, and there is the type that ...won’t be offered to more than 200 investors. And you cannot offer it to a non-sophisticated according to the [the regulation] ...A limited offer is offering to 60 investors and you have to list down their names. If not a limited offer, you don’t have to list the names. But they all have to be sophisticated. After the offer, you have to keep and submit to [Regulator] the list of the people who subscribed, paid money and basically the amount subscribed the amount of shares, you have to send it to [Regulator]”.*

Although the type of investors was a given requirement, some IFIs still faced issues with regards to meeting them satisfactorily. It was not easy to determine whether the potential investor possessed the technical characteristic required by the definition. Whereby in most definitions the potential investor would need to have a certain wealth and to possess the ability to analyse financially. The IFI were able to determine the potential investor’s wealth (through proof of documentation), yet determining the investor’s analytical skills was difficult. As expressed by IFI-12: *“It is very difficult to define sophisticated investors because they are wealthy individuals but they might not be sophisticated. When it comes to technical stuff... they define that someone who is able to analyse...and also who has a financial advisor... basically it is very difficult”.*

**Table 7.62 - Focused Coding 1 For Are There Any Regulatory Requirements on Your Institution With Regards to Promoting and Selling IPE?**

<b>Subtheme</b>	<b>There are pre-requirements</b>
<b>Interviewees</b>	<b>Remarks</b>
IFI-01, IFI-07, IFI-09	Require license
IFI-02, IFI-06, IFI-08, IFI-10, IFI-11, IFI-15	Approval on investment/SPV
IFI-01, IFI-05, IFI-06, IFI-08, IFI-10, IFI-11, IFI-12, IFI-13, IFI-14, IFI-15	Approval on marketing documents/PPM
IFI-03, IFI-15	Shari’ah Auditor/Shari’ah Board Approval

It depends on the jurisdiction whether a specific requirement for the prompting and offering of IPE is required or not. With some IFIs, if they had the appropriate license to offer such an activity, they were good to go ahead, and no other requirements were required, as IFI-07 notes, *“I know you have to have license. So if you want to place investment you have a specific license...From the [Regulator] you have to apply for a special license, there is no requirement as such [for promoting and selling IPE specifically]”*.

While others, in addition to the license of an Islamic financial institution, it was required that they seek approval on the documents to be offered to investors, *“On documents of course. We provide them with summary memo and the proposal investment, the proposal equity that would be offered to the investors and you get their approval. Yes, they have to see it [the offering document]. They [the Regulator] come up with some questions. They challenge some numbers. They challenge some assumptions as well”* (IFI-10). And in some jurisdictions, approval was also required on the investment itself, *“The [Regulator] has to approve the PPM, before we use it, pre-approval. Even if we want to establish an SPV or a special purpose vehicle for the structure, even it has to be approved by [Regulator]”* (IFI-08). In addition to certain jurisdictions, the IFI needs to submit the promoting documents and to have a waiting period. Upon which once it expires, if they have not heard from the regulator they can proceed with the offer, *“In a Private Placement, usually they [Regulator], the no objection rule is, if you don’t hear from us within 10 days, please proceed with the offering. If they come back to you, that there is something you need to change, or basically they have comments. But after 10 business days, usually if they have no comments you just proceed with it”* (IFI-12).

Moreover, in certain jurisdiction, where the documents have to be approved, it is not the regulator that does the review, but the compliance officer that has been hired from an authorised list, *“The compliance officer has to see it [the documents]. He has to see it. The way it goes, if there is an issue, he reports it. The way they [Regulator] put it, is that the compliance officer needs to follow the requirements of the [Regulator] and report. If you breach it, he [compliance officer] doesn’t tell me... he goes and reports it [to the regulator]. Sometimes he tells me, this is a breach, if you will remedy it. Or sometimes the breach is big, he just goes and reports it. Everything, invitation, document, PPM, everything. He [the compliance officer] is outsourced. They [the Regulator] have licensees and entities authorised by them so you hire from them, and you hire somebody and they become your clientele”* (IFI-05).

At times when the product is offered in more than one jurisdiction, where the document would be offered to investors in other jurisdictions, regulatory approval was required of the other jurisdiction, yet

it was not necessarily always obtained. Time was an essential factor, and at times, it was difficult to obtain the other jurisdiction’s approval, if the IFI was not one of their licensees, so the way around it was to get the interested investors to come across and sign in the country where the IFI was licensed.

Furthermore, since the product to be offered is to be *Shari’ah* compliant, *Shari’ah* approval is required, in addition to having a SSB. As IFI-15 explains: “*Part of it [the regulatory requirements] you have to be in compliance with Shari’ah,...You have to get approval for any product before you launch in the market. The Shari’ah board has to be there. There is a checklist... Shai’ah approval has to be there*”.

However, with regards to submitting the documents in full, it is not necessarily the case. At times a summary of the investment/document is submitted, and if the regulator requires further detail it will request it, as noted by IFI-15, “*You have to submit the summary, but sometimes they [Regulator] ask for more information...*”.

### 7.7.2 Post-Investment Regulatory Requirements

Table 7.63 below summarises whether IFI have any post-investment regulatory requirements, when they offer IPE to investors.

**Table 7.63 – Post-Investment Regulatory Requirements**

Interview Question	Are there any on-going regulatory requirements with regards to disclosure and transparency that your institution needs to abide by, once the investment has been offered?
Focused Coding	Subtheme/remarks
1	There are post requirements
2	There are no post requirements
Concluding Theme	In some jurisdictions there are post investment requirements, while in other there are not

While nearly all jurisdictions had pre-regulatory requirements, not all had post regulatory requirements.

**Table 7.64 - Focused Coding 1 For Are There Any On-Going Regulatory Requirements With Regards to Disclosure and Transparency That Your Institution Needs to Abide by, Once the Investment has Been Offered?**

Subtheme	There are post requirements
<b>Interviewees</b>	<b>Remarks</b>
IFI-05, IFI-08, IFI-10, IFI-13, IFI-14, IFI-15	To the investor
IFI-05, IFI-03, IFI-08, IFI-10, IFI-11, IFI-12, IFI-13	To the regulator

Some post-investment requirements were for the investors and others were also for the regulator. It depends on where the investment is being offered, and on the jurisdiction of the investment. IFI-05 notes, *“There is requirement if the product is licensed by [licensee’s Regulator]. Depends on the product. Because if it is offshore, it is different. [Licensee’s Regulator] license you have to follow their requirement on the reporting, type of reporting. Usually it is to the investor and they [being the Regulator] get notified”*. In addition, with regards to the investment, it also depends on whether it falls under a specific authority, whereby the requirements of that authority would need to be adhered to. Hence, if the investment company was an FI, then it would need to adhere to the licensed authority, and if the invested company was a listed company then it would have to meet the listing requirements. As IFI-11 notes, *“So it depends which investment we are exposed to and which geography they are in”*.

The IFIs usually try and maintain post-regulatory requirements, which are basically guidelines on how to act with clients, *“there are on-going regulations related to the treating client fairly, conflict of interest and ensuring compliance”* (IFI-14). In some jurisdiction the requirements are as per those for funds<sup>209</sup>, *“How can I deal with my clients? How can I report to them? And there is market conduct?”* (IFI-13).

Moreover, any changes/amendments to the terms and conditions of the investment to those stated in the approved document, the IFI would need to update and notify the regulator. IFI-14 notes, *“They ask for any amendments, when we have the funds terms and conditions, and if the fund manager amends anything, any single material thing, we have to report it...just notify, and if they have questions they would come back to us... 15 working days”*.

<sup>209</sup> In some jurisdictions, such investments (pooling of funds/capital for investment into a project/real estate/company) fall under the fund regulations.

**Table 7.65 - Focused Coding 2 For Are There Any On-Going Regulatory Requirements With Regards to Disclosure and Transparency That Your Institution Needs to Abide by, Once the Investment has Been Offered?**

Subtheme	There are no post requirements
Interviewees	Remarks
IFI-04, IFI-06, IFI-07	There are no post requirements

Some IFIs did not face any post-regulatory requirements when investing in IPE related investments, “No, not that I know of” (IFI-04); “There is not, post, nothing. I don’t think nothing at all [across other GCC jurisdiction]. Pre there was, but post nothing” (IFI-06); “...as an investment firm, there is no, to date, there is no need for like reporting. We do [report to investor]” (IFI-07).

On the other hand, there were some IFIs that were not aware of whether the IFI faced any post-regulatory requirements, since once the investment is done, the on-going matters are dealt with by another department, “I assume, yes. Because we haven’t done it... These questions are more related to our compliance department; they would know” (IFI-01); “Honestly I don’t know. The compliance might be able to answer” (IFI-02).

Just a note on regulatory requirements: in recent years (2-3), due to the change in the financial environment/set up of some jurisdictions and to financial events that have taken place, some regulations have changed. Some changes were related to risk management and more layers have been added to procedures in addition to there being more regulatory bodies involved, as IFI-03 explains: “The regulator now forces upon me the risk, the compliance. You have Capital Market Authority, the Market, the Ministry of commerce, the Central Bank. You have more layers of regulations. Before it was the Central Bank and the securities market... ”.

While in some jurisdictions, improvements were made to existing regulations by elaborating on existing regulations, and placing more emphasis on enforcing the regulations, as IFI-08 remarks: “I think [Regulator] has recently re-emphasised that aspect. So I believe it was there from the beginning, but it wasn’t enforced probably. Now, I feel from the communication, I see from the [Regulator], they are emphasising the fact that the content of those update [2014] should be achieving or checking certain boxes... ”.



### 7.7.3 IFIs' Opinion on Regulations

The following section looks into the IFIs' opinion on IPE's regulations, in addition to their opinion on capital adequacy, since it also has an affect when it comes to investing in IPE.

#### 7.7.3.1 IFIs' Opinion on IPE Regulations

Table 7.66 summarises the IFIs' opinion on IPE regulations.

**Table 7.66 - Opinion on IPE Regulations**

Interview Question	What is your opinion with regards to these regulations?
Focused Coding	Subtheme/remarks
1	Have concerns about the regulations
Concluding Theme	The majority were in favour of the regulations, yet they had some comments

Overall, the IFIs were in favour of the regulations and that they are being developed to international standards, with the opinion that: *"I think that the regulatory body is put in place to safeguard the interests of everyone involved. From the regulator to the investor to the shareholders of the assets..."* (IFI-11). Yet there were some observations that were made and that are summarised under Table 7.67 below.

**Table 7.67 - Focus Coding 1 What is Your Opinion With Regards to These Regulations?**

Subtheme	Have concerns
Interviewees	Remarks
IFI-04, IFI-08, IFI-10, IFI-15	Need to be flexible, affects the business
IFI-05, IFI-08, IFI-12	Time consuming
IFI-06	Do not have capacity or experience to implement
IFI-06, IFI-07, IFI-13, IFI-15	Not adequate, still needs developing/updating
IFI-08, IFI-13	Require flexibility in implementation

Most IFIs are in favour of regulations. However, they have various concerns. Although it is good to have regulations, they are at times time consuming and not flexible enough which affects the business and hinders their access to the market. Also, they would like to see the support of the regulator in facilitating matters, *“although I believe regulations are necessary and they have to be in place. But again it is creating a sort of barrier for smooth and easy access to the market. ... we would need support ... rather than more and more levels of regulations, which will eventually would become, it could reach a point that any investment you touch would become unprofitable”* (IFI-08). In their opinion, in order to maintain risk, risk awareness is necessary and there should be more transparency and disclosure of the risk involved, *“If companies ensure their investors are well informed and are aware of the risks. Ethically and even from investment point of view, it makes it a lot easier if the investor is aware, in case something goes wrong. Regulations should be to serve the investors and not to hinder them...I think protecting the rights of investors...Make sure that the company is transparent with them basically”* (IFI-04).

Even though quite a few of the IFIs mentioned that they are bombarded with regulations and requested flexibility in the implementation, *“in applying it they [being the regulator] have to be flexible...in the implementation. Business nature is quite hard sometimes and the people are difficult ...”* (IFI-13). There are those that thought that some relevant regulations were not enough, as IFI-06 comments: *“the deal by deal... if it is done properly then it is fine. But the problem it doesn't have a lot of regulation. This is not really regulated. The CIS [collective investment schemes] is regulated; anything above that [private placements/offering that do not fall under CIS] is lost. Even GP/LP, I don't think regulation is very tight”*. In addition to those who thought that the regulations were lacking, especially in investments where the investor performs more of a passive role, as indicated by IFI-07: *“... it is specific security created funds, then if you market those funds, then I would expect the same kind as on the asset management side, they have reporting guidelines... I think we should have the same regulation on the set up of that fund as well”*.

Furthermore, some also thought there were areas open to improvement. One of which is the independence of the *Shari'ah* scholars. By being on several boards, in addition to also being on the boards of retail and investment banks at the same time, *Shari'ah* scholars' independence is questioned. Even though the scholar does not do it intentionally, information transfer from one institute to another can occur, especially during the review of products that are to be launched, as IFI-15 explains:

*“From Shari'ah point there needs to be real independence. For Shari'ah scholar, you can't have 2 or 3 members in the same institutions. I [scholar] am in commercial bank and another [investment] bank, I know what product we are launching ... I will do structure for each*

*product. ... I will try to give my comments. Information from this bank transfers to the other bank through the scholar, whether intentionally or not intentionally, it is transferred ...”.*

The other area of improvement is with the governance of the SPV of the investment. Proper/disciplined corporate governance of the SPV is important since it forms an important role in the set-up/structure of investing in IPE. It is generally where the funds collected from investors are pooled. And since the SPV is usually managed by the IFI that is collecting the funds, in addition to SPVs not always being reported, some form of control is required to mitigate any conflict of interest that could arise. It appears that at times funds that were collected for a specific investment, the IFI/the investment managing company would use the funds to invest in other investments (with the hope of generating extra returns), jeopardising the current/specific investment’s opportunity for development/success, as IFI-15 explains:

*“In an SPV you don’t report where you put all your money.... The board takes a decision to invest ... They take the money from [Project-A] and invest it in [project-B]... The SPV is the management ...the CEO is the chairman of the SPV... This is part of corporate governance. The [Regulator] should nominate or insist that the board of the SPV shouldn’t be the bank itself. Because always the bank will work for the best of his interest first, then the interest of the others [investors]”.*

However, it is suggested that although as a preventative and controlling matter, the regulator’s intervention is required; it should be more in the form of a supervisory role. Whereby to have rules in place that would help to keep in check those matters that are of concern, as IFI-15 notes, *“they have a supervisory role, more than a management role... There should be a regulation and rules for policies that eliminate these things. To safeguard the interest of the investor”.*

### **7.7.3.2 IFIs’ Opinion on Capital Adequacy Regulations**

The capital of the IFI has an affect on the amount/percentage of capital that it can participate/enter in with regards to the investments it makes. It is the basis that determines the IFI’s exposure. Table 7.68 below summarises the IFIs’ opinion on the regulations on capital.

**Table 7.68 - Opinion of Capital Adequacy Regulations**

Interview Question	What is your opinion on the regulations on capital?
Focused Coding	Subtheme/remarks
1	An acceptable control mechanism
2	Restricts development
Concluding Theme	To some it helps to reduce the risk, while to others it restricts development

Having regulations on capital has its pros and cons, some of which have been presented below.

**Table 7.69 - Focus Coding 1 What is Your Opinion on the Regulations on Capital?**

Subtheme	An acceptable control mechanism
Interviewee	Remarks
IFI-02, IFI-04, IFI-10, IFI-12, IFI-14	Reduces risk

Some IFIs saw that there was a rationale in having restrictions on the capital, in that not everyone entering the market will try to launch investments, only those who are strong enough and capable with a good track record would be able to do so. As IFI-02 noted: *“I think this is the rationale behind it... they try to cap the number of funds that are launched. And that the ones that do get launched, are highly weighted and reputable known institutions, and has a track record and has the capability to raise capital and has the know-how”*. While others see that it helps to diversify risk, *“capping this way [restriction on capital/exposure] minimising the risk, because we encountered some problems with some of the projects.... the project was doing well, and after the collapse and the crash [of the market]... Had we been within the cap or below, we would have minimised the loss”* (IFI-10). Moreover, some also thought that it helps the financial institution to stay financially and sustainably healthy.

**Table 7.70 - Focus Coding 2 What is Your Opinion on the Regulations on Capital?**

Subtheme	Restricts development
Interviewees	Remarks
IFI-05, IFI-08, IFI-11, IFI-13	Restricts development

On the other hand, some IFIs saw that having restrictions on capital affected the progress and size of the transaction that an IFI can take on board. Whereas prior to the restriction, they were able to go for large size transactions, post restrictions they are unable to do so independently. IFI-08 notes: *“If before we can easily go do the 40 to 50m ticket, now probably, I can only go the 20m so I have to seek a very small universe transaction, that is not necessarily the most profitable or the best one...or try to co-invest, find another player, who is in a similar situation”*. The restriction on capital also affects the overall contribution of the IFI regarding the progress and building up of the economy, in that there will be fewer investments and developing projects that they participate/contribute in, as IFI-13 remarks, *“I think we need to increase the capital, to rebuild the countries. We need to increase it”*.

In addition, some IFIs thought that such regulation is inappropriate to suit all types of IFIs. The role of a retail bank (taking deposits) differs from that of an investment bank (that uses shareholders' capital to invest), and as such, there should not be the same requirement on both. IFI-11 notes: *“...Basel 3 is quite strict. It works on some models. We are not a retail bank. We are an investment bank. I think it doesn't cater and segregate between the two. ...there shouldn't be the same Basel 3 for all”*. Furthermore, being an investment firm, although it is important to manage risk, having to maintain a certain amount of cash on the side, at all times, affects the financial institution's ability to manoeuvre, as IFI-05 explains: *“We are an investment boutique firm, sometimes it bothers us, because you have to always maintain cash. You cannot use it. You cannot do a lot of things. So, it depends on the business... sometimes the capital adequacy ... it is risk management, but also it could tie your hand a little”*.

Moreover, with globalisation, in order to survive the IFI needs to be strong enough. IFI-15 notes, *“my personal opinion, the Central Bank shall encourage the bank for merging, small player. Because now ..., due to globalisation, unless you are strong you will not survive. So, I think Central Bank should think about encouraging, not forcing the banks, give them some incentives to merge. That merger and acquisition will build a strong institution that can survive in all crisis and all situations”*

## **7.8 CONCLUDING REMARKS**

This chapter covers the findings of the IFIs that were interviewed as part of this study. In trying to meet the research objectives, the questions of the interview revolved around the IFI's investment approach to investors; the IFI's post-investment relation with its investors; the due diligence the IFI undertakes; the level of transparency it maintains and the corporate governance it follows towards protecting the

investors' rights. The questions also tried to seek the IFI's *Shari'ah* governance system, through exploring whether the IFI had a mechanism for handling the *Shari'ah* compliant supervision aspect. And in order to be able to derive possible improvements, the current regulations were looked into, and the IFI's point of view on them was sought. This was to seek their perspective (the business/industry perspective), which is an essential part when developing markets and regulations.

Moreover, engaging in fair transparent transactions is one of the important characteristics of the *Shari'ah* principles, and from the interviews, there appears to be some issues that are related to transparency that could jeopardise the *Shari'ah* compliance of the IPE contract. In order for the IPE relationship to be *Shari'ah* sound, it is expected that the IFI/investment manager will perform his role in a transparent manner, without any exploitation or holding back information from his investor. The investor trusts the IFI with his funds and relies on its decision-making, by giving the IFI proxy, and in return expects openness and timely communication. It appears that issues related to the extent of the IFI's openness with the investor, which in turn affects the investor's rights need to be addressed. Issues such as: the way deals are structured in controlling voting rights; the different treatment among investors; how information is communicated to the investor pre- and post- and how funds are used appear to be some of the weaknesses that need to be dealt with.

## Chapter Eight:

### SHARI'AH SCHOLAR'S ROLE IN IFI INVESTING IN ISLAMIC PRIVATE EQUITY INVESTMENT: RESULTS AND FINDINGS

#### 8.1 INTRODUCTION

This chapter reports the results of the semi-structured interviews conducted with 13 *Shari'ah* scholars (ShSc)<sup>210</sup> who are members of *Shari'ah* Supervisory Boards' of Islamic financial institutions (IFI) that invest in Islamic private equity/private placements from across the GCC.<sup>211</sup> The results were analysed using content and thematic analysis. Initially, the responses were transcribed and translated by the researcher, after which the content analysis was carried out manually. No analytic software for coding, such as Nvivo, was used since the original transcripts were in Arabic.

The data analysis first examines the general themes which are then further explained by focus coding and looking into the subthemes. Discussion on each subtheme is supported by the related quotations of interviewees.<sup>212</sup>

#### 8.2 TERMS OF REFERENCE AND RESPONSIBILITIES

The Shari'ah Supervisory Board (SSB) is bound by its terms of reference that engages its members with the IFI. Hence, having clear terms of reference (TOR) and proper working procedures in place is at the core of the relationship between the SSB and the IFI.

##### 8.2.1 Terms of Reference

This section examines the ShSc's contractual agreement, appointment, responsibilities and working procedures and the responses received on those matters.

---

<sup>210</sup> In presenting the results, the ShSc interviewed will be represented in code form (ShSc-01, ShSc-02, etc.) to preserve the confidentiality and the identity of the ShSc. While the Shari'ah scholars cannot be identified due to confidentiality, the basic characteristics of them are given in Appendix 4.

<sup>211</sup> GCC - Gulf Cooperation Council countries.

<sup>212</sup> The quotations used were translated from Arabic to English by the researcher.

### 8.2.1.1 Contractual Agreement

Table 8.1 below summarises the responses to whether the ShScs had signed an agreement upon being appointed as a member of the IFI's SSB. It also looks into the details of their appointment if they were clearly stated in writing, whether it is in the agreement or in the internal procedures of the IFI.

**Table 8.1 - Shari'ah Scholar's Contractual Agreement**

Interview Question	Does the agreement of appointment that you signed clearly state the TOR regarding your mandates and responsibilities? I.e. have you signed an agreement with the IFI and are there procedures?
Focused Coding	Subtheme/remarks
1	Contract existed
2	No contract
Concluding Theme	Not all SSB had a contractual agreement with its IFI

As all jurisdictions in the region do not require there to be a contractual agreement between the SSB members and the IFI itself, not all scholars had a contractual agreement with the IFIs where he was a member of their SSB. And since some scholars were on SSB across different jurisdictions, they could have signed with an IFI in one jurisdiction and not in another.

**Table 8.2 - Focused Coding 1 For Does the Agreement of Appointment that You Signed Clearly State the TOR Regarding Your Mandates and Responsibilities?**

Subtheme	Contract exists
Interview with	Remarks
ShSc-06	Contract in detail
ShSc-09, ShSc-10	Contract and details in procedures
ShSc-01, ShSc-07, ShSc-12	Varied in detail
ShSc-01, ShSc-05, ShSc-11,	Varied: some had, some did not

Some ShScs had a detailed contracted signed with the IFI, as noted by ShSc-06, *“Contracts stating what are your powers, your responsibilities from a confidentially aspect, from the aspect of the things you undertake”*. While others who had signed an agreement, the details of their responsibilities and obligations were not in the agreement but in the internal procedures, *“For every Shari'ah supervisory board there is a procedure. And the procedures display the member's responsibilities, the*



*committee's<sup>213</sup> responsibilities, the bank's obligations and all the matters related to the Shari'ah supervisory board work, ...in all the institutions without exception...the level of details varies from one institution to another, but the main issues, like number of meetings, the decision process, these are in all of them" (ShSc-10).*

In some institutions, the agreements covered the SSB mandates, role and responsibilities in detail, while in others not as much. It was those institutions whose regulators had specified (and in some a specimen is provided) and enforced such a requirement, and those are the ones with detailed agreements. While where such a requirement was not part of the regulatory requirement, the terms of reference were usually only outlined in the agreement. As explained by ShSc-12:

*"the level of detail varies. In some banks, under the supervision of the Central Bank, there is a certain level of detail. Since the Central Bank places upon them a specimen for the agreement which is very detailed. In other cases, agreements only summarise the main duties...while these are adequate they are not in such detail as in countries where central banks enforce a specimen contract".*

It appears that the reason behind the matter of not signing an agreement goes back to the initial concept upon which the *Shari'ah* supervisory board was appointed. Initially, their role was to be considered as providing a voluntary service. However, over time, the work that the SSB performs, or is expected to perform, has developed as the industry developed, and their role/function can no longer be considered as a voluntary service. The specialisation required in performing the role of SSB has developed into a profession. As clarified by ShSc-05:

*"Initially when Shaikh X (may he rest in peace) first established the Shari'ah supervisory board in [Jurisdiction] he had the concept that this duty is to be performed as voluntary. And so, in such a case, we do not need a contractual agreement between the Shari'ah supervisory board and the institution...And that is why here in [Jurisdiction] the Shari'ah supervisory board are assigned and the board of directors decides on their terms. Even we do not know how much we take, because it is not determined [the remuneration is considered as a gift]. I don't think it is right, because the Shari'ah supervisory board role is no longer a fatwa process or a calculation process; it is a specialisation, a profession...".*

---

<sup>213</sup> The reference is to the executive committee that is a subset of the SSB. For more details, see section 7.3.1. on *Shari'ah* Member's Performance-Function.

**Table 8.3 - Focused Coding 2 For Does the Agreement of Appointment that You Signed Clearly State the TOR Regarding Your Mandates and Responsibilities?**

Subtheme	No Contract
Interview with	Remarks
ShSc-02, ShSc-03, ShSc-08	Only procedures
ShSh-04, ShSc-13	No contract and no procedures

In jurisdictions where the regulators have set an outline for the SSB, the procedures are set by the SSB as per the regulatory requirements and are endorsed by the Central Bank, as noted by ShSc-03: *“In [Jurisdiction] ... It is left to the parties involved... we perform our role as per what is stated by the Central Bank, and as per the duties endorsed by the SSB itself as procedures and we perform accordingly. We prepare it [working procedures], but we have to have it endorsed by the Central Bank...”*. While in jurisdictions where the SSB TOR is not clear, the SSB have tried to overcome them by having internal procedures as ShSc-05 notes, *“In [Jurisdiction] the practice is still vague...and as such we do not have agreements...The SSB has prepared internal procedures, where it identifies the role and responsibilities of the SSB, and related parties... The board of directors has endorsed the procedures and they have been adapted. This at least compensates for this deficiency”*. However, not all procedures were detailed as confirmed by ShSc-11: *“there are banks that have procedures that are of one page and those are of 10 pages”*.

ShScs have a preference for having some form of obligations, so that everything is clear among the parties and so they request it and have a preference to see it in the regulation for it to be obligatory, as expressed by ShSch-04: *“today there are no agreements. In some institutions agreements used to take place at the request of the Shari’ah Board, meaning...we feel there needs to be a law...this is supposed to be the work of the Central Bank. It is supposed to determine [the duties and responsibilities of the Shari’ah board] and enforce it on the institution”*.

Though the preference is to have such a requirement in the regulation, it appears that it is not always followed. Some SSBs have taken on board and implemented procedures that they have drawn up and endorsed among themselves, as *Shari’ah* scholars, with regards to issuing *fatwas*. They do not have internal procedures and have not signed a contractual agreement with the IFI, even though it is a requirement. Based on the concept that the details (the SSB’s role and responsibilities) are in the regulations, and as such, this is more than sufficient, there is no need to have a signed agreement. The

understanding being that the regulation's (the Law's) power and status of enforcement is higher than a contractual agreement, as ShSc-13 explains:

*“We have an Ameer Law issued by his highness the Ameer with regards to organising the Shari’ah boards and their powers and there are instructions issued by the [Regulator] on the duties of shari’ah boards... We don’t have an agreement. It is assumed that we have agreements, but we have instructions [being the Regulations] and the system [being the law] and they are stronger than the agreement. There are no internal procedures at IFI. We have endorsed resolutions from one of the forums that had taken place with regards to the fatwa procedures and how they are conducted<sup>214</sup> ...”*

### 8.2.1.2 Appointment

Appointment in general gives an indication on the line of reporting, or in reality who has the influence on those reporting, and to whom one is accountable. Overall, as part of the SSB’s function in the organisation chart, its line of reporting is to the general assembly, the shareholders, and the owners of the IFI. In order for the SSB to obtain and maintain independence, the SSB insists on certain matters, as ShSc-02 notes: *“we always place a condition on the IFI that the SSB is appointed by the general assembly, and not the BOD. Secondly, we make sure that the organisational chart shows us as an independent party from the executive management. Thirdly, we insist that there is permanent Shari’ah supervision department. That it has employees, and submits its reports to the SSB and informs the executive management”*.

**Table 8.4 - Shari’ah Scholar Appointment**

Interview Question	Who do you (as SSB) usually report to? I.e. who appoints you and to whom do you report?
Focused Coding	Subthemes/remarks
1	General Assembly by name
2	General Assembly general approval
Concluding Theme	The SSB is appointed by the General Assembly

<sup>214</sup> The following are the headings in the two-page procedure that was provided to the researcher: The adaptation of contract (relationship between the SSB and the SSB and the *Fatwa* process); Rules on IFI asking for another opinion from another SSB; Controls in prohibiting financial *fatwas*; Controls of consenting and permitting financial *fatwas*.

Generally, the SSB is appointed at the Annual General Assembly (AGM) by the shareholders of the IFI. However, the shareholders do not always appoint them by name, but leave it to the IFI's senior management to select the members of the SSB.

**Table 8.5 - Focused Coding 1 For Who Do You (as SSB) Usually Report to? I.e. Who Appoints You and to Whom Do You Report?**

Subtheme	General Assembly by Name
<b>Interview with</b>	<b>Remarks</b>
ShSc-01, ShSc-02, ShSc-03, ShSc-04, ShSc-05, ShSc-06	General Assembly by name upon nomination by the BODs

In most cases, the SSB is appointed by the General Assembly by name, *“After the names are approved by the General Assembly, the board of directors are delegated to contract, so we sign [the contract] with the board of directors”* (ShSc-05).

However, although the appointment of the SSB is at the general assembly, the selection process is not completely independent. The shareholders base their selection on the nomination provided by the BODs, and this matter of nomination is a cause for concern for some of the SSB members. The concern being that at times this process of nomination of a scholar depends on how cooperative he is with the IFI and in approving their products, as expressed by ShSc-06:

*“For independence purposes, we follow the general assembly... but, what is currently happening, unfortunately, is that the board of directors are nominating. No doubt because most of the shareholders don't know the scholar, so they [BOD] recommend and nominate and in the event of any dispute, it goes back to the general assembly to decide. But in some places, that this is not the case, and it is the BOD that are making the decisions [selecting the SSB members] ...of course this is not right. Because you cannot have independence, you are threatened at any moment, if you did not approve this product; it means ma'salama [farewell]”.*

Even though the mechanism is better than it used to be, whereby the appointment was by the BOD and now it is the general assembly, there is still room for improvement. Since the shareholders rely most of the time on the BOD and very rarely question their decisions, the aspiration is to get the regulator to intervene more, so that the threat to independence is reduced. One scholar explains the reason for this is that it is in human nature that certain things do affect us unconsciously, even if it is not admitted, and

that it is important “...to make sure that no member is dismissed without providing a comprehensive and clear statement and the approval of the Central Bank, not just a notice. I don’t think have been treated in a satisfactory manner. Leaving it to every member and his conscientious [in that his Shari’ah decisions are not affected by the concern of being re-appointed]. And even though many members say that these things do not affect their independence ... we are kidding ourselves” (ShSc-07). As such, the hope is to get the regulators to intervene, as expressed by ShSc-04: “in my opinion the Central Bank needs to have a role. Any Shari’ah member whose contract does not get renewed, needs to attend the general assembly and talk in front of the shareholders”.

In some jurisdictions, the approval of the regulator is a must, as indicated by ShSch-13 “*appointment is through the General Meeting of each bank and the approval of [Regulator], is a must*”.

**Table 8.6 - Focused Coding 2 For Who Do You (as SSB) Usually Report to? I.e. Who Appoints You and to Whom Do You Report?**

Subtheme	General Assembly General Approval
Interview with	Remarks
ShSc-05, ShSc-06	General Assembly general approval no names selected

The SSB member could be a member on several IFIs and in some jurisdictions he is appointed by name by the general assembly, while in other jurisdictions, the BOD selects him, after having been given the authorisation to do so by the general assembly. As ShSc-05 explains, “*here in [Jurisdiction], the Shari’ah supervisory board is assigned by the AGM and the board of directors are authorised to decide and hire them.*”

The SSB, whether appointed directly or indirectly by the general assembly, the report that they produce, as part of the IFI’s Shari’ah compliance, is presented to them at year-end at the annual general assembly, “*Usually the SSB submits it [the SSB report] to the general assembly through the board of directors*” (ShSc-08).

### 8.2.1.3 Mandates and Responsibilities

For the effective performance of the SSB, its mandates and responsibilities need to be clear and understood. The following section looks into the ShScs' understanding of their mandates and responsibilities as members of the IFI's SSB.

**Table 8.7 - Mandates and Responsibilities**

Interview Question	What are your mandates and responsibilities?
Focused Coding	Subtheme/remarks
1	Providing <i>Sharia'h</i> legal opinion and indirect follow-up
2	Providing <i>Sharia'h</i> legal opinion and direct follow-up
Concluding Theme	<i>Shari'ah</i> legal opinion and follow-up on its implementation whether directly or indirectly

In general, the main understanding of the SSB mandate is to give its *Shari'ah* opinion, i.e. *Fatwa*, in addition to there being an overall understanding of the requirement for a follow-up on the proper implementation of the *Fatwa*. Yet, where the responses differ is on whether the follow-up is performed directly or indirectly by the SSB. Whether the SSB conducts it itself, or assigns it to the *Shari'ah* department of the IFI, and the SSB supervises through the reports that the *Shari'ah* department produces.

**Table 8.8 - Focused Coding 1 For What are Your Mandates and Responsibilities?**

<b>Subtheme</b>	<b>Providing <i>Sharia'h</i> legal opinion and indirect follow-up</b>
<b>Interview with</b>	<b>Remarks</b>
ShSc-01, ShSc-02, ShSc-03, ShSc-04, ShSc-05, ShSc-06, ShSc-07, ShSc-08, ShSc-09, ShSc-10, ShSc-11, ShSc-13	Giving <i>Fatwa</i> (legal opinion) and supervise audit

The overall understanding from among the scholars is that the role of the SSB is to provide its *Shari'ah* opinion, *Fatwa* and supervision of its implementation. Their role is to respond to inquiries/questions and provide their *Shari'ah* opinion on the products/investments presented to them. In addition to following the issuing of a *Fatwa*, make sure that the *Shari'ah* department performs its role in the implementation. The *Shari'ah* department's role is to pass the *Fatwa* on to the related department and

to follow-up on the proper execution of the *Fatwa* through performing an audit. As elaborated by ShSc-03:

*“We are divided into two divisions: the first is Fatwa or what we call the decision, and the second is supervision. The fatwa and taking decisions on related questions and agreements... and the other part, is the supervision which most of the time is executed by appointing supervisors [within the Shari’ah department], we supervise those supervisors... so it’s two parallel lines. Taking the decision and the following of the implementation and the soundness of the decision, both take place at the same time...”*

Moreover, the *Shari’ah* department usually generates regular reports to the SSB on the extent of compliance of the IFI, as noted by ShSc-10: *“the Shari’ah board...look at the reports either quarterly, semi-annually and annually is on the activities of the institution, and its compliance with Shari’ah board’s decisions.”* Furthermore, the SSB reviews these reports for any violations or shortfall in compliance, which it then discusses with the *Shari’ah* department, as noted by ShSc-02: *“we review these reports and if there is any shortfalls we call upon the department to discuss such shortfalls...”*

Even though in some instances the title of the SSB indicates that supervision is to be undertaken by the SSB member directly, due to the practice having always given such a role to audit, the SSB have not done so themselves. This was acknowledged by ShSc-13: *“...in actual fact the board should perform the role of fatwa and the role of supervision, meaning audit. But from long ago there is a Shari’ah audit set-up that performs this role and raises its observations to the Shari’ah board.”*

It appears that the weight of following up on the implementation of the SSB’s decisions falls heavily on the internal *Shari’ah* department of the IFI, due to the fact that not all members of the SSB are available full time, and that the *Shari’ah* department is in contact on a regular daily basis with the IFI. Such a responsibility means it is important that the *Shari’ah* department is independent from the influence of the IFI’s senior management and employees. ShSc-06 confirms the importance of independence and explains the current set-up of the *Shari’ah* department: *“...it is expected in every financial institution, that there is a supervision department, and internal Shari’ah department. This internal Shari’ah supervisor [member of the Shari’ah department] technically follows the Shari’ah board, but administratively is under the board of directors. He is the eye of the Shari’ah board and for this, he needs to be independent. The board of directors has no right to dismiss him without the Shari’ah board’s approval and justification”*.

However, since the internal audit function itself is not independent from the IFI, some scholars consider that with the *Shari'ah* department supervisors/officers also falling administratively under the IFI management this affects their independence and as such their performance. The IFI's management controls the appointment and salaries of those officers/supervisors, and as such, this has some effect on the employees. In that since, with such matters under the IFI's management control, the employees of the *Shari'ah* department might be influenced in trying to keep on the IFI's management's right side, which could jeopardise the quality of the compliance/audit reports being generated. Therefore, the matter of independence remains a concern as expressed by ShSc-04:

*“In my opinion I consider it problematic that for the supervision to be in a strong position, administratively it should follow the board [the SSB]. This is my opinion. But, unfortunately, till today this does not exist in Islamic banks, overall... If you do not provide them with the sense of security, whether it is the members or the supervisors, how is he going to perform his role?”*

**Table 8.9 - Focused Coding 2 For What are Your Mandates and Responsibilities?**

<b>Subtheme</b>	<b>Providing <i>Shari'ah</i> legal opinion and perform audit</b>
<b>Interview with</b>	<b>Remarks</b>
ShSc-12	<i>Fatwa and perform audit</i>

While in most cases the scholars responded that their role in the audit aspect was supervision, one of the scholars stated otherwise. ShSc-12 claims to the SBB to be performing both roles: *“The Shari'ah board member in all the boards performs fatwa and Shari'ah audit. Shari'ah audit that he submits to the general assembly. Which as per the terminology is known as external Shari'ah audit...we in the Shari'ah board that we have, the level of control in it, is high... Meaning the Shari'ah board audits all the authorised transactions to arrive at the information and provide its final decision on the extent of compliance to the general assembly. The Shari'ah board's report is directed to the shareholders”*. They were able to perform both roles (*fatwa* and audit) due to being a *Shari'ah* firm and had adequate staff to perform both roles, reducing reliance on the IFI internal *Shari'ah* department and enhancing independence, as ShSc-12 elaborated: *“we as a Shari'ah board are a part of an advisory firm, we offer the service. As such, this part [the SSB's reliance on the internal Shari'ah audit performed internally] does not exist, which is a weak point”*.



### 8.3 SSB MEMBER’S PERFORMANCE AND INDEPENDENCE

The skills, tools that the SSB member requires to perform and function efficiently and effectively, are examined in this section. The independence of the members and the SSB is an essential feature that cannot be compromised in order to maintain the credibility of its decisions and performance.

#### 8.3.1 SSB Member’s Performance-Function

What the ShSc member requires or uses as a basis in order to perform his duties and obligations is summarised in Table 8.10 below.

**Table 8.10 - SSB Member's Performance-Function**

Interview Question	How do you as a member of the SSB operate with regards to meeting your duties and responsibilities?
Focused Coding	Subtheme/remarks
1	Having administrative competencies
2	Following procedural systems
Concluding Theme	Mainly duties and responsibilities are being performed based on possessing certain administrative competencies and having procedural systems in place

ShScs try to perform their duties and responsibilities as efficiently as they can because it affects their reputation. Their outcome and decisions made are usually based on the information provided and the documents presented to them by the IFI and its employees. There are times when the decisions made were not as proficient as they ought to be, due to not receiving adequate information at the time, as experienced by ShSc-06: *“Employees sometimes do not provide you with a true picture of the matter, so you decide on something different to what you imagined. You provide your opinion on the information and image of the thing. Then after that, you discover that the matter was not like that. Now you can withdraw. You can eliminate, you can object on the structure”*. There are also times when employees of IFI take up the initiative of introducing new products prior to obtaining the SSB’s approval, thinking that it is similar to a product already introduced, as ShSc-06 continues to explain:

*“Sometimes, some employees conjecture, and offer a product [without SSB approval], thinking that there is nothing wrong, from a conceptual point of view. But there could be one condition that damages everything and he offers it and then the Shari’ah board hears that there is a product that was launched. Or after offering it they put it forward to the SSB. He [the IFI’s*

employee] is at fault. Now, either the IFI stops it, or amends it, if possible to amend, and reprimands the employee... ”.

Having said that, according to the ShScs, in order to be able to perform one’s duties, certain administrative skills are required, along with having procedural systems in place. Table 8.11 to Table 8.12 below cover this in more detail.

**Table 8.11 - Focused Coding 1 For How Do You as a Member of the SSB Operate With Regards to Meeting Your Duties and Responsibilities?**

Subtheme	Having Administrative Competencies
Interview with	Remarks
ShSc-02, ShSc-03, ShSc-05, ShSc-06, ShSc-11	Time management
ShSc-02, ShSc-04, ShSc-06	Know-how/experience
ShSc-07	Professionalism

Most of the ShScs were able to meet their duties and responsibilities through proper time management of their own time, and some of them, through regular weekly meetings, as noted by ShSc-03: *“Weekly meetings with supervisors and the relevant department in the department that we call the Shari’ah department, in addition to the regular reporting”*. In addition to requesting to be provided with the documents for review ahead of time, to be able to prepare, as put forward by ShSc-07: *“I have to do whatever I can to meet the responsibilities appointed to me. So, if there is a set meeting and there are agreements to be discussed in the meeting, I make sure that they send the agreements within adequate time, not two days before the meeting or at the Shari’ah board meeting, so as it’s a quick read. This doesn’t work”*.

Moreover, technology has contributed to the time management factor, in that it has facilitated communication and coordinating, for a smoother performance, *“time management, and then the modern means of communication has now smoothed things. Instead of, for example, having to travel back and forth every week, they send you the agreements through e-mails, and you review it and send it back. Meaning the modern communication has reduced the load of work (ShSc-05)*.

Some ShScs, in addition to handling their time efficiently, consider experience and knowledge to contribute greatly to their ability to perform. Due to experience, they are able to identify the weak areas, and concentrate on them during the review of documents. On this ShSc-02 claims: *“When one has spent a long time in this area, he knows the areas of weaknesses in the agreements, where are the areas that need focusing on...we concentrate on the origins of the agreement, on what it is built on, the price, the underlying asset, the conditions required. Hence, even your reading to the agreement is reduced due to your experience ...”*. ShScs have also benefited by being members of several SSB, whereby similar matters/products are sometimes discussed, and by reviewing and commenting on one SSB, the work is also done towards their input in the other SSB. Moreover, ShScs have also started to share work with newly established IFI. Those documents that are common in IFI, and on which the ShScs have reviewed and standardised a format, they share them with the newly established IFI. Regarding this ShSc-02 confirms:

*“After a period of close to 45 years, many of its agreements have become normal, and new agreements are few. I wouldn’t say rare, but have become less. For example, after a bank is established, we bring them our agreements. We have read and approved them; we give it to them. How much effort have we saved them? And we do not have to review them. The bank discusses any changes it makes on them and not the whole agreement. This without doubt reduced a lot of time on us”*.

Over time, some ShScs have gained profound understanding and experience that has helped them to be able to attempt to resolve matters, and not only provide an opinion as experienced by ShSc-04: *“The experience broadens the perspectives a lot on how to handle matters, and ways to deal with it. If you face a problem, you have to think, how you are going to resolve it. Meaning I do not stop at the problem and that’s it, I think how I can resolve it”*.

Some scholars, even with proper time management, and experience cannot see themselves being able to handle being on too many SSBs. As such, they have limited their *Sharia’h* board membership, as noted by ShSc-11 and ShSc-06 respectively: *“Before I was on many Shari’ah boards, but now I have limited it to less than 10.”* *“Sometimes some people, without doubt, they have over 200 [SBB membership], they are to be asked about, how do they cope? Maybe by virtue of their long years of experience, the matter has become easy...But I do not see this capability in me”*. While other scholars view it differently, and handle the matter of being on many boards as professionals and professional firms. The IFI prior to appointing them is aware of their multiple *Shari’ah* board seats and they are bound by the confidentiality agreement that they sign with the IFI. Furthermore, the SSB’s

responsibility is not a promotional one but is rather limited to *Shari'ah* products and its compliance as ShSc-07 explains:

*“I don't think there is a problem [with being a member on several boards]. You have the legal institutions, financial audit institutions performing audit and it provides these services to more than one institution. The Shari'ah board's role has nothing to do with marketing and promoting. The Shari'ah board's responsibility is limited to the extent of the product and the working environment as whole being Shari'ah compliant or not, only within this framework”.*

However, ShSc-07 also notes that although the role the SSB member performs is a professional one (meaning a member can be on the SBB of several competing IFIs, in order to do it professionally and efficiently he would need to be solely dedicated to this role. *“No doubt if a Shari'ah board member has a job commitment, meaning that for example he teaches at the university, and even if it is only one or two subjects in a term. And at the same time, he is a member, in let us say 60 Shari'ah boards, of course [on it affecting his performance-function adversely]”.*

**Table 8.12 - Focused Coding 2 For How Do You as a Member of the SSB Operate With Regards to Meeting Your Duties and Responsibilities?**

Subtheme	Following Procedural Systems
Interview with	Remarks
ShSc-01, ShSc-08, ShSc-10, ShSc-12	As per approved working procedures
ShSc-01, ShSc-02, ShSc-05, ShSc-13	As per setup established within SSB
ShSc-01, ShSc-02, ShSc-03, ShSc-05, ShSc-12	By standardisation of agreements and checklists for reviewing products

Scholars perform their duties and responsibilities as per the agreed upon working procedures on: how matters are handled; how the review process is undertaken; how inquiries are put forward and how they are dealt with and so forth; with all those involved performing their expected role. The SSB tries to be involved right from the beginning of the process, as ShSc-13 comments: *“it is necessary that all the transactions are presented to us from the beginning; from when they first start working on it until it is ended. All of it, we are with them step by step, until we place the controls and the standards and we look at it from a Shari'ah perspective only... And this is before the execution of the transaction and after the execution we also audit the transaction [through supervising the audit process]”.* This is in addition to having to meet certain governance regulatory requirements, such as a number of meetings per year.

Some SSBs, in order to be able to implement the working procedures, have created an executive committee from within its members, that deal with urgent matters, undertake further research when need be for any inquiry or product/investment, review documents and coordinate with the IFI's internal *Shari'ah* department. And in dealing with urgent matters, ShSc-02 explains:

*“We have setup an executive committee. Which, in reality, deals with the urgent, quick matters that the bank wants to make quick decisions on. ...and no delays on their investment decisions. The executive committee, most of the time it looks into the urgent matters, and gives the opinion. After that, at the earliest Shari'ah board meeting, it puts forward its decision, the executive committee's decision to the Shari'ah board for endorsement or amendment or to see what they see”.*

Moreover, any amendments that the SSB makes, at a later date (when they meet), after the executive committee has given its opinion, is not considered a contradiction nor does it affect its implementation to that date, as ShSc-02 goes on to elaborate:

*“We have a principle with the jurists, in the Islamic Shari'ah, the ijihad [effort] is not invalidated by a similar ijihad [effort]... So what went before [the period between the executive committee's decision and the SSB meeting], goes as per the executive committee's ijihad. But what is forthcoming [post SSB meeting] goes, by the Shari'ah board decision”*

Furthermore, once the SSB has made a decision on an agreement/contract, it is taken as standard which the *Shari'ah* department uses as a base when reviewing the agreements that are submitted for the SSB's approval. Agreements that are submitted to the *Shari'ah* department that are similar to previously submitted agreements are reviewed by the *Shari'ah* department and only the changes/differences are put forward to the SSB for their input. The *Shari'ah* department follows the same concept on all matters/transactions that the IFI considers entering into and puts forward for *Shari'ah* opinion, as ShSc-01 explains: *“When an institution is considering entering into a project, it from the start gets the Shari'ah department involved, at the least. The Shari'ah department sees if there are Fatwa/Shari'ah decisions around the subject, if it has been reviewed before or not. So if it is something new, then it has to be presented to the SSB, and so forth”.* Such a process has reduced the load on the SSB as admitted by ShSc-02: *“this has simplified a lot of things... we check that it has not been changed through Shari'ah supervision, in that all the agreements that the Shari'ah board has approved are the ones that are being used”.* Similarly, the same concept applies to supervising a *Shari'ah* audit. Those performing the audit have a checklist upon which they base their review of product/investment compliance.

### 8.3.2 SSB Member's Independence

This section looks into the independence of the ShScs and how they try to maintain their independence, so as not to affect their performance and hence decision.

**Table 8.13 - SSB Member's Independence**

Interview Question	In your association with the IFI as a member, how do you try and maintain your independence?
Focused Coding	Subtheme/remarks
1	Treated as profession
2	Through no association physically and mentally
3	Provided in the regulation
4	Self-consciousness
Concluding Theme	There are several factors that affect independence in relation to effective performance from authoritative, to professional to it being a self-control matter.

The ability to maintain independence is based on some form of control or treatment of matters. Table 8.14 to Table 8.17 provides the various views of the scholars and their responses.

**Table 8.14 - Focused Coding 1 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?**

Subtheme	Treat it as a profession
Interview with	Remarks
ShSc-01, ShSc-09	Maintaining confidentiality and independence

Some scholars linked independence to the ability to be able to perform their role without transferring information from one IFI to another. They looked at it according to their ability to maintain confidentiality and compared it to other professions that deal with several competing organisations at the same time, as commented by ShSc-01: *“Auditors provide services to several establishments and consultant provides services to several establishments. They all sign on to keep confidentiality”*.

Even though many see that maintaining independence is not easy, when the *Shari'ah* scholar is on multiple boards, not all see it as a concern, due to treating it as any other profession, as ShSc-09 explains: *“There is no conflict, because I am only an independent member. My situation is like any external*

advisory company...like E& Y, audit several banks. This does not affect that it audits this bank and this bank.... The same thing with the scholar... This does not intervene with his work, never.”

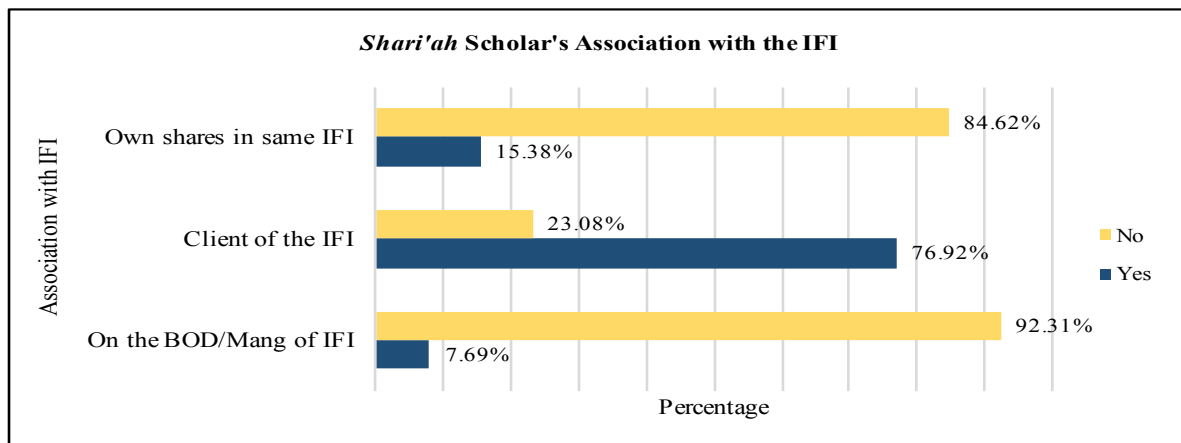
**Table 8.15 - Focused Coding 2 For In Your Association With the IFI as a Member, How Do You Try and Maintain your Independence?**

Subtheme	No Association
Interview with	Remarks
ShSc-03, ShSc-06	No association physically and/or mentally
ShSc-02, ShSc-05	No income association

Some scholars consider that they attain their independence by not being associated or being disconnected from the IFI in some way or another: Physically and mentally. ShSc-12 explains this: *“Independence has to be real. That the scholar is not an employee of the institution. He has not received any financial facility. Not a significant shareholder or a board member or so and so”*. Moreover, he goes on to emphasise the importance of physical disassociation, to the extent of personal relationships and dealings: *“also in his practice, has to also be independent, to be mentally independent. Meaning that he does not fall under, or place himself in position that tarnishes his independence; like personal relationships, through financial relationships and so forth”*.

The following figure presents the level of the interviewed ShSc’s association with the IFI on which the scholars were on their SSB.

**Figure 8.1 - Shari’ah Scholar's Association with the IFI**



At the time of the interview, the principle of association was questioned in terms of whether the scholar was: on the BOD or part of the management; or if he was a client of the IFI or had ownership in the IFI. From the responses, it appears that with the exception of one scholar<sup>215</sup>, they are not part of the BODs or its management (92.31%-12 count). Not being on the BOD or management was taken as a set standard rule, taken up by the understanding of all the ShScs. For those that owned shares in the IFI (2 or 15.38%), their ownership was not of a significant amount (less than 5%). One of the scholars mentioned that even though it is not a significant percentage, he abides by the insider rules of reporting such ownership. While another stated that he has taken it as a rule not to own shares in the IFI that he is an SSB member of. Even though, according to him, the idea of ownership (less than 5%) creating a conflict of interest is not seen in such a way by all. According to him, there are two views on this: *“One that does not consider owning shares (a non-controlling interest) in the IFI as conflict of interest and the other that considers owning shares (a non-controlling interest) in IFI a conflict of interest”* (ShSc-05). Most of them (10 or 76.92%) were clients of the IFI since they need to have accounts with IFI, especially since they are preaching Islamic banking. However, in addition to having an account, some scholars have taken financial facilities from the IFI. Some from the same IFI that they are on, and in such cases have disclosed such a matter, and others make the effort when it comes to taking financial facilities, for it to be from another IFI to the one where they are on their SSB.

Even though some think it affects the SSB’s performance, not having to be dependent on the remuneration as a source of income, along with having another job, it provides the scholar with independence and the ability to leave in the event he thinks it is affecting his performance. As ShSc-05 explains: *“first thing I am not an employee at the bank. And if I felt that there was any pressure, I would resign. Since I am a lecturer at the university, I do not have a problem. The one who has a problem is who is an employee. Not being an employee of the bank gives him strength with regards to being independent shari’ah board member, in my opinion. No one can impose their opinion on you”*.

**Table 8.16 - Focused Coding 3 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?**

Subtheme	Given in the regulation
Interview with	Remarks
ShSc-13	In line with law and Central Bank instructions

<sup>215</sup> He is head of Internal *Shari’ah* Supervision and a member of SSB of the same IFI. He is also a member on another IFI’s SSB.



Some scholars draw their independence from the regulations, which when implemented provides them with it, *“I do not have any connection with them [the financial institutions]. We have our full independence, backed by the law and the Central Bank’s instructions”* (ShSc-13).

**Table 8.17 - Focused Coding 4 For In Your Association With the IFI as a Member, How Do You Try and Maintain Your Independence?**

Subtheme	Self-consciousness
<b>Interview with</b>	<b>Remarks</b>
ShSc-03, ShSc-10	Reputation
ShSc-04	Self-control

With some scholars, it is a matter of trying to maintain reputation, *“the scholar, like the institution has his reputation. He quickly loses his reputation if he falls into such a problem [not able to resist pressure]. The strength of the member and its importance and its status is derived from many things, the most important of which is independence”* (ShSc-10). Furthermore, as ShSc-03 comments, to perform one’s duties and responsibilities effectively is a matter of being able to handle the duties that have been assigned as per the role to be performed, *“if one can handle the assigned duties, he accepts, if he can’t [handle what is being assigned, due to added pressure], he decides on this matter. Because in return his contract will not be renewed. For it is annual relationship. The general assembly has the right not to renew”*.

While with others, maintaining independence is a self-conscious matter, as ShSc-04 notes: *“This means questioning, what we call self-censorship. A responsibility in front of Allah before the people”*. On this note, ShSc-07 comments that being self-conscious of one’s behaviour, is not sufficient to maintain independence, especially if performance is linked to remuneration and renewal with the IFI. He considers this can only be controlled by an authoritative third independent party: *“This third party can only be governmental, central authority. To make sure that the Shari’ah board performs its duties with adequate freedom...to make sure a member is not disposed without a clear comprehensive statement and approval of the Central Bank, not only notification”*.

In addition to ShSc-07’s observation concerning independence, attention to the number of terms a scholar can be reappointed needs to be looked into. Since other than what was discussed above

concerning the member's selection and appointment, the ShSc's term is open, both regarding the number of terms he can serve along with the length of his terms. The number of terms that a scholar can be re-elected is open, there is no regulatory cap on the number of times a scholar can be re-elected, which can affect the scholar's independence by being associated with an IFI for too long, "*For us it is open, there is no limit imposed...*" (ShSc-03).

## **8.4 SHARI'AH COMPLIANCE AND SHARI'AH RISK**

As seen above, under the Mandates and Responsibilities section, an internal *Shari'ah* audit/review is performed mainly by the internal *Shari'ah* department of the IFI. All departments within the IFI undertake an audit, and depending on the importance of the department determines whether it is audited more than once a year. Usually the *Shari'ah* audit plan is reviewed earlier in the year with the SSB, and once agreed on, the *Shari'ah* auditors check on the executed transaction if they have been implemented as per the SSB's decisions.

The review is mainly performed on the basis of a sample taken depending on the size of the institution, the number of transactions, and the number of reoccurring mistakes but not less than the international standard of 10%, as ShSc-03 notes: "*as the mistakes are reduced the percentage is reduced... depending on the mistakes that we encounter. For example, ... you have checked there for one year and no mistakes, so now reduce the percentage to 40 or 30 or 20 depending on how comfortable we see the transactions are as per the rules and standards*".

### **8.4.1. *Shari'ah* Compliance Reporting**

*Shari'ah* compliance is maintained through performing a *Shari'ah* audit. However, the results of the review/audit that is undertaken are not necessarily reported in the annual report that is presented to the shareholders at the general assembly. Table 8.18 below summarises whether *Shari'ah* compliance is reported or not and how.

**Table 8.18 - Shari'ah Compliance Reporting**

Interview Question	Have the SSB encountered any Shari'ah compliance issues? Have they been documented/reported? Have they been made available to shareholders, investors and local authorities?
Focused Coding	Subtheme/remarks
1	Reported
2	Not reported
Concluding Theme	Some non-compliance matters are reported while others are not and at times when they are reported it is in a general form.

It appears that it is not always the case that the details of the outcome of the *Shari'ah* audit that is performed are reported. Although corrections of *Shari'ah* non-compliance matters are taken up, the disclosure of it mainly depends on the SSB's policy on disclosure.

**Table 8.19 - Focused Coding 1 For Have They Been Documented/Reported? Have They Been Made Available to Shareholders, Investors and Local Authorities?**

Subtheme	Reported if
Interview with	Remarks
ShSc-01, ShSc-04	Intentional
ShSc-05, ShSc-07, ShSc-09	Significant effect
ShSc-11	Continuously repeated
ShSc-06, ShSc-08, ShSc-13	When reported, reported in general

For some of the SSBs when non-compliance matters arise during the review, it is looked at from the aspect of whether it was an intentional mistake or not. If the IFI's policy was not to violate the *Shari'ah* principles and the error that occurred was more due to an employee's lack of understanding and improper procedures, it is usually rectified and not disclosed in the annual *Shari'ah* report. Any violations/non-compliance is reviewed and appraised to certain criteria or a colour coding scheme, as to whether they are reported in the annual report or not. As ShSc-04 explains: "*the level of error, [as per the financial institution's criteria] affects my appraisal. A mistake is what they call a big mistake, medium mistake, no mistake. So if it is very high, this means that if it generated profits, we purify it... It is mentioned [in the annual report] especially if high*".

Another instance where the SSB does report to the general assembly is when the IFI is not heeding to them and keeps repeating the mistake, so as a form of indirect reprimand, it discloses it, as noted by ShSc-11: *“If the management overdid the matter or repeated the error it is written [in the report]. For example, we this time [reference to the last report produced] we found they repeated, so we put it in the report. So that the shareholders know and the faulted the management harshly”*.

However, when the reporting takes place on significant matters, it is not always in detail, but more often than not, it is in a general form. On that, the term ‘routine mistakes’ has been developed and used, so as to give the general idea of compliance having been undertaken, as ShSc-13 elaborates: *“we derived this phrase’ we say: the Shari’ah board has reviewed the products, agreements and transactions and they were in accordance with the Shari’ah principles and rules, in whole. Why we say this. There is a difference in the language from when I say, ‘in whole’ and ‘as a whole’. As a whole means, all the transactions are correct; in whole means, two to three four mistakes, that is normal in all institutions”*.

Such non-compliance details are not always reported to the regulator either, yet it is accessible to them if they want to view/inspect it. This is confirmed by ShSc-06, *“We don’t report it to the Central Bank, but it is available in the minutes. The minutes are assumed confidential, but the Central Bank can look at what it wants. Sometimes they ask”*.

In most institutions, violations are documented based on the severity of the violation, and some rank them into high, medium and low, while others colour code them (as mentioned above). There are no set ways of documenting non-compliance in addition to the criteria of ranking that is set which is subjective from one SSB/IFI to another. The way they are reported/documented and categorised varies from one institution to another. There is no set standard (set specimen) of such a non-compliance report, as there is with the conventional audit, as ShSc-09 notes: *“Everyone and his way [in classifying compliance and documenting the audit]. Unlike the external auditors who have procedures that they follow internationally, we as Shari’ah auditors, have our own way. It can be developed, because we are still developing. So, you will find one Shari’ah auditor has his way in writing it, I write my report in different way, a third Shari’ah auditor might write it better than him”*.

**Table 8.20 - Focused Coding 2 For Have They Been Documented/Reported? Have They Been Made Available to Shareholders, Investors and Local Authorities?**

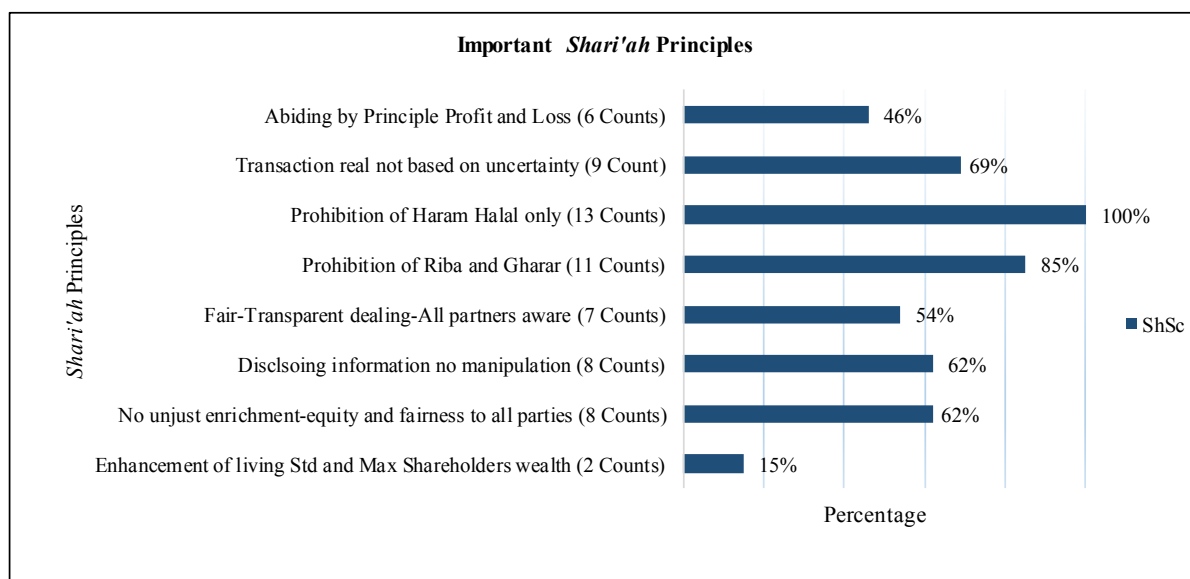
Subtheme	Not Reported
Interview with	Remarks
ShSc-02	No financial effect
ShSc-03, ShSc-10, ShSc-12	Protecting reputation

There are times when the SSB does not see the value of reporting a non-compliance matter, especially if it has not had a financial effect. It depends on the SSB’s policy on disclosure and reporting whether it does so or not. Reputation is usually a decision factor in the matter. Whether the reputation’s impact is greater than the financial impact. There are times when as per *Shari’ah* principles the violation is considered severe, yet its financial effect is much smaller and if reported would have a negative impact. In such instances the SSB would record it in the minutes of the meeting and would follow-up with the management so it is rectified but not necessarily report it in the annual report. Sh.Sc-03 rationalises: “*it [SSB] forced the executive committee to follow-up and provide it with regular updates ‘til it is informed that it has been internally rectified, instead of putting it forward in the report, because this could open doors of inquiries.*” Furthermore, non-compliance matters that occur are usually only reported to the general assembly when it is a significant matter, due to it being a public open meeting and the negative reputational effect it could have on the IFI, as ShSc-09 remarks: “*You are now at the general assembly, meaning shareholders are sitting, ministry of commerce is present, the Central Bank is present, auditors are present, the press is present; so the meeting is open. So it can’t be that I expose them, unless it’s a major wrong doing*”.

#### **8.4.2 *Shari’ah* Risk**

This section looks into the main *Shari’ah* principles that the *Shari’ah* scholars consider to be related to *Shari’ah* matters and that impose a risk on a transaction being non-*Shari’ah* compliant.

**Figure 8.2 - The Shari'ah Scholar's Opinion on the Shari'ah Principles**



As can be seen in Figure 8.2 above, of the 8 principles put forward to the scholars, they all (100%) agreed that ‘prohibiting in dealing in items which are *haram* and the requirement to deal only in *halal* items’ was the main principle. As ShSc-10 explains: “*If a mistake occurred, for example that does not have an effect from the Shari’ah aspect, from the halal haram, but it violates, for example, the decision taken by the Shari’ah board [in implementation], in such incident, we can’t say that it violated Shari’ah. But we can’t leave the matter be, we record it in the minutes that this and this was noticed... after which follow-up and correction is taken*”. Quite a few of them considered that the other principles were a means for deciding on the *halal* and *haram* principles. For example, disclosure, clarity of information and elimination of *gharar* are needed to be able to have a full picture, in order to determine whether it meets the *halal* principle, as ShSc-03 explains: “*This is not important, as much as it is a ‘means’. The most important thing is halal and haram. Transparency is a means. How do I know the halal and haram without knowing the true facts? Deciding on a matter before being able to imagine it... the Shari’ah board is captive to the information that it is provided with*”.

The principle of ‘prohibition of *Riba* and *Gharar*’ scored 85%, and the principle of ‘Abiding by *Shari’ah* principles of clarity, and disclosing information, so as not to be manipulating’ scored 62%, “*The most important that the IFI abides at a minimum, the red line, that can’t be forgiven with the issue of *riba* and *gharar*. The IFI in all cases must avoid *riba* and *gharar* in all its degree and forms. And then the other matters, depending on the strength of the institution and its size can be considered*” (ShSc-07). With regards to clarity and disclosing of information, 8% considered that this is for the regulators. Furthermore, 15% considered that the abiding of the principle ‘requirement for fair and

transparent dealings to ensure all partners are aware of their rights and obligations' is part the regulator's role, and 8% considered it to be the IFI's role, while 54% of the scholars held it to be a *Shari'ah* risk.

Nine of the 13 scholars (69%) considered that the 'transactions have to be real and be certain and not based on uncertainty or speculation' as a *Shari'ah* risk. While one of the scholars considered that the matter of the transaction being real or not is a subjective matter, and depends on which school of thought is being looked at. Meanwhile, 62% of the scholars thought that the principle of 'No unjust enrichment, equity and fairness to all parties' could also affect *Shari'ah*. To this ShSc-01 commented: "*if we hold by the Islamic Shari'ah principle, then Shari'ah contracts has within it that assures of this matter [referring to the no unjust principle]. If you've notice most of the Shari'ah principles are related to the lifting of gharar and jahalah between parties and transparency, for we are ahead of the west*". One of the scholars considered it as part of the IFI's role, while another considers that in principle justice is required, and such a term/phrase is too wide and hence ambiguous to consider.

With regards to the principle 'the goal of the IFI is not limited to the maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community', the majority of the scholars that commented (46%) mentioned that this is too wide a *Shari'ah* principle and too much to impose on the IFI; it is more for the government. Only 15% considered it a matter to look into, and one scholar thought it was part of corporate governance and social responsibility.

Moreover, six of the scholars (46%) were of the view that the principle of profit and loss is a characteristic in all investments, and others thought it is not a requirement for transactions to be Islamic. The sharing of loss and profit is only one of several ways of transacting in a *Shari'ah* way (*Musharakah, Mudarabah, Wakala*). Furthermore, there was also the understanding that risk-sharing is not *Shari'ah* related. The concept of risk sharing was not associated, and the scholars were defensive and asserted that if losses are incurred they are not due to it being a *Shari'ah* issue or that the SSB has anything to do with it. Shsc-9 clarifies, "*Some people say you are the Shari'ah board and the bank lost because you the Shari'ah board closed on them in the transactions [in that the SSB's Shari'ah decision placed restrictions on the investment/IFI]...I tell them I have no relationship, that the bank made profits, the bank made losses, I'm not related...*".

While bearing these in mind, and in relation to the study, the link between the IFI and the investor is the agreement that they sign. This imposes emphasis on the content of the agreement and the causes or

effects of violation. And in *Shari'ah*, no agreement takes place without both parties being satisfied and in agreement. As such, it depends on the type of agreement that is signed and maintaining the conditions of the specific type of agreement, as to whether any *Shari'ah* risk is emanate or incurred. ShSc-10 elaborates on this:

*“Agreements, are not valid if they [parties] aren't satisfied... so being satisfied, is an important matter for the validation of agreements. And satisfaction is not achievable without knowledge; it is associated with knowledge...So the providing of information is something essential, and holding it back, is what spoils it. It is important to ensure the matters are in the text of the agreements, this issue...it [an incident/matter that occurred and is not meeting a clause in a contract or has been left out] is considered a deficiency, and is looked at ... whether the contravention affects significantly its Shari'ah features, that it transfers the agreement from a valid agreement to void agreement, or it is just a violation and no harm has been inflicted on the others”.*

## **8.5 CONCLUDING REMARKS**

This chapter presented the findings of the interviews conducted with ShScs that were on the SSB of the IFI that deal in Islamic private equity/private placements. In meeting the objective of the study, the organisational and work relationship of the SSB with its IFI is as to how *Shari'ah* function is undertaken and what could jeopardise its quality, was looked into. The findings present the scholars' response right from being appointed to performing their duties, as part of a team/board, to the decisions made prior and post investment. It also looked into *Shari'ah* compliance and the outcome of the *Shari'ah* audit that is performed. In order to arrive at any weaknesses in the *Shari'ah* supervision system of the IFI governance system, the scholars' concerns were also presented because this is an essential part when trying to improve the SSB's role and hence, the *Shari'ah* supervision function of an IFI.

From the interviews it appears that the operations of the *Shari'ah* supervision of the IFI can impose operational risk, which can affect the performance of the SSB function. There appears to be internal and external causes. Some of the internal causes, as seen from the findings of this chapter can occur due to the SSB having unclear roles and responsibilities. It can also be due to the lack of independence of both the SSB from the IFI (remuneration dependence) and those performing a *Shari'ah* audit internally, when administratively they fall under the IFI. Furthermore, the approval of products (before and in some cases after their launch), full transparency, and asymmetry of information from the employees of the IFI. In addition, along with there being no set standard for classifying *Shari'ah* compliance and



compliance process documentation, the lack of transparency in the reporting of non-compliance, and as such affecting accountability/responsibility. While the external causes appear to be the shortfall in the laws and regulations of the *Shari'ah* supervision function. In addition to the fact regulations vary from one jurisdiction to another, the matters mentioned above would need to be addressed. For example, independence/conflict of interest, *Shari'ah* audit, *Shari'ah* non-compliance reporting, standardisation of compliance process and classification are but a few that would need to be regulated and effectively enforced.

The above causes could lead to compliance risk, which turns into *Shari'ah* risk. Moreover, from the interview findings with investors (see Chapter 6); the investors appear to be heavily relying on the SSB for product/investment approval, the ongoing *Shari'ah* compliance (supervision) and the effective function of the SSB and its members. Hence, in light of the above, these causes would need to be addressed to enhance investors' trust and confidence in the IFI.

## Chapter Nine:

### CONTEXTUALISATION OF THE RESULTS AND FINDINGS

#### 9.1 INTRODUCTION

This chapter aims to synthesise the findings of the empirical part of the study (Chapters 6, 7 and 8) in light of the related theories and concepts discussed under the literature review chapters. In its attempt to explore the weaknesses in the relationship between investors and Islamic private equity firms<sup>216</sup> in the GCC, the empirical part of the study followed a sequential exploratory research design, using the mixed model method for the collection of data (Saunders et al. (2009), as mentioned in Chapter 5. Such a method of data collection helps to explain and complement the findings of the quantitative and qualitative approaches undertaken. In order to seek responses to the research questions related to the investors, questionnaires were used to obtain their views and to be able to standardise the results and interpretations. This was then followed by in-depth interviews with the financial institutions (FI) to obtain responses to the research questions related to the FI and these were followed by in-depth interviews with *Shari'ah* scholars (ShSc) to understand the issues related to *Shari'ah* compliance. Furthermore, since IPE is based on the conventional form of private equity, as discussed in Chapter 3, it was interesting to also seek the views of investors who invested in the conventional firms and to include their responses in the study and to compare their responses and experiences with those who invested in IPE.

The relationship between the investor and the FI in private equity investment is one that is based on a contractual agreement between the principal (owner of funds/capital - investor) and the agent (managing and making the investment decisions - FI). However, since contracts cannot be complete, such a relationship is not without gaps and flaws. The main issues that arise in light of the principal-agent theory covered in Chapter 2 relates to the alignment of interest and information asymmetry leading to moral hazard and adverse selection. Furthermore, as seen in the chapter on regulations (Chapter 4), such a form of investment is beyond the main securities'/capital market authorities' radar, as the investors involved are considered sophisticated investors, and are supposedly able to handle their decision making by themselves. As such, the study attempts to seek the investors' awareness, familiarity and approach in investing in private equity, through seeking to explore the investors' experience. Moreover, there are different forms of investing in private equity, yet the authority of control and managing of the investment is mainly in the hands of the FI, who controls not only the investment but also the flow of

---

<sup>216</sup> Financial Institutions that invested in Islamic private equity/ private placement (including real estate projects).

information to the investor. Consequently, the study attempts to examine the FIs in their handling and operating of such a relationship. What is more, the only way the investors are able to appeal against the FI is by attempting to enforce the contract/agreement signed and to take legal action. However, this is not a route that many investors take to claim their rights (or losses), because the legal outcomes are not always in their favour. This is due to the fact that both parties have entered the agreement/investment on agreed terms, and hence, are expected to accept the outcome (Spindler, 2009). Moreover, *Shari'ah* forms of investment are also based on contracts and the relationship is handled as per the agreed terms, in addition to it having to meet *Shari'ah* compliant issues that have been covered in Chapter 3.

Seeking to answer the research questions and contextualisation of the findings is undertaken under two broad themes: Transparency & Information and *Shari'ah*. Accordingly, in an attempt to respond to the research questions, the questions related to the two main parties in the relationship (investors and financial institutions/PE firms) will be discussed through the above themes. Moreover, under the *Shari'ah* theme, the ShScs' responses will also be considered. In particular, the chapter first addresses research questions related to Transparency & Information, (Research Questions [RQ]: A.1 to A.5 in Figure 9.1) and then examines the questions that are related to *Shari'ah* (RQ: B.1 to B.4 of Figure 9.1). In addition, within each theme, the related regulatory requirement will be explored by addressing the research questions related to the participants' (FI and investors) views on regulating the PE market (RQ: C.1 of Figure 9.1).

Figure 9.1 - Research Questions

TRANSPARENCY & INFORMATION		SHARI'AH		REGULATING PRIVATE EQUITY MARKET	
A.1	How do the FI and investors handle the pre-investment stage? <i>Source: FI and Investors Results &amp; Findings</i>	B.1	What is the FI/Investor's/ShSc's level of Shari'ah understanding? <i>Source: FI, Investors and ShSchs Results &amp; Findings</i>	C.1	What are the views on regulating the PE market? <i>Source: FI &amp; Investor Results &amp; Findings</i>
A.1.a	-What is the FI's/ Investor's approach to the investment? <i>-Approach -Familiarity</i>	B.1.a	-What are the important Shari'ah principles to FI/IPE Investor/ShSc? <i>-Shari'ah principles</i>	C.1.a	-What are the FI/Investors views on regulating the PE market? <i>-Favour/Beneficial -Effective post enforced</i>
A.1.b	-What is the information shared and discussed prior to investing, undertaken by FI/Investor? <i>-Information &amp; Discussions pre-investment</i>	B.1.b	-What are the Shari'ah risks to FI/IPE Investors/ ShScs? <i>-Shari'ah risks</i>		
A.1.c	-What is the due diligence performed and documents prepared/received by the FI/Investor, prior to investing? <i>-Information/ sources -Documentation</i>				
A.2	What are the pre-investment regulatory requirements? <i>Source: FI and Investors Results &amp; Findings</i>	B.2	How is Shari'ah compliance maintained? <i>Source: FI, Investors and ShSchs Results &amp; Findings</i>		
A.2.a	-What pre-investment regulatory requirements apply to FI/Investor? <i>-Regulatory requirements</i>	B.2.a	-How is Shari'ah compliance maintained by FI/IPE Investor/ShSc? <i>-Shari'ah Compliance -Shari'ah Report</i>		
A.3	How do the FI/Investor handle the post-investment stage? <i>Source: FI and Investors Results &amp; Findings</i>	B.3	What are the Shari'ah regulatory requirements? <i>Source: FI, Investors and ShSchs Results &amp; Findings</i>		
A.3.a	-What is the frequency and format of update provided/Received by FI/Investor? <i>-Frequency -Format of reporting -Info.Updates / Analysis</i>	B.3.a	-What are the Shari'ah regulatory requirements that apply to FI/IPE Investor/ShSc? <i>-Shari'ah review/audit report</i>		
A.3.b	-How is the decision making on conflicts of interest matters maintained by the FIs/Investor? <i>-Decision making &amp; Maintaining investors' interest</i>				
A.4	What are the post-investment regulatory requirements? <i>Source: FI and Investors Results &amp; Findings</i>	B.4	What are the issues of concern in the framework of PE with regards to Shari'ah? <i>Source: FI, Investors and ShSc. Results &amp; Findings</i>		
A.4.a	-What post investment regulatory requirements apply to FI/Investor? <i>-Regulatory requirements</i>	B.4.a	-What are the issues with regards to the Investment framework set-up? <i>-Key issues</i>		
		B.4.b	-What are the issues with regards to the Information Disclosure? <i>-Key issues</i>		
A.5	What are the Investors' view's on the investment relationship? <i>Source: Investors Results &amp; Findings</i>				
A.5.a	-What is the Investor's view on the contractual relationship with FI? <i>-Trust -Negotiation</i>				
A.5.b	-What is the Investor's view on the FI Communication of information? <i>-Updates/Go back -Reason no update</i>				
A.5.c	-What is the Investor's future investment plans? <i>-Expectation Continue/Not continue</i>				
A.6	What are the issues of concern in the framework of PE with regards to transparency and information? <i>Source: FI and Investor Results &amp; Findings</i>				
A.6.a	-What are the issues with regards to the Investment Set-up? <i>-Key issues</i>				
A.6.b	-What are the issues with regards to the Information Disclosure? <i>-Key issues</i>				

## **9.2 TRANSPARENCY AND INFORMATION**

According to Muller (2008), information asymmetry is the main cause of the principle-agent relationship in PE investments. Thus, the main factor contributing to eliminating information asymmetry is transparency and the communication of information. Hence, this section examines the responses of investors and Islamic financial institutions (IFI) analysed in Chapters 6 and 7 in seeking to respond to the research questions related to transparency and information. While the first part of the section summarises the main findings of the IFI's handling of the pre-investment stage of investment followed by the main findings of how the investors deal with the pre-stage, the second part covers the post investment stage of both the IFI and the investors. At the end of each stage, any related regulatory requirements are noted. With regards to the investors, the responses of the three groups of investors (Islamic individuals, Islamic institutions and conventional) are reported, in a similar way as the results and analysis were presented in Chapter 6.

### **9.2.1 Pre-Investment and Transparency & Information**

As mentioned above and in Chapter 2, the main concern to be addressed in the investment relationship is the asymmetry of information, which is affected by several factors that are mainly derived from the concept that the interests and risk appetites of both parties are different. One is risk averse and is seeking to maximise income (FI), while the other is risk neutral and is seeking to maximise returns (investor) (Guang-Ming, 2011 and Spindler, 2009).

*RQ-A.1. How do the FIs and the investors handle the pre-investment stage?*

#### **9.2.1.1 Pre-Investment Stage**

##### **a) Approach and Familiarity**

*A.1.a What is the FI's approach to the investment?*

From the findings in Chapter 7 of the interviews conducted with the IFI, it was apparent that the IFI approaches investors in stages. In line with Crémer's (2010) assertions, at the outset of the relationship neither party knows one another and as the relationship progresses the gap between the parties narrows, and the parties become more familiar with one another. The IFI gets to know more about the investors, his understanding, investment interest, and risk appetite, which helps them in how they pitch the

investment to the investor (section 7.2.2). And at the same time, the investor gets to become more familiar with the IFI and the investment, develops confidence in the IFI and gets to enquire about the investments and to invest. The principal-agent model changes as the process of interest develops, as described by Waterman & Meier (1998), in that the asymmetry of information and goal conflicts are dynamic and not constant.

#### *A.1.a What is the investors' approach to the investment?*

In order to attain the investors' familiarity with the area of PE investment, especially since it was part of the IFI's reasoning in taking the investment to the investor in stages, the investors' understanding and familiarity with investing in PE was sought.

The Kruskal-Wallis (K-W) test in Table 6.3 shows that there is a significant difference in the familiarity of the three groups of investors. Specifically, there appears to be a difference in the level of understanding between the individual investor group and the conventional investor group. The effect appears to be large and they appear to be in opposite directions, implying that one group is more familiar than the other (Figure 6.2). The responses indicate that both the conventional and institution groups had specialised investors, with the conventional being more dominant which is reflected in their weighted scores (Table 6.3). As indicated in Chapter 3, Islamic private equity is based on the conventional system, and most of the structuring participants have a conventional background. As such, the results (of the level of familiarity of the individual investor (investing in IPE) and the conventional investor appear to be in line with Abdull Mutalip's (n.d) thoughts on investors (investing in IPE) lacking the correct awareness with regards to *Shari'ah* requirements and principles. Furthermore, it is also reflected in the level of industry experience. According to Bose & Mcgee (2008), this could be due to the investors' knowledge being shallow and that the understanding they have gained is mainly from networking, as discussed earlier in Chapter 3.

Such an approach of testing the waters is the norm in most investments, as it provides an opportunity to both parties to be more familiar with each another. However, to the investor, other than the information he is provided with, the reputation and track record of the FI is important to him. This was commented on by many of them (management's past performance and track record). However, access to such information is obtainable from the market and more accurate information on the FI's reputation and past performance is more easily obtainable for those who are in the industry (whether directly or indirectly) than those outside the industry.

### *Concluding Remarks*

Although the results in Table 6.8 showed that conventional and institutions had more difficulty in obtaining market information, it should be noted that around 28% of the individual group of investors did not actually try to obtain market information. As stated by one of the FIs interviewed, although the investors are supposedly sophisticated, investment and finance is not necessarily their area of expertise (section 7.2.2). Hence, by the IFI approaching the investor in stages, a rapport is built between the parties and the investors are given the opportunity to become more familiar with the IFI and the investment. This helps to build confidence and works to the advantage of the investor, provided the information he receives is clear and transparent and all issues related to the investment are disclosed.

With regards to the FI approach towards meeting the investors' expectations, close to half of the investors thought it did, while around a quarter each reported it met a "Few" and "All" their expectations (Table 6.47). The responses show that all three groups of investors had similar responses with regards to the FI's procedure and approach meeting their expectations.

### **b) Presentations and Discussions**

#### *A.1.b What is the information shared and discussed by the FIs with the investors prior to investing?*

The IFI in discussing and presenting to the investor, tries to keep matters simple for ease of understanding, avoiding any complex investment structures, so as not to lose the investors' interest, through the complex investment set-ups (Chapter 7, section 7.3). On the other hand, these complex set-ups correspond to various levels in the investment structure whereby each level has different voting/controlling rights (Chapter 7, section 7.3.2). The IFI's intention, in trying not to overload the investor, is to place investors at the level where their interference is the least (Aghion & Tirole, 1997). The reason for the IFI holding back such information (complexity of the investment structure) is to maintain its (IFI) personal perspective of ownership of the idea and the decision control (Sapienza & Korsgaard, 1996). Both Spermann (1990) and Sann (2007) rationalise the IFI's behaviour of not presenting and holding back on the investment set-up as the holding up of information and hidden intentions/information, as opposed to the reason of avoiding the investor getting confused.

#### *A.1.b What is the information shared and discussed by the investors with the FIs prior to investing?*

Following Muller (2008), Kut and Smolarski (2006) and Zhang (2009), on the communication of information being a critical factor in private equity investment and the root of information asymmetry, the matters that the FI discusses while putting forward the investment to the investor were analysed. The findings showed that there was some statistically significant difference on Alignment of Interest, Governance, and *Shari'ah* compliance matters that were discussed (Table 6.14). With regards to Alignment of Interest, the findings revealed a large significant difference in the level of discussion between individuals and conventional investors (Figure 6.5). Such matters were discussed in more detail with the conventional investors than with individual investors. Furthermore, in discussing governance matters, the findings revealed a large significant difference in the level of discussion between individuals and conventional investors only (Figure 6.6). While there was a smaller difference (medium size effect) in the level of discussion with regards to *Shari'ah* matters between the institution investors and the individual investors (Table 6.14). With institutions being professionals, they are more aware of what to discuss, and it is expected that matters would be discussed in more detail with them. However, although the makeup of the conventional investors group is more conventional individuals than conventional institutions, the conventional investors group appears to be closer in strength in obtaining/discussing information than the institutions group. Their experience in investing in PE is reflected in the level of information being discussed.

### *Concluding Remarks*

It appears that specialisation and greater familiarity (of institutions and conventional investors, as seen above, under approach and familiarity) affects the discussions on important matters of the relationship (alignment of interest and governance or control), as they have been taken in up in more detail with the investors that are more familiar and specialised. It is most likely that the investor himself brings them up in the discussions, rather than the FI raising them. These issues are related to the risk/returns of the investment affecting the incentive scheme of the IF and are of great importance. Consequently, following the theory (Chapter 2), the FI representative will do his best to seek the best terms possible for his institution. Moreover, from the understanding in Chapter 2, for the investor to give the FI direct control, the investors need to see that both (investor and FI) interests are aligned and one of the ways this is done is through discussing the control mechanisms that would place some control, which keeps a cap on the risk the FI can take up. As such, matters that could restrict the FI's decisions will most likely be kept to a minimum during discussions, unless questioned by the investor.



Furthermore, with regards to meeting the investors' expectations on Risk/Return (Table 6.47), just over a third responded "Some" and a quarter said "All". Yet there were individuals (unlike the institutions and conventional) who said "None" of the investments had met their expectations on risk/return.

### **c) Due Diligence and Documentation**

#### *A.1.c What is the due diligence performed and documents prepared by the FI, prior to investing?*

The IFI due diligence process is performed in stages, based on their approach to the investor. As the investors develop interest, deeper due diligence is undertaken. This depends on the institution and area of investment and specialisation as to whether it is done internally or externally (Chapter 7, section 7.5). Moreover, since Islamic investing is based on the *Shari'ah* principles, it is inter-related with the Islamic economy (as deliberated by El-ashker & Wilson, 2006; Laldin, 2008 and Naqvi, 1981 in Chapter 3). In addition to the normal due diligence that is usually performed in the investment industry, the IFI was asked if social or environmental due diligence is performed. It appears that little consideration is given to environmental and social aspects. Instead, such due diligence is considered as a personal matter and is left to the individual (the investor). However, some consider (as commented on by one of the participants) such a matter to be an embedded attribute in being *Shari'ah* compliant (Table 7.41).

Some form of documentation, put together based on the due diligence undertaken by the IFI, is then left with the investor for him to review and make his decision. From the IFI interviews, it appears that the Rate of Return (RoR) and the Date of Exit (Exit) were the two main pieces of information that investors were interested in when making their decision (Chapter 7, section 7.2.2). As such, many IFIs used this interest (of maximising returns) to their advantage and would state the RoR on the front of the documents they presented to the investors. Moreover, in line with similar behaviour to that discussed in the literature, individuals entered into a relationship based on trusting their friends' decision making (Doney et al, 1998); while many investors got on board with the investment just because others they knew had done so (Chapter 7, section 7.2.2).

#### *A.1.c What is the due diligence performed and documents received by the investor, prior to investing?*

In addition to discussing matters, the FI provides investors with documentation on the investment when promoting an investment. Upon analysing the respondents' experience in reviewing the documents, with regards to the simplicity of the language and the comprehensiveness (with regards to investors'

rights) of the documents, the individuals found the documents simpler than the conventional and institutions (Table 6.11), yet the conventional found the documents more comprehensive than the individuals and institutions. The conventional investors found the documents easier than the institutional investors (Table 6.11). The institutions received documents related to investing in IPE and the conventional received documents related to CPE. While the greater portion of the conventional group is individuals, it was interesting to see from the weight scores that the conventional institutional investors found it both easier and more comprehensive than the conventional individual investors (Table 6.12). The results indicate that since the institutions are professional organisations, it is easier for them to understand the language of the documents.

The type of information the investors relied on and were interested in was examined. Moreover, since in examining the theories underling the PE relationships, network and social relationship appear to play an important role, accordingly the questions in the questionnaire segregated between the weight given to Personal Sources of information and to impersonal sources of information.

Some of the thoughts discussed in Chapter 2 considered culture and values to be embedded in the social relations, which in turn generate a certain acceptable level of behaviour (Granovetter, 1985 and Johnson & Droege, 2004). However, even though the responses from all groups appear to place a considerable portion of their decision making on personal sources, when looking at the outcome of the K-W tests there appears to be no significant differences with regards to Personal Sources of information among the three groups of investors. Moreover, although the results show no significant differences, it was interesting to see that the institutions group has a higher weight than individuals in basing their decision making on Personal Sources (Table 6.4). It appears that the institutional investor, being an institute and in the market, relies on networking to share information and to gain knowledge (experience of others), as suggested by Bose & Mcgee (2008).

With regards to Impersonal sources, the responses indicate that conventional placed the greatest weight on Impersonal sources, which was confirmed by the K-W test (Table 6.6). The K-W test revealed a significant difference between institutions and conventional, with a moderately strong difference in behaviour towards Impersonal sources (Figure 6.3). This draws further attention to the fact that CPE popularity and existence/practice has been around longer than IPE (from discussions in Chapter 3), and as such the market participants are more experienced in the due diligence process and the importance of impersonal information.

The long-standing existence of the conventional market is also reflected in the weighted scores of the importance of environmental, social and governance (ESG) matters (Table 6.9). Although the K-W test revealed no significant differences, the weighted scores of the responses of conventional reflected that this group of investors gave a “Substantial Extent” of their consideration to ESG. While from the reflection on the literature on the Islamic economy and in line with the thoughts of El-ashker & Wilson (2006), Laldin (2008) and Naqvi (1981) on the communal and proper use of resources, it was expected that the other two groups who invested in IPE matters related to ESG would exceed the conventional.

### *Concluding Remarks*

It appears that proper documentation is provided to the investors, with over 80% receiving a full set of documentation (Table 6.10). The question is how many of them really read the documents in detail? Although close to 71% responded that they had read the documents (Table 6.13), from the responses of the FI, they did not think that all investors read the documents. Many of them were more based on trust in the FI (Chapter 7, section 7.2.2). These comments by FIs appear to be reflected in the responses the investors provided, with around 61% of the investors basing it on information and trust together and about 27% basing it on information alone or 8% just on trust alone (Table 6.14).

## **9.2.2 Transparency and Information on Pre-Investment Regulatory Requirements**

The PE market in most jurisdictions is considered an exempt (from regulation) form of investment and is undertaken privately by institutions with sophisticated/accredited investors (Chapter 4). Although the investors are considered accredited/sophisticated, it is an opaque market when it comes to the availability of information. To be able to make informative investment decisions, investors require quality rather than quantity of information. Furthermore, as understood from the above discussions, transparency and information play an important role in such an investment relationship. Hence, as asserted by Andnas & Chiu (2014) and Morris & Philippou (2012), for such a market to grow information needs to be available in a convenient and consistent format, with some form of oversight for it to function effectively. The following sections reveal the results with regards to any regulatory oversight in the pre-investment stage.

*RQ-A.2 What are the pre-investment regulatory requirements with regards to transparency and information?*

## **a) Pre-Investment Requirements**

### *A.2.a What pre-investment regulatory requirements apply to the FIs?*

The pre-investment regulatory requirements were not the same across the GCC. They varied from just the need to have the proper activity licence to the need to seek the regulators' approval on the documents to be used and approval on the investment vehicle. The one common pre-investment regulatory requirement was that such a form of investment was to be offered to sophisticated/accredited investors only (Chapter 7, section 7.7.1). However, their experience has shown them that this definition was not easy to verify and uphold as per the regulatory requirements. There are two features to the definition: one is wealth and the second is tech-know-how. FI had no issues with the ability to identify the wealth aspect by demanding bank and balance statements from investors. While the second aspect was a cause for concern to them because it was not easy to identify the investors' financial technical know-how.

### *A.2.a What pre-investment regulatory requirements apply to the investors?*

As seen from the above, the pre-regulatory requirement on investors was that the investors that can invest in such investments need to meet a certain wealth/income bracket and a technical level of know-how. This was basically done by meeting the KYC requirements (for individuals) and entity verification (for institutions) that were placed by FI. However, about a third of the investors said that there were no regulatory requirements that they had been asked to meet, nothing. They were mainly individual and institution investors (IPE investors) (Table 6.46).

### *Concluding Remarks*

The pre-regulatory requirements across the GCC appear to vary, with the common one being the offer is to be made to a specific type of investors. The next requirement that applied to quite a few was the submission of the documents to be used in the offering. Moreover, they are required to assess the investors' awareness of the requirements in the PE market and whether they knew about the regulations imposed on their investment counter-partners, which the investor is affected by indirectly. Around 50% of the investors were fully aware and those dominantly were the institutional investors. There were more individual investors that were not aware than conventional investors (Table 6.44). The institutions' awareness comes from them being in the professional market/sector, and hence they are more aware of regulatory requirements. With regards to conventional investors, CPE has been operating for a longer

time in the market than IPE and so the conventional investors appear to be more aware of the regulatory requirements imposed on their investing partners.

### **9.2.3 Post-investment and Transparency and Information**

According to Sapienza & Korsgaard (1996), the FI can gain the trust and continuous financial support of the investors by reducing the asymmetry of information and maintaining a continuous flow of information. Thus, this section looks into the post-investment stage and the flow of information/communication between the FI and the investors. As per the discussion above on the pre-investment stage, the section will also look at both the FI and the investors' handling of this stage.

*RQ-A.3. How are the FIs/investors handling the post-investment stage?*

#### **9.2.3.1 Post-investment**

##### **a) Frequency and Format of Update**

*A.3.a What is the frequency and format of update provided by the FIs?*

The frequency of reporting by the FI to the investor depended on various factors such as the type of asset of the investment, the availability and quality of information, and the need for additional funds (Chapter 7, section 7.4.2.1). In addition, in line with Sapienza & Korsgaard (1996), the process of collecting and collating the information is time consuming which in turn was reflected in how the FI saw the act of maintaining the flow of information. The interviews revealed that providing information once a year was the usual norm, while some reported providing it quarterly and semi-annually. Communication is usually maintained with the relationship officer and the investor, and in addition to reports, calls or visits are made.

The reports covered the financial and operational performance for the period and some compared the performance to the market. Moreover, in reporting more emphasis and detail is given to favourable news, while communication of less favourable news is kept to a minimum (Chapter 7, section 7.4.2.2) to avoid loss of authority of the investment (Riordon (1990), and Aghion & Tirole (1997)). Furthermore, generally the information reported initially is the same to all groups of investors (whether institutions or individuals), and then depending on the request for further information from the investor, the FI

accommodates accordingly. However, this is not always the case when updating the investor after having exited an investment. Due to investors having entered the investment at a different price level, full transparency would only create more unfavourable behaviour and discontent for the investor (Chapter 7, section 7.4.2.2). The FI, in an attempt not to risk jeopardising the relationship (and possible loss of the investor's interest), holds-up/holds-back some of the information on exit (Spermann, 1990).

#### *A.3.a What is the frequency and format of update received by the investors?*

Close to a quarter of the investors responded that FI kept in touch frequently, with the institutions scoring the highest, followed by conventional and then individuals (Table 6.28). Furthermore, with regards to the reports being in a standard format as mentioned by FI above, over 70% of the respondents thought that the method of reporting was standard and consistent for comparison. Yet, they thought that the information was not enough and they would need to go back to the FI for more information and clarifications (Figure 6.14).

#### *Concluding Remarks*

The FIs initially provide minimum information and when asked provide further details. With regards to institutional investors, due to the licensing/legal structure it has certain requirements to meet and disclosures to make, so the FI provides them with the additional information more frequently. Additionally, the FI appears to be selective to whom visits for updates are made (Chapter 7, section 7.4.1). It is to the FI's advantage to maintain such relationships (institutions and selective investors) so as to maintain their participation in current and future investments (Chapter 7, section 7.4.2.2). Moreover, it appears that the FI keeps the information being communicated to a minimum, due to the fact that it is time consuming and is an overload for the FI's staff handling the matter. Although the investors appear to have placed a considerable amount of trust in the FI, the FI's voluntary cooperation and provision of sufficient information is lacking. This does not appear to be in line with Kim & Mauborge (1998) and Baker et al. (1999), whereby the principle of trusting and committing to invest is expected in return for receiving voluntary cooperation from the FI (agent).

### **b) Decision Making Involvement and Maintaining Investors' Interest**

#### *A.3.b How is the decision making on conflicts of interest matters maintained by the FI?*

Overall, investors' involvement in the post-investment phase is kept to a minimum. As the FI is taking up the management of the investment and has proxy, usually the FI only goes back to the investors when strategic/material decisions need to be made and are outside the terms and conditions of the Private Placement Memorandum (PPM)/offering document they had initially provided the investor with. According to Sapienza & Korsgaard (1966), such behaviour is expected by the FI, since he is the owner of the investment idea, seeks the freedom to make decisions with the least interference and to have real control (Aghion & Tirole, 1997). However, not all investors are treated equally with regards to their restrictions on voting and decision making. Those investors that are taken on at the first level of the investment structure (the SPV) have no voting rights compared to those that are taken on board at the investee company level who do.<sup>217</sup> For those investors who have been able to acquire high stakes of ownership without their ownership/stake being diluted (by the FI spreading the ownership across various investment vehicles), their ownership rights places them on a level on the investment structure where they are able to have some voting power (Chapter 7, section 7.3.2).

#### *A.3.b How is the decision making on conflicts of interest matters maintained by the investor?*

Ideally, the investors would need to, either initially or later in the investment, give proxy to the FI and transfer the real authority to the FI (Aghion & Titole, 1997). However, close to half of the investors said that signing a proxy at the time of subscription and signing the agreement was optional (Table 6.22). In such a situation, the investor is placing his trust in the expertise and competence of the FI. This is with regards to the investors who were not among those that were offered board seats; other than the investors mentioned above (under 9.2.3.1.b and FI's decision making involvement), where the FI treated some investors differently and gave them some involvement in the decision making.

#### *Concluding Remarks*

Both in the conventional PE set-up and in the Islamic PE set-up in the form of *Mudarabah*, the investors usually play a passive role and the day-to-day management is left to the FI/GP (Chapters 2 and 3). Hence, the taking of proxy by the FI is expected. However, this is based on the fact that the investor has discussed and agreed on certain terms that are fair to both parties. As can be seen above (9.2.1.1.b), with regards to limitations of details on discussions undertaken and to below (9.5.a), with regards to the

---

<sup>217</sup> Some investors (with greater negotiation power) were taken on board directly onto the investment company and not on the SPV entity that pooled the funds. And hence, had board seats on the investment company and voting rights (more of the shareholder's agreement than a subscription agreement).

ability to negotiate, agreements appear to be drawn up more favourably towards the FI (Chapter 6, section 6.4.3).

### **9.2.3.2 Transparency & Information Post-Investment Regulatory Requirement**

Flow of information post-investment appears to be an important factor in maintaining a healthy relationship, builds confidence and enhances further flow of capital in the PE market, as seen from the discussion above and in prior chapters. As such, this section analyses the responses related to any regulatory requirements to disclosure of information post-investment.

*RQ-A.4 What are the post-investment regulatory requirements with regards to transparency & information?*

### **9.2.4 Post-investment**

#### **b) On-going Requirement**

*A.4.a What post-investment regulatory requirements apply to the FI?*

Post-investment regulatory requirements on the FI depend on the jurisdiction. Some had none, some related to treating investors equally and fairly and in other cases the regulator had to be notified of any changes to the original terms and conditions set in the documentation. While some jurisdictions followed the funds regulations and market conduct rules. Moreover, regulations appear to be in the form of principles/guidelines and more recently, some regulators have been paying attention to provide more details on those guidelines (Chapter 7, section 7.7.2). These post-requirements do not appear to be very different to other international markets and private equity investments. The private equity market until the crisis of 2008/2009 was a market that was left to its players. The international standard setting bodies and regulators only made some changes after the financial crisis, and much of this is on private equity buy-outs and hedged funds (Chapter 4, section 4.3).

*A.4.a What regulatory requirements apply to the investors?*

In PE, once the contractual agreement is signed, the FI managing partner takes control and runs the investment/project. As such, in general, the investor takes a passive role, and there are no requirements on him. Hence, there are no post-investment requirements on investors. However, what concerns the



investor post-investment and where he is affected is whether there exists an effective mechanism for taking up any breaches to the agreement that may occur. His concern lies in the effective enforcement of the regulations, when it comes to any misconduct from the part of the FI. With regards to the regulations on FI having been enforced, the individual and conventional investors responded that they were “Somewhat” enforced, while there were a large number of institutional investors that thought they were “Fully” enforced. Moreover, just under half of the individual investors had “No Idea” as to whether the regulatory requirements were enforced effectively on FI (Table 6.45). With regards to the investor testing the enforcement system on breaches to the agreement, the experience shared was not a positive one. The investor was de-incentivised for taking the matter to arbitration, due to the high administrative fees, just to hear the case prior to taking it up (Chapter 6, section 6.8.3.1).

### *Concluding Remarks*

Internationally, the PE market drew some regulatory attention, after the 2008/2009 financial crisis. As discussed in Chapter 4, some regulatory organisations, international standard setting bodies and industry associations have come out with some form of requirements/guidelines on the FI (mainly with regards to transparency and information disclosure/communication). These guidelines are international and not easily integrated into the regional/local market, without being taken up directly within the region/domestic regulator or industry association (Andenas & Chiu, 2014). As can be seen above, it appears that there is no standard and consistent flow of information requirements in the regional regulations that deal with investing in PE or an effective/satisfactory legal/arbitration system that caters for any violations to the contract.

## **9.5 Investors’ Views on the Investment Relationship**

Before moving on to examine the issues and concerns in investing in PE with regards to transparency and information, as the investor is the party in the relationship that is greatly affected/impacted by transparency and communication of information, their views on their relationship with the FI were studied. Their views on the contractual relationship and thoughts on FI behaviour were also assessed, in addition to their going forward intention in continuing to investing in PE. The following section summarises the investors’ views on the above matters.

*RQ- A.5 What is the investors’ view on the investment relationship with the FIs?*

## **a) The Contractual Relationship**

### *A.5.a What is the investors' view on the contractual relationship?*

#### **Trust in IFI**

According to Beccra and Gupta (1999), when evaluating trust in a relationship two things need to be considered: the difference in attitudes of the other party and the evaluation of the other party in the relationship. In evaluating the investors' level of trust in the FI, the K-W test showed there to be no significant differences among the groups of investors. On the other hand, many individual investors stated that they are entering the investment based on their trust in the IFI (Chapter 6, section 6.2.2). This is reflected in the individual group scoring a higher weight on basing their decision on trust (partially or fully) than the other groups of investors. Furthermore, with regards to the investors' views on trust in the IFI meeting their expectations, close to two thirds of the responses were between "Some" and "Few" (Table 6.47).

#### **Negotiation and Agreed Process**

Investors and the FI bond together in the type of contract/agreement they sign, as discussed in Chapters 2 and 3. Furthermore, as part of the trust building process, FI's willingness to perform some changes in the contract demonstrates to the investor that the FI is seeking mutual interest rather than self-interest (Das and Tag, 1998). Moreover, the optimal contract, according to Harris & Raviv (1979) discussed in Chapter 2, depends on the ability to monitor and when drawn-up is based on two parts: one on monitoring the agents' behaviour and the other is on payoffs to the agent based on the monitoring outcome. As such, the study looked into the investors' ability to negotiate prior to signing the agreement and whether the process of handling conflict of interest matters was documented and agreed upon.

With regards to the ability to negotiate, the chi-square test of homogeneity revealed a significant difference in the portions of those who were and were not able to negotiate, prior to signing (Table 6.20). In comparing the group of investors, there was a difference, of a large size effect, between the individuals and the conventional (Figure 6.12). The difference between the institutions and conventional groups of investors was not significant. Nevertheless, among the three groups of investors, the conventional group appears to have had the greater ability to negotiate (Table 6.19 and Table 6.20). Overall, negotiation was on reducing the fees and with some the yield. However, the ability to negotiate further terms such as board seats, valuation and exit, appear to have been in the hands of large size investors. The investment bracket of 10m+ scored the highest bracket of investors being given the

opportunity to negotiate (Table 6.21). This is in line with Perrow (1986) and Saam (2007) who maintain that power is the intervening variable in looking into solutions to agency problems. However, Saam had a wider scope than Perrow, in addition to power acting as an intervening variable, the principal also possesses a greater power base than the agent. This was not the case here; for although power (size of investment/commitment) had an effect, not all investors (principals) possessed such ability/power to negotiate (Table 6.21).

Based on the “participation model” of Rawls (2005), fairness in a relationship is achieved by both parties creating and agreeing on a process of decision making and in handling matters of conflict of interest that might develop later on in the investment tenure. This builds trust (Kim & Mauborgne, 1998) in the relationship and whatever the outcome is, good or bad, it is accepted by the principle, in addition to reducing the need to monitor by the principal (Sapienza & Koesgaard, 1996). Accordingly, investors were asked if the FI had established a clearly documented process with regards to dealing with conflict of interest matters/decisions that may arise later during the investment term. The Pearson chi-square test revealed a statistical difference, with a large size effect (Table 6.26). Although, pair-wising no two groups were significantly different (Figure 6.13), most of the positive responses with regards to there being a documented process were by conventional investors followed by institutions and lastly individuals (Table 6.24).

## **b) The FI Communication of Information**

### *A.5.b What is the investors' view on the FI's communication of information?*

#### **Reason for Holding Back of Information**

With regards to the reasons for FI not getting in touch regularly, the K-W test revealed there to be a statistical significance in information advantage. Investors considered that the main reason for the FI not getting in touch as frequently as they would like is due to the fear of the FI jeopardising its Information Advantage (Table 6.29). As explained by Sapienza & Koesgaard (1996), in addition to enjoying the power of information advantage, if the practice of regular information does not exist, then the FI is not penalised for a delay in reporting or in not fully reporting negative news. It was also interesting to note that two investors considered the reason for such a hold back as a shortfall in the operational competency of the FI and there being no incentive for the FI to report, due to having received its fee upfront.

## **Effect on Investor in Receiving Information**

In line with Sapienza & Korsgaard (1996), the majority of investors considered that regular reporting by the FI would enhance their trust in the FI and nearly half of the investors considered that it would reduce the investors' need to monitor, and close to a third were willing to inject further capital (Table 6.30).

### **c) Investment Expectations Going Forward**

*A.5.c What is the investors' future investment plan?*

Based on the investment meeting the investors' expectation of the risk/return, there was a statistical significance in the investor with no plan to continue to invest and plans to continue (Figure 6.19). Moreover, the most favoured form of investment going forward is direct equity investment, followed by indirect equity investment (Table 6.49). Preference for such forms is because it provides them with some control in seeing where their investments (funds) are going rather than wanting to get involved in the management.

## **9.2.5 Key Transparency & Information Issues**

This section looks into the key issues in PE investment with regards to transparency and information.

*RQ-A.6 What are the issues of concern in the framework of PE with regards to transparency and Information?*

The key issues are viewed from the points of those related to the investment set-up and from the view of information and disclosure. They are the outcome of responses obtained from the interviews of both the FI and investors.

### **a) Key Issues in the Investment Set-up**

*A.6.a What are the transparency and information issues with regards to the investment set-up?*

### **Structure, FI Management, Alignment of Interest and Fees**

Usually when investing in PE, one party provides the capital while the other party manages the investment. They are bought together through a contact/agreement, and according to Fama and Jenson (1983), in order to reduce conflict of interest that might arise through the managing agent, there is to be a separation between ownership and control. However, such a separation could prove to be costly in the PE form of investment. Nevertheless, it appears at times it is an area that the FI are exploiting through: having several levels in the structure, different treatment in alignment with their interest, the amount of fees charged and when fees are taken. Such matters appear to be affecting the investors' confidence, as reported by their responses to the key issues. The K-W test on the key issues of the IFI-GP management was statistically significant (Table 6.51).

### **Valuation, Price, Liquidity and Exit**

As PE is outside the public market, the value and price of an investment is in the hands of a limited few (as one investor described it as being a "black box"), and this affects investment as well as exit decisions. Exiting investment is an important factor in PE as through it both parties, especially the investor, make gains. High prices placed upfront, at the start of the investment, make it difficult to attain an acceptable exit price when it comes to exiting. This in turn affects the liquidity in the market, due to the low investment turnaround. More than 70% of the total investors considered valuation and liquidity were important key concerns (Table 6.51).

### **Governance of the Investment Structure**

In setting up the investment structure, at times a vehicle is created to hold the pooled funds (so they are not on the books of the IFI) (Chapter 3). One of the purposes of this segregation is to keep the investors' fund/capital at arm's length from that of the IFI's. However, in doing so, the running and managing of the SPV is not reported along with the activities of the IFI (Chapter 4). For the benefit of guarding the investors' interest/capital, some form of regulation is required in the governance and reporting of the SPV. As per the concern stated by an IFI interviewee, the governance of the SPV<sup>218</sup> needs to be addressed, as currently it is the IFI management that is governing the management and the board of the SPV, which is open to conflict of interest behaviour (Chapter 7, section 7.7.3).

---

<sup>218</sup> It appears that AAOIFI is working on developing a standard on SPVs. For as per the AAOIFI's website, under the Standards Under Development page, among the standards under development is: *Shar'ah* Standard on SPV. <http://aaoifi.com/standards-under-development-3/?lang=en> (accessed 13/4/2017).

Furthermore, in structures where the investor has a passive role, which appears to be in most PE investments, the regulations with regards to the conduct of the relationship between the investor/LP and FI/GP are lacking and need to be developed (Chapter 7, section 7.7.3).

## **b) Key Issues in Information and Disclosure**

*A.6.b What are the transparency and information issues with regards to information and disclosure?*

### **Transparency and Investor Communication**

Having clear transparent agreed upon mechanisms of decision making along with maintaining information flow is crucial in PE investment, as it builds confidence between the parties and strengthens relationships. The increase in confidence reduces the need for the investor to have control because trust and control supplement one another in a partnership (Das and Tag, 1998), as well as reducing the need to monitor, as seen above (9.5.b). Moreover, more than 70% of the total investors considered transparency and investor communication were important key concerns (Table 6.51).

The main areas that the investors were interested in receiving information/reports on were: information on the investment plan and exit strategy, information on the financials and valuation of the investment, and market/economy/industry/sector performance for comparison purposes (Table 6.51).

### **Disclosure and Reporting Requirement**

The results of the IFI interviews on the regulatory requirements on pre-and post-PE investment (Chapter 7) in the documents that are presented/reported to the investors are not clearly available, or standardised (or as a minimum) across the GCC. This is not much different from the overseas markets. Currently, it appears that the industry association, outside the region, are trying to fill this gap by providing their members with guidelines of the format of disclosure and reporting. An industry association in GCC appears to be following suit, but do not seem to be as dynamic in its progress as its counterparts overseas (Chapter 3, section 4.3).

## 9.3 SHARI'AH

As the study is on IPE, the *Shari'ah* related issues are important. Hence, awareness of *Shari'ah* and views on how *Shari'ah* compliance is maintained were sought from the IFI and the investors who invested in IPE (individuals and institutions). Furthermore, what constitutes *Shari'ah* risk and how *Shari'ah* compliance was adhered to was also viewed. Moreover, due to *Shari'ah* being a specialised area, the *Shari'ah* scholars' (ShSc) views were also taken. The following section analyses the outcome of the responses of all three.

### 9.3.1 *Shari'ah* Awareness

From the understanding of the literature review in transacting as per *Shari'ah* principles (of *mu'amalat*) there are 6 main principles, of which three are more towards the community as a whole and three are when dealing among one another (Chapter 3, section 3.2). When dealing with one another, the dealing needs to be real and based on transparency, equality and risk sharing. Furthermore, there are also *Shari'ah* principles that include prohibitions in the Islamic transactions (*haram*, *gharar*, and *maisir*). Hence, the participants (investors, IFIs and ShScs) identified important *Shari'ah* principles as per their understanding, in addition to what they foresaw as being *Shari'ah* risk, in order to be familiar with the participants' level of *Shari'ah* awareness.

*RQ-B.1 What is the IFI's/IPE investors'/ShScs' level of Shari'ah understanding?*

#### **a) Important *Shari'ah* Principles**

*B.1.a What are the important Shari'ah principles for IFIs?*

The majority of the IFIs viewed that dealing only in *Halal* products along with prohibition in dealing in *Riba* and avoidance of *Gharar* were the top two *Shari'ah* principles. While clarity of disclosure of information and for the transaction to be real ranked the lowest, lower than enhancement of living and welfare of the community (Figure 7.1). Only a quarter viewed transparency in dealing and profit and loss as important. They appear to understand the *Shari'ah* principles from an Islamic economic perspective only, with little association to the *Shari'ah* principle of *mu'amalat* (Chapter 3, section 3.1.2).

### *B.1.a What are the important Shari'ah principles for IPE investors?*

The majority of individuals thought that abiding by the principle of profit and loss and the prohibition of *Riba* and *Gharar* were the top two important principles, while for the institutional investors it was dealing in *Halal* only and the prohibition of *Riba* and *Gharar*. For both groups of investors, the disclosure of information and no manipulation scored lower, and more with the investors than institutions, yet this was not as low as the IFIs ranking on the principle (Figure 6.14). Similar to the IFI, their understanding of the *Shari'ah* principles appears to be more associated with the principles as a whole (economy perspective) rather than with those associated with the transaction/*mu'amalat*.

### *B.1.a What are the important Shari'ah principles for ShScs?*

All ShScs agreed that dealing in *Halal* was the most important principle. The next in the rank was the prohibition of *Riba* and *Gharar*. Disclosure of information ranked lower, yet not as low as the enhancement of living and welfare of the community (Figure 8.2). The understanding appears to be that the other principles such as disclosure of information transparency are a form of verifying the *halalness* of the product. A clear transparent picture is required to be able to make a sound *Shari'ah* decision. The other principles related to *mu'amalat* (transparency, disclosure, real ownership) (Chapter 3, section 3.1.2) followed the above ranking. The concept of profit and loss was viewed as being only one of the forms of *Shari'ah* investment, in addition to the view that if any losses were incurred, it was not necessarily due to it being a *Shari'ah* investment. They did not see or associate it, as to also mean risk sharing in the investment (Chapter 3, section 3.3.1). Hence, the principle was ranked low. The social community principle was last, and even though the social principle is encouraged, its role is considered beyond the responsibility of the financial institutions and more as the state's responsibility.

### *Concluding Remarks*

The FI and the investors appear to agree on the importance of prohibiting *Riba* and *Gharar*, in agreement with the ShScs, and the IFIs seem to see the importance of the *Halalness*. However, it appears that both the IFI and investors do not associate disclosure of information and transparency with being contributing factors to the product/investment being *Halal*, as do the ShScs. Moreover, the principle of profit and loss sharing ranked top with investors, but was not as high with the IFI, and even less with the ShScs. It appears that the principle of profit and loss sharing to them is not associated with the sharing of risk (Chapter 3, section 3.3). In equity investment, risk and revenues are shared, and it is based on the sharing of risk rather than the transfer of risk. It appears from the responses that the



investors can associate more with the concept than the IFIs. Moreover, the view that the ShScs have of the social principle could be a reason for the low interest of IFI and IPE investors in ESG seen above (section 9.2.1.1.c). The ShScs appear to be more inclined to Al-Gazali and Al-Shatibi individualistic view of Maqasid *Shari'ah* rather than towards Ibn-Qayyim's holistic (including society) Maqasid *Shari'ah* view (Chapter 3, section 3.1.1). Furthermore, in line with their thoughts, and the ranking of the social community welfare principle, they appear to be more inclined towards the understanding of *Shari'ah* compliant rather than *Shari'ah* based (Chapter 3, section 3.6.5).

### c) *Shari'ah* Risk

As per AAOIFI, the *Shari'ah* risk is the risk of non-compliance with the *Shari'ah* rules and principles and the risk of violating the terms of the agreement/contract (Chapter 4, section 4.5.2). The participants' views on *Shari'ah* risk were addressed by what risk they foresee that can affect the *Shari'ah* compliance of an investment. Furthermore, in order to evaluate the importance of an investment/product being *Shari'ah* compliant to investors, in addition to seeking what they foresaw as *Shari'ah* risk, their opinions on how important it was to be *Shari'ah* compliant were sought.

#### *B.1.b What are the Shari'ah risks to IFI?*

With regards to IFI, the main *Shari'ah* risk is the risk of the product/investment being and remaining *halal* post-investment, which in turn affects the income (amount of purification). In addition to being a *halal* investment activity, maintaining the debt/equity ratio and the investment structure were also seen as areas of *Shari'ah* risk (Chapter 7, section 7.6.4). There were no concerns about the possibility of breaching the terms of the agreement, or a shortfall in the treatment of the investor. These matters were not considered to be a *Shari'ah* risk.

#### *B.1.b What are the Shari'ah risks to IPE investors?*

The *Shari'ah* risks that the IPE investors foresaw appear to be related to the governance of their relationship with the IFI, of which concealing and shifting of funds, alignment and conflict of interest, and risk shifting are some (Chapter 6, section 6.5.5). While over half of the investors considered *Shari'ah* risk as important, it was interesting to see a few investors did not foresee any *Shari'ah* risk once the investment was judged as *Shari'ah* compliant in the pre-investment stage (Table 6.36).

### *B.2.b What are the Shari'ah risks for ShScs?*

The ShScs stressed the importance of maintaining the validity of the agreement, since it is the link in the investment relationship. To which, information and transparency are the contributing factor to clarity and to the coverage of all the terms and conditions that are acceptable to all parties (Chapter 8, section 8.4.2). Furthermore, the quality of their decision/*fatwa* is only as good as the information put forward to them. The ShScs base their decision on the information and documentation provided to them by the IFIs and its *Shari'ah* department/team, and thus, their decisions are based on the IFI's employees' level of transparency and disclosure.

### *Concluding Remarks*

It appears that both the IFIs and the investors see *Shari'ah* risk as being compliant with the *Shari'ah* rules and regulations only and maintaining the terms of the contract was not mentioned. While it is an important factor to the investor, the possibility of not considering it as part of the *Shari'ah* risk could be due to the lack of comprehensive understanding of the *Shari'ah* principles and to the limited practice/ability they have had in negotiating. This is reflected in the investors' limited knowledge of their rights and entitlements. However, the SSB did consider maintaining the terms of the agreements/contracts as an important risk, reflecting the understanding of IPE being based on contractual relationships.

## **9.3.2 *Shari'ah* Compliance**

This section looks at the views of the IFI, IPE investors and ShScs on *Shari'ah* compliance and how *Shari'ah* compliance is maintained.

### *RQ-B.2 How is Shari'ah compliance maintained?*

#### *B.2.a How is Shari'ah compliance maintained by IFI?*

Following the AAOIFI's governance standards, *Shari'ah* compliance is maintained by seeking the *Shari'ah* Supervisory Board's involvement, either directly or indirectly. The IFI, directly through the

IFI *Shari'ah* co-ordinator or indirectly through the IFI *Shari'ah* department/team, liaise and follow-up with the SSB for approval/report. Documents are prepared and submitted for the SSB's approval and certification before entering an investment. Once investment takes place, internal *Shari'ah* review reports are produced based on reports received from the related IFI's departments and/or meetings undertaken with related parties in the IFI for follow-up on the investments.

#### *B.2.a How is Shari'ah compliance maintained by IPE investors?*

Although investors invested in IPE as a *Shari'ah* investment, the due diligence into the *Shari'ahness* of the investment/product was not highly ranked (Table 6.16). Having the SSB certification/pronouncement, and a governance process system, as per AAOIFI's governance standards (Chapter 4, section 4.5.2) was sufficient and no further work/inquiry is considered necessary. The same reliability/dependence applied to post-investment *Shari'ah* compliance. Since the IFI has an SSB and/or also the company they invested in (investee company), then it is expected that a *Shari'ah* compliance review will be performed by either or both. The majority of investors were aware that an SSB oversaw the investment and relied on the SSB/*Shari'ah* audit report of the investee company or the IFI's SSB for the *Shari'ah* compliance of their investments (Tables 6.38 and 6.39).

#### *B.2a How is Shari'ah compliance maintained by the ShScs?*

The SSB provide their approval of the investment product at the outset of the investment, then through reviewing the internal *Shari'ah* reviews/reports that the IFI generates through the IFI's *Shari'ah* department or *Shari'ah* representative, the SSB issues the *Shari'ah* annual review report (AAOIFI GS-2 and GS-3). Not all non-*Shari'ah* compliance is reported in the report; especially once the FI has rectified it, so as not to tarnish the reputation of the IFI (Chapter 8, sections 8.2.1.3 and 8.4).

#### *Concluding Remarks*

It appears that the investor relies on the SSB and both the SSB and the IFI depend on the IFI's *Shari'ah* team's review for *Shari'ah* compliance. Thus, it all depends on the effective performance of the IFI's *Shari'ah* team/member. The results indicate that complete independence in the generated review/report does not appear to exist. This leads to the importance of the independence of the *Shari'ah* compliance/review report to ascertain the quality of the review undertaken and to reduce any possible bias.

### 9.3.3 Regulations Related to *Shari'ah* Compliance

In investing in IPE, it is important that the investment is *Shari'ah* compliant throughout the term of the investment. Moreover, as discussed in Chapter 4, both the AAOIFI and IFSB mention the requirements of the *Shari'ah* review/audit to be performed to ensure *Shari'ah* compliance. However, the IFSB guidelines are considered general guiding principles and AAOIFI standards are not compulsory in all jurisdictions. Nevertheless, even though abiding to either AAOIFI or IFSB is not compulsory for all IFIs, the study has used these as a benchmark for the required *Shari'ah* regulations/ requirements. Thus, this section looks into the IFI's and ShScs' (SSB members) input towards the requirements in maintaining *Shari'ah* compliance.

*RQ-B.3. What are the Shari'ah regulatory requirements?*

#### a) *Shari'ah* Compliance Report

B.3.a *What are the Shari'ah investment requirements that apply to IFI?*

The IFI should ensure that the investment/product is *Shari'ah* compliant at all times. As such, prior to entering an investment the IFI is required to make sure that the investment is in line with *Shari'ah*. Hence, the SSB's approval on the investment is sought, by performing all the due diligence/background necessary on the product/investment and forwarding all the related documents to the *Shari'ah* department/representative member for the SSB's approval. Although AAOIFI in its standards encourages the IFI to be transparent with its stakeholders (GS-6.4/4) and IFSB promotes publishing the details of *Shari'ah* opinions so as to increase awareness (IFSB-3.56), at times the pronouncements produced in the documents offered to investors are brief and lack details (Chapter 7, section 7.6.2.1).

Once entered into the investment, the IFI must have a mechanism by which it follows-up on the investment to ensure its *Shari'ah* compliance (Chapter 7, section 7.6.2). IFIs that have a *Shari'ah* department/team perform regular (quarterly) reviews on the extent of the IFI's *Shari'ah* compliance. For IFIs that do not have a *Shari'ah* department/team the review is usually undertaken by an IFI employee (usually from the investment or legal team) who produces a report after the review. These reviews/reports are then submitted to the SSB and IFI management. At times the responsibility is outsourced (usually in smaller FIs/PE firms) and they undertake the above task (Chapter 7, section 7.6.2.2).

### B.3.a *What are the Shari'ah regulatory requirements that apply to SSB?*

The SSB is required to provide its *Shari'ah* opinion (*Fatwa*) on an investment/product prior to the IFI promoting or entering it. Once it receives the relevant information from the IFI's *Shari'ah* team/member, the SSB studies this and accordingly issues its pronouncement (Chapter 8, section 8.2.1.3). Once the IFI enters the investment the SSB is required to ensure that the IFI maintains *Shari'ah* compliance of its investment. As such, the SSB<sup>219</sup> liaises with the relevant *Shari'ah* person in the IFI with regards to the planning and undertaking of the review. Then the review is performed by the *Shari'ah* person/team who submits the outcome to the SSB, which then reviews the report. The SSB then produces the SSB's *Shari'ah* annual review report based on the outcome of the accumulated reviews, which is then included in the IFI's annual report (Chapter 8, section 8.4). One ShSc noted that due to them being a firm, they are well equipped and it is the members of the *Shari'ah* firm that conduct the SSB review, rather than depending on the IFI's *Shari'ah* team review.

#### *Concluding Remarks*

The *Shari'ah* pronouncement that is made available to the investor is brief and lacks details, which does not assist the investor in becoming familiar with the *Shari'ah* aspect of the investment/product (Chapter 7, section 7.6.2.1). Furthermore, both (*Shari'ah* quarterly review and *Shari'ah* annual review/audit) of the on-going compliance *Shari'ah* review reports initially appear to be performed by the same internal party/ies, which could defeat the purpose (of cross checking) placed by the requirement of obtaining both the IFI's and the SSB's views. Although the responsibility, as per the standards, of maintaining *Shari'ah* compliance falls on the IFI, the purpose of having an independent SSB to oversee the *Shari'ah* governance of compliance is to add assurance by providing an independent supervision/opinion on the extent of *Shari'ah* compliance. The SSB base their opinion on reviews performed by an internal IFI member, but if he is under the supervision of the SSB, this raises some questions about the extent of the independence and quality of such a report. Such concerns also came up in the literature review by Grais & Pellegrini and Hamza (Chapter 4, section 4.5.2) as well as from participants during the interviews.

### **9.3.4. Issues of Concern in the Framework of IPE with Regards to *Shari'ah***

This section examines other key issues in IPE investment with regards to *Shari'ah*.

---

<sup>219</sup> For those with a sub-executive committee, then it is the SSB's sub-committee that liaises with the IFI's *Shari'ah* responsible person.

*RQ-B.4 What are the issues of concern in the framework of IPE with regards to Shari'ah?*

The key issues are viewed from the points of those related to the investment set-up and from the view of information and disclosure. They are the outcome of responses obtained from the interviews with IFIs and ShScs. They are the views of IFIs, since they are the party that the regulations are applied to/practiced by in undertaking PE investment. This is in addition to the views of ShScs because they have to ensure the *Shari'ah* practices and implementation are maintained.

### **a) Key Issues in the Investment Set-up**

*B.4.a What are the Shari'ah issues with regards to the investment set-up?*

#### **SSB Independence**

As the role of the SSB is an independent form of supervision, its independence is crucial. Although the SSB's appointment is approved by the shareholders, they are usually based on the recommendation of the IFI's board of directors. Moreover, re-election of the ShSc members is open with no restriction on the number of terms an SSB member can be re-appointed (Chapter 7, section 7.6.3.2). This longevity, through continuous re-appointment of the same SSB member, along the IFI's board/management's continuous nomination, affects the true independence of the SSB and its work, because as noted above, not all non-compliance matters are reported, especially if they are resolved prior to the date of the report (Chapter 7, sections 7.7.3/7.6.3.2 and Chapter 8, section 8.6.3.2). The AAOIFI Governance Standards (5) also refer to this matter as a matter of concern. However, the suggestion of the standard is to rotate at least one SSB member every 5 years (Chapter 4.5.2). Yet this was not mentioned by any interviewee, implying that it does not appear to be observed, even in cases where the AAOIFI standards are obligatory. Moreover, in some jurisdictions, recently a cap on the term an ShSc can serve at an IFI has been introduced (Chapter 4, section 4.6), yet no mention of this was brought up in the interviews. Hence, it appears that enforcement of those adopting the AAOIFI standards or the recent requirements, in addition to regulations on the terms of reference and appointment of the SSB still need to be addressed.

### **b) Key Issues in Information and Disclosure**

*B.4.b What are the Shari'ah issues with regards to information and disclosure?*

## **Independence and quality of the *Shari'ah* review/opinion**

As mentioned above, investors rely on the SSB's report/opinion for the investment being and maintaining *Shari'ah* compliance, which emphasises the importance of the report/opinion generated. However, in performing their duties, the SSB relies heavily on the work of the IFI's *Shari'ah* team/member, which in turn jeopardises the quality of independence. As per the AAOIFI Governance Standards (1.14), it is the responsibility of the SSB to provide an independent opinion based on their review of operations of the IFI, and among the documents that are to be examined is the internal audit report. Hence, by basing its opinion on the internal *Shari'ah* review reports, this gives rise to whether the SSB's opinion report is comprehensive and independent as per the Standards. Moreover, even though the IFI's *Shari'ah* team/member is supervised by the SSB, they fall under the IFI's management and administration, which could have an effect on the quality of the information they provide (Chapter 7, section 7.6.1 and Chapter 8, section 8.2.1.3). On a similar note is the concern expressed about the shifting of funds between investments (between SPVs) (Chapter 7, section 7.7.3.1). While in complying with Governance Standard (4) attention is to be given to the imperative monitoring of RIAs (since they are off the balance sheet) to ensure that the funds are invested in accordance with the terms of the agreement<sup>220</sup> (Chapter 4, section 4.5.2). Hence, this raises the question of whether such matters are reported and brought to the attention of the SSB by those performing the review.<sup>221</sup>

## **9.4 REGULATING PRIVATE EQUITY MARKET**

Reducing agency conflict, uncertainty, transparency and investor protection are important matters that cannot be ignored in PE, and especially in IPE for it to be *Shari'ah* compliant (Chapter 3). Regulation in the PE market is not given as much attention as in the public equity market. Although many might think it does not have much of a systemic risk, this was not the thoughts of the investors. The investors' views were that indirectly the performance of the PE market affects the financial sector and eventually ripples out in the economy. Since it is another form of liquidity in the market parallel to banks and exchanges, and as quite a few large institutions (such as pension funds) invest in these investments, both market liquidity and public savings are affected (Table 6.47).

---

<sup>220</sup> Earlier this year (Feb. 2017), the AAOIFI announced it was working on an exposure draft on the External *Shari'ah* Audit. This could contribute to resolving the issue/concern; however, its success would depend on the effective implementation of the standard.

<sup>221</sup> Consideration is to be given that it could also be related to audit/accounting matters, an area that the ShSCs are not necessarily knowledgeable about. This is an area to be considered for further study/research.

Furthermore, as per the de Larosi re Report conducted after the financial crisis of 2008 (Chapter 4), regulations are required to extend to all financial entities that have a direct or indirect systemic impact. Thus, some form of regulation is required. However, the regulation required is to provide for a flow of consistent, comprehensive information so that the investor can make informative decisions and to limit the FI's risk taking. The regulatory interference should not be too much, yet it must enhance market efficiency (McCahery & Vermeulen, 2012).

As such, the next section presents the views on regulating the PE industry of both parties involved, the IFI and the investors.

*RQ- C.1 What are the views on regulating the PE market?*

#### **a) IFI Views on Regulating PE Market**

*C.1.a What is the IFI's view on regulating PE market?*

Overall, the IFIs appear to be in favour of regulations, however, up to a level that does not hinder market access, or that are too time consuming so as not to affect business. There are some regulations that are coming out which are set in line with international standards. Although it is good to be in line with the standards, there needs to be flexibility in the introduction and implementation of these regulations. Furthermore, the regulators are to take more of a supervisory rather than a management role (Chapter 7, section 7.7.3).

The FIs were also asked about their views on capital adequacy, as it has an effect on their equity participation in the investment. Generally, the view is that it is not suitable for their form of investment (it is more suitable for retail banks). The cap imposed affects their ability to manoeuvre. However, one of the IFIs (from experience) was of the opinion that the restrictions set by capital adequacy are a positive form of control mechanism to maintain risk taking (Chapter 7, section 7.7.3.2).

#### **b) Investors' Views on Regulating PE Market**

*C.1.a What is the investors' view on regulating the PE market?*



The majority of the investors were of the view that regulations covering both pre- and post-investment would be beneficial for the PE market (Table 6.49). They were also of the same opinion as IFI, in that the regulations should be balanced and not affect the business. Some investors were of the view that provided a proper, effective legal system is available to deal with post-investment matters, regulatory emphasis is only required in the pre-investment stage. Furthermore, as stated by an investor, it cannot be assumed that the regional investors possess the proper risk assessment knowledge, which is also a reason for the need to regulate the PE industry (Chapter 6, section 6.8.3).

The general opinion is to have either the regulator regulating both stages or for both the regulator and the industry to regulate together. The institutions were more in favour of both regulating, while the conventional and individuals were more towards the regulator regulating (Table 6.50). Those who were in favour of the industry being involved was due to the fact that the industry association will be more aware of the business risks involved. However, some of them also thought that there will need to be some form of supervision of the industry association. This is due, in addition to communicating (to the market), to there being regulatory support and to enabling enforcement. There is also a need to reduce “regulatory capture” (Chapter 4), in line with Gunningham & Sinclair’s (1998) views. This is to prevent the industry from supporting their interests over those of the investors. While those who were for the regulators emphasised the need for qualified and able to monitor regulators (staff), with the capability for effective enforcement, in line with Parker et al.’s (2000) views (Chapter 6, section 6.8.3.2). Furthermore, nearly half of the investors were of the view that the compliance with regulations should be obligatory, while just over a third thought that it should be more on a comply or explain basis (Table 6.51), especially when it is supposed to be the private market, in addition to not everyone understanding the Islamic principles and some explanation being needed at times (Chapter 6, section 6.8.3.3).

Furthermore, more than 80% of the investors had the opinion “Agreed” to “Very Much Agree” on having an investors’ advisory committee that represents the investor in the investment and meets regularly with the IFI (Table 6.55).

### *Concluding Remarks*

In line with the changes that are happening in the market following the financial crisis, both the IFI and investors are in favour of some form of discipline/regulation in the PE market. In line with the overseas markets, there appears to be some interest in the “Smart Regulation” (Chapter 4, section 4.2.3.3), and introducing the Industry Associations (IA) in having a role in providing guidelines. This latter addition is interesting, and could serve the purpose of adding publicity to the equation. Involving the IA promotes

the availability of information and the expected form of reporting, reducing lack of awareness to investors and costs to FI. In line with Naurin's (2007) views, through publicity, transparency is made available and in turn promotes accountability. However, no mechanism is effective without the availability of sanctions and effective enforcement. Moreover, in an attempt for the IA to standardise information reporting and documentation, it needs to take into consideration the individual investors' needs and not only institutions' perspectives (Alim, 2014).

## **9.5 CONCLUDING REMARKS**

The chapter attempted to answer the research questions and meet the research objectives by analysing the main results of the findings of the investors, the IFIs and the ShScs involved in the relationship of investing in IPE. The findings were cohered and compared to the findings of the related theories covered in the literature review. The approach taken was based on the two main themes: Transparency & Information and *Shari'ah*. Following the discussion of the findings of each theme, the chapter looked into the relevant regulations and the key issues that were conveyed through the findings. Emphasis on the two themes is due to the type of relationship under study. Transparency plays an important factor in the relationship between the investor and the FI. Such a relationship follows the agency-principle affiliation, where in such a relationship the transparency, flow and timing of information is imperative to a successful outcome. It builds trust between the parties, in addition to reducing conflict of interest. *Shari'ah* is important since the study is on Islamic equity finance and a review of the *Shari'ah* aspect and more so the *Shari'ah* compliance is imperative.

The main findings reveal key issues related to the flow of information, and governance of the investment structure, governance of the IFI management, ability to negotiate, independence of *Shari'ah* supervision and review, and post-enforcement system are some of the key issues that would need to be addressed/strengthened to enhance the investors' confidence, induce improved investor rights and contribute to the growth of the Islamic equity financing/investment market. In making sense of the mixed method of analysis conducted, certain matters and investors' preferences were identified. Overall, the investors (those who plan to continue to invest in private equity), with the current investment, regulatory and professional environment, prefer the direct/indirect equity method of private equity. This is because this form of investment allows them to know where and how their money is invested. While Regulators with their regulations, in making sense of interpreting the investment market pre-crisis period, appear more towards the pooling of funds, collective investment schemes and limited partnership form of investment. Hence, displaying divergence from the investors' preferred form of future investment in private equity. Notwithstanding the above, some current movements/approaches

of updates in the regulations/supervision, appear to be in alignment with the display of the greater need for disclosure and SSB independence. Great details in the guidelines, recently (post-crisis), in some jurisdictions, have been added to the information the FI is to provide its private investors. In addition to the recent step taken by most of the GCC jurisdictions, in recognition of the need for SSB independence and accordingly updating the regulatory requirements to be implemented in 2018-2020 (see Chapter 4, section 4.6). However, greater benefit would resonate in benefiting from the opinions expressed on regulating the PE market, because enhancement of the enforcement and legal system post-investment is paramount to gaining confidence, developing the players'/stakeholders' professionalism and the growth of the private equity market. Moreover, the findings seem to suggest developments, enhancement and supervision could be delegated to or in liaison with industry associations, in acting as standard setting and regulatory agencies.

## Chapter Ten:

### CONCLUSION AND RESEARCH RECOMMENDATIONS

#### 10.1 INTRODUCTION

The aim of the study was to explore the relationship between the investor and the IFI investing in Islamic private equity/placement and to identify the area of weakness in relation to transparency, *Shari'ah* and regulation, with the objective of strengthening the relationship, and enhancing the investor's rights, through the identification and putting forward recommendations to the related parties that have a hand in developing the relationship: the IFI and the regulatory authorities in the GCC region. To achieve the above objective, investors were surveyed using a questionnaire and IFI and *Shari'ah* scholars were interviewed. The responses were then analysed and contextualised with the theory.

In summarising the findings, the FI approached investors in stages, giving them an opportunity to be familiar with the investment, because not all investors, although considered to be sophisticated are experts in investment and finance (especially the individuals). Specialised investors (institutions and conventional), unlike the less specialised, could discuss important matters in more detail, which contributed to their decision making. While many of the investors had based their decisions on trust in the FI and the information/documentation provided. It appears that FI voluntary cooperation in providing sufficient information to investors post-investment was not in proportion to the trust that the investors placed on the FI. In addition, the regulatory requirements did not assist in that matter because it appears that there are no standard or consistent flows of information requirements in the regional regulations that deal with investing in PE nor is there an effective/satisfactory legal/arbitration system that acted as a deterrent.

With regards to the *Shari'ah* aspect of investing in IPE, both the investors and the FI saw not abiding by *Shari'ah* rules and principles as being non-compliance. The importance of meeting the terms of the agreement/contract was not reflected as being an element of *Shari'ah* compliance and hence was not considered part of *Shari'ah* risk. However, the ShScs thought otherwise. *Shari'ah* compliance is maintained through *Shari'ah* reviews and reports. The results indicate that complete independence in the generated review/report does not appear to exist. Both the SSB and the IFI depend on the IFI's *Shari'ah* team's review for *Shari'ah* compliance. Furthermore, from the assessment of their views on the *Shari'ah* principles, the FIs and ShScs were more inclined in their understanding towards *Shari'ah* compliant investment than *Shari'ah* based investment.

The key issues identified from the research are recapitulated in this chapter, to form the basis of the recommendations and matters to be dealt with going forward. In addition, this chapter highlights the research's limitations and provides suggestions for future research.

## **10.2 IMPLICATIONS FOR IFIS**

Islamic finance emphasises using risk-sharing modes of financing and IPE is one of the organisations that uses this mode. The intention in undertaking the study was to improve the relationship between the IFI and the investor. To look into the investor's experience pre- and post-investment in dealing with the IFI and to identify the issues of concern. In order to contribute towards developing and growing the relationship, and in turn to encourage the growth of Islamic equity financing (IEF). The study draws the following outcome and provides suggestions for the IFI to review and develop, if they aspire to improve the relationship and to increase equity investment business.

### **10.2.1 Transparency, Information and Investor Communication Recommendations**

The relationship between the two parties is an economic relationship that is greatly influenced by social behaviour, where trust is a major player. The investor's confidence in the IFI, during the period under study (2003-2014), was stained, which affected the investor's trust in the IFI. The weakness in the disclosure system has left the investors feeling manipulated. The lack of transparency in the layering of the investment structure, and the difference in treatment has not contributed to the alignment of interests. The IFI needs to work on enhancing voluntary transparency. IFIs need to improve on the institution's flow and quality of information and the disclosure mechanism towards its investors. And instead of providing the bare minimum, so as to be in control and avoid the investor's involvement, to provide clear, transparent detailed updated progress reports. The investor's main interest is not in directly managing the investment but to know where and what is happening with their money. Investors are seeking clear standardised detailed information. Information on the investment plan, exit strategy, financial information and investment valuation, in addition to comparative market and industry information.

Producing an acceptable format of reporting might initially be costly, yet over time would be worth the investment. IFIs can form an Islamic private equity association, or even through the current associations (Banking Association or the MENA Private Equity Association) efforts can be made to provide

guidelines on the format of the reports to be reported to investors, for all their members in the industry/market to use and for investors to know what to expect. This will contribute to lowering of the costs that the IFI might have incurred if produced alone, in addition to contributing towards increasing the availability of IPE market information. Furthermore, making more information available by industry association also contributes towards developing investors' knowledge. Investors, although they have a high net worth, are not necessarily familiar or knowledgeable about the IPE and/or in finance. Hence, by making such information available, both the IFIs and investors would benefit. IFI's costs will reduce and creditability would increase. While the investor's awareness will broaden and in turn this will reflect in the investment decision process and in preserving their rights. Furthermore, publicity and availability of information can assist in achieving accountability, and will contribute towards reputation building.

The IFI need to reconsider the setting of a high initial price when offering to the investor. The initial high price has two main negative outcomes: the first is that the high price entails the fees, which gives an indication to the investors (even if it is clearly disclosed), the signal of the misalignment of interest of the IFI to that of the investor. Taking a large fee at the outset is not seen as part of the services earned, but more of 'I have taken my gains, and I am not concerned what happens next.' The other is that by setting a high price (due to the high embedded fees) it becomes difficult to seek an acceptable exit price because the bar has been set too high. This in turn does not benefit both parties. Neither party is able to generate a return, nor to enter into a newer investment by both parties.

### **10.2.2 Governance of the Investment**

In such a relationship, it is mostly believed that one party will always seek self-interest. In order to minimise this and to develop and enhance the ties, arrangements are required to be taken up, to maintain balance in the relationship. The IFI needs to provide investors with the ability to negotiate at the time of agreement. Investing in IPE is a form of contractual agreement and the investor needs to feel this. By offering a take it or leave it investment opportunity, the wrong picture of IPE is being reflected. The IPE concept of sharing in the risk, as well as the profits, rather than transferring of the risk, is not detected/experienced. Moreover, at the initial stage of entering the relationship, the IFI needs to agree and document, with the investor on a process, a mechanism that the IFI would take up in dealing with conflict of interest matters. This displays the willingness of the IFI to seek the investor's interest and to share in the risk and decision making.

Meeting the demands of many investors is not an easy task, as such, a representative person(s), from the investors (Investors Advisory Committee-IAC)), appears to be an acceptable idea among the investors. The IFI and investors/IAC can agree on the outcome on the matters/issues that are to be subject to consent and decision taking/vote. Upon which, both parties would be in agreement as to when the investor would be approached. The IFI would do so through meeting with the IAC, and so would reduce the effort and time in having to go to the investors individually, while at the same time having gained the investors' trust.

### **10.3 IMPLICATIONS FOR REGULATORS**

The concept that the private market would discipline itself, and would be able to resolve a conflict of interest without any regulatory hand, is starting to be questioned. The opaque flow of market information, along with the shortfall in awareness has demonstrated otherwise. Following the study, the implication is the need for regulatory intervention in the areas of information and *Shari'ah* governance.

#### **10.3.1 Transparency, Information and Investor Communication Recommendations**

All six GCC countries apply the AAOIFI standards to varying degrees<sup>222</sup>, and as such when it comes to the IFI dealing with *mudarabah* and *musharakah* (*shari'ah* private equity forms), they are treated as restricted accounts (investments of investors' funds for specific projects) and are treated off the balance sheet of the IFI. In such an equity investment, both the fund mobilisation (the investor and IFI) and fund utilisation (the IFI and the entrepreneur/project) is based on profit sharing, and there is no liability on the IFI to return the investor's initial funds invested (other than in the event of negligence on the part of the IFI). No liability and off balance sheet status gives rise to a potential conflict of interest, making the availability of market information essential to the investors/stakeholders. Furthermore, restricted profit sharing investment accounts and PE funds require the establishment of a company (SPC), under the commercial law, where the regulations on such companies are limited. Hence, increasing the need to monitor the performance and disclosure of such investments.

Regulatory supervision appears to be necessary to ensure discipline in the market. While discipline is required to preserve investors' rights, the market should not be imposed with too much regulation.

---

<sup>222</sup> At the date of this review, AAOIFI standards in Bahrain, and Oman are a mandatory regulatory requirement, while in Kuwait, Qatar, Saudi Arabia and UAE they are voluntary.

Specifically, regulation on IFI to provide information to investors is required. The information has to be consistent, comprehensible and to some extent standardised. This is information that meets the needs and overcomes the risks associated with all stakeholders involved (investors as well as IFIs) and the investment (exposure). Furthermore, there should be clear rules and regulations that are explicit rather than implicit made available by the regulators. These should be less ambiguous and easily accessible to all.

The proposal of including an external organisation to assist the regulator in implementation appears to be gaining interest. Regulatory authorities and industry associations could develop/provide documents/guidelines as templates, which will enhance the economies of scale and reduce costs to participants. Should the regulators take up the proposal of introducing a third party into the supervision framework, a supervisory mechanism on the regulatory representative agent by the regulator would be required, to ensure equal treatment to participants/stakeholders.

Regulators in steering the IFI conduct towards strengthening the availability of information need to ensure the availability of information is from two perspectives. First, the perspective of what information is required to be available to the investor and second, that it is made available to the investor. By making clear what information is to be disclosed and publically available, the investor himself will be more aware of his rights and entitlement. When to what information is to be made available, is disclosed through the supervisory process directly or indirectly, the investor's confidence and long-term stability in the market is enhanced.

Investors' ability to have a say in the investment being sought by investors is not being experienced. Moreover, the concept of the risk sharing form of investment by participating in IPE is not being sensed either. Hence, it is recommended that regulators provide the power of negotiation among the parties. Currently, it is more one-sided, and the IFI has command of the agreement. To develop the concept of IPE as an investment whereby risk and returns are shared, then both parties need to come to an agreement. IFIs, as institutions will seek every opportunity to reduce risk, and to increase their returns. Hence, if it can do so without negotiating, it will do so. It is recommended that regulators place requirements (of which the investor is also aware) to open the door to negotiation to take place between the parties. In order to maintain the IFI's stability, the regulators can restrict certain matters (or place parameters) from negotiation.



### 10.3.2 *Shari'ah* Governance of the Investment

In *Shari'ah* compliant private equity, regulations and discipline to uphold and maintain *Shari'ah* compliance in line with the Islamic principles is very important (more than the conventional private equity). As mentioned in the previous chapter, the issue of independence is an important matter that regulators need to consider. This is independence of the SSB and/or the IFI's *Shari'ah* team and the *Shari'ah* review/compliance audit report.

Investors rely highly on the opinion and review of the SSB. As the situation stands today, complete independence of the SSB members is questionable, even among the SSB members themselves. The SSB was a setup put forth initially as part of the IFI organisational structure as an independent board. However, such independence is being questioned which places risk on the quality of the SSB role and purpose. Some regulators have recently, been moving towards creating a central *Shari'ah* Board (SB) at the Central Bank. In instances where the SB role is to perform the function of SSB for all IFIs, this would be a good step towards resolving the matter, yet not completely. There will still be *Shari'ah* scholars and *Shari'ah* compliance officers at the IFI level, who will be performing *Shari'ah* reviews and making *Shari'ah* decisions. Indications from the study have been for regulators to consider disassociating the *Shari'ah* scholars'/*Shari'ah* compliance officers' remuneration from the IFI, to achieve effective independence. Some suggestions have been towards outsourcing the function, yet that would not resolve it completely, because the IFI would still be indirectly paying for their services.

The recommendation is to establish an organisation that provides these services. An organisation that is funded by the membership fees that the IFI pays on an annual basis, and in return such services of SSB members and *Shari'ah* compliance officers are made available. This setup would contribute towards developing other related matters too. Both *Shari'ah* and financial/auditing know-how skills would be developed by the organisation, ensuring availability of the appropriate persons/skills/expertise. The framework can also work on unifying the TOR, role and responsibility of the SSB function in line with the guidelines suggested by AAOIFI or IFSB. Furthermore, the external *Shari'ah* audit/review can be performed, resulting in an independent *Shari'ah* report. The quality of conducting/undertaking a compliance review and generating a compliance report would be developed and standardised among the industry players. This would also apply to the pronouncements of SSB, whereby, detailed *Shari'ah* certification on the investment would form part of the information and documentation provided to investors. This will also have an indirect positive effect on the managing of the SPV, where the funds are pooled. The independent report/review performed on the extent of *Shari'ah* compliance would enhance the quality of the report and confidence of the investors.

Furthermore, to complete the chain of *Shari'ah* governance, and in line with the concept of IPE investment being a contractual agreement, an effective supervision and enforcement system is required. It has been suggested that supervision within the regulators, as well as the legal enforcement system needs enhancement. The desire is not for regulations on the availability of information and the ability to have a say alone, but to ensure they are enforced and that the consequences may result from non-compliance.

#### **10.4 LIMITATIONS**

In undertaking the study several challenges came about that could have limited the outcomes of the study. Some of which are the following:

1. The study was focused on the GCC region only, and thus the findings cannot be generalised and do not necessarily reflect those outside the region.
2. The study was on the relationship between the investor and the FI, and the views of the parties, investors and FI were obtained, along with the members of the SSB, with regards to their contributing role in *Shari'ah* compliance. However, although the PE market is not much of a regulated market, the regulator's perspective on the subject could have added another dimension to the study. This was not taken up due to time and word count constraints, and is an area for further study.
3. In relation to the collection of data, the regulations in the GCC regions are continuously changing and developing and they are changing at different paces in the region under study. Although the researcher made all efforts to examine all the regulations related to PE, there might have been some that are related to the study which the researcher did not come across. Consequently, this would have some effect on the literature review, the basis of the analysis and the comparisons of the regulations available.

Furthermore, in dealing with the existing regulations (those the researcher reviewed), there were different terminologies used among the GCC in relation to the same subject, which made it difficult at times to identify the regulation. In this regard, it is recommended that the GCC regulators consider unifying the terms in accordance with the GCC standard rules being

developed by the Gulf Cooperation Council, in preparation for the integration of the GCC financial markets, as per the Economic Agreement.<sup>223</sup>

4. Time was a factor that placed constraints from two aspects. One was in seeking participants to participate. Searching for the appropriate and eligible participants (whether it was an investor or an IFI or a ShSc), required a lot of time, due to the sensitivity of the topic (private investment). Not only in seeking, but also in obtaining input; in some cases, the turnaround between the approach and receiving a response in acceptance or returning the questionnaire was quite long. As such a time-cap was used, after which, the researcher would move to the next set of sample/data collection. The second time constraint was due to the researcher working during the time of the study. This placed a constraint on the time given to the research and data collection.
5. Following on from the above point, the size of the sample was not large enough to conduct parametric statistical tests, which are considered to be more robust and powerful tests.
6. The constraint in finding appropriate eligible participants limited the ability to arrive at an acceptable number of diversified investors from across the GCC, and hence, analysis of the findings specifically by country was not possible.
7. In exploring the relationship between the investor and the IFI investing in IPE, the researcher tried to gain the rare opportunity of being able to access private investors, and to obtain as much information on their experience pre- and post-investment as possible. This could perhaps have hindered performing an in depth analysis of all the areas generated from the findings/results of the study, due to the time and word count limitations.
8. The word count set by the thesis requirements limited the areas in which certain outcomes could be covered and expanded on.

---

<sup>223</sup> The economic agreement provides for the integration of financial markets in the GCC states and to unify their respective policies and regulations; to the development of local, inter-foreign and intra-GCC investments, and for the provision of a transparent and stable investment environment.

## 10.5 SUGGESTIONS FOR FUTURE RESEARCH

Following the study, a few areas and matters have surfaced where further research would benefit and contribute towards the development of the Islamic equity investment market. Some of which are:

1. This thesis is one of the first in-depth research studies on Islamic private equity. Islamic equity investments are usually looked at from the aspect of an investment instrument/tool. The study shows that the relationship between investors and the IPE is a contractual agreement, and as such it is recommended that future studies are performed to explore the underlying contractual details. In particular, research studies on PLS contracts, as applied in IPE, can be undertaken. This will assist in further understanding the requirements of the parties involved, and will provide suggestions to improve and protect the rights of the parties in the relationship.
2. The dual components of an Islamic financial contract are governance rules and legal responsibilities. Accordingly, following on from the above point, the legal and dispute system of resolving legal matters related to such contracts would also benefit the development of the Islamic equity investment market. The research touched on this slightly as it was a matter of concern raised during the study, but was not taken up in detail, due to the scope of the thesis and the word count limitation.
3. Further research can be undertaken to seek the regulators' views. They play an important part towards enhancing the relationship under study and their input would assist in assessing the extent of implementing the above recommendation, in addition to contributing with further recommendations and solutions to improve the relationship between the investor and the IFI and the IPE market.
4. An area of further research is the capital adequacy requirement and its effect on the IFI's participation in investing and contributing towards the development of IEF in general, and in investing/financing *Musharakah* transactions in particular. The current research touched briefly on the IFI's capital adequacy with regards to determining the IFI's participation in investing along with investors in the IPE investment. From the responses, the current capital adequacy requirements are not suitable for investment in financial institutions' activities because it restricts their ability to invest. This in turn is expected to have an effect on the IFI's ability to invest in financial instruments such as *Musharakah*, a form of investment currently not undertaken as desired by the industry.

5. The current study viewed the effects of transparency and information on the relationship between the investor and the IFI investing in IPE. Further research can be conducted on the effects of transparency and information on other areas of IPE investment, such as their effect on the performance of the investment.

## **10.6 EPILOGUE**

Good Islamic principles that encourage information adequacy, equal bargaining power, efficient coordination, preserving rights and social solidarity are required to be maintained. It appears that rules governing the *Shari'ah* private equity market operators are to be considered with the objective of steering the stakeholders' conduct towards strengthening the availability of information associated with such a market and enhancing compliance and enforcement through the regulatory development of greater oversight, in coordination with the industry to gain depth and trust in such a market.

Furthermore, the objective of this researcher was and is not fault finding. The aim was and is to study a form of investment that was mushrooming (had a lot of interest) and then began to languish. To understand this promising industry more, it is essential to study and reflect on the upsurge and down surge of this venture, in the hope of emerging with findings that would contribute towards a better understanding of the reasons for the shortfalls and subsequently be able to find ways to develop and enhance a relationship, a partnership that if looked after can contribute significantly to the development of an economy and to the Islamic finance industry in particular.

## **APPENDICES**

## Appendix 1: Investor's Documents

### Investors Investing in IPE Information Sheet:

## Durham Islamic Finance Programme

### Business School

Dear Participant,

I am part time PhD candidate at the Durham University Business School, United Kingdom. The purpose of this study is to explore the relationship between the investors and Islamic private equity firms in the GCC. As empirical study is a key part of my PhD dissertation, I am conducting a survey of investors and private equity firms.

The questionnaire aims to provide insight into the investor's experience in Islamic private equity and provide information and recommendation on how the relationship between the investor and the Islamic private equity firm can be strengthened in terms of transparency, *Shari'ah*, and regulation. Therefore, I request you to kindly choose and answer the questions that correctly reflect your experience, as it will effect the results of the study.

You will be provided with the questionnaire before hand and then arrangements will be made for an interview at your convenience and time to go through the questionnaire and discuss related issues. Should you have any questions and or concerns regarding this study/questionnaire, you may e-mail me at: [m.a.al-mannai@durham.ac.uk](mailto:m.a.al-mannai@durham.ac.uk). A written summary of the outcome of the study will be made available to interested participants following the end of the thesis.

### Ethics and rights of the respondents

While presently studying part time for my PhD, I currently am an employee of the Central Bank of Bahrain (where I am a Head in the Capital Markets Supervision Directorate).

I wish to stress to you that any information you give to me will be purely used for the purpose of research related to my PhD thesis. It will not under any circumstances be shared with or used by the Central Bank of Bahrain.

I also wish to stress to you that any information you give me will be kept strictly confidential at all times. Furthermore, the information provided will be used anonymously in my thesis and I will not use your name or any other details that would result in your identity being known.

The interviewee has the right not to answer any question for any reason.

The project has been given advisory approval by the Durham University Business School Sub-Committee for Ethics.

Thank you in advance for your co-operation, and you answering all questions is extremely important and highly appreciated.

For Researcher Use Only: \_\_\_\_\_

Case Identification No.: \_\_\_\_\_

Date: \_\_\_/\_\_\_/201....

**Questionnaire to Investors Investing in IPE:**

**Part A- Investor Profile:**

**A.1.** You are an investor in Islamic private equity as a: *(Please tick and indicate if more than one)*

- |  |  |  |
|--|--|--|
| <input type="checkbox"/> High net worth individual | <input type="checkbox"/> Financial Institution | <input type="checkbox"/> Insurance/Takaful Company |
| <input type="checkbox"/> Asset Manger              | <input type="checkbox"/> Sovereign Wealth Fund | <input type="checkbox"/> Government Entity         |
| <input type="checkbox"/> Endowment                 | <input type="checkbox"/> Pension Fund          | <input type="checkbox"/> Family office             |
| <input type="checkbox"/> Consultant/Advisor        | <input type="checkbox"/> Other -Specify: _____ |  |

**A.2.** Please specify your domicile: *(Please tick)*

- Bahrain     Kuwait     Qatar     Oman     Saudi Arabia     UAE

**A.3.** Your investments in Islamic private equity are/were carried out through: *(Please tick)*

- Direct equity investment (partnership)
- Indirect equity investment (pooling into co-investment vehicle-SPV)
- Private equity funds of funds
- Limited partnership (LP)

**A.4.** Year of most recent investments in Islamic private equity: *(Please tick)*

- 2003-2005     2006-2008     2009-2011     2012-2014

**A.5.** Country, allocation, type and form of Islamic private equity investment: *(Please fill)*

<u>Country</u>	<u>% Allocation</u>	<u>Type</u> Start-up (SP), Capital growth (CG), Other (O)-Specify	<u>Form</u> Musharaka(MK); Mudaraba (MD) Wakala (WK); Other (O)-Specify
Bahrain			
Kuwait			
Qatar			
Oman			
Saudi Arabia			
UAE			
Other – specify:			



**A.6. Number of Islamic private equity investments made in the last 10 years? (Please tick)**

Number of Investment(s)	Amount Invested (in US\$)	Management Fees paid (%) (Please fill)
<input type="checkbox"/> 1-2	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	
<input type="checkbox"/> 3-4	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	
<input type="checkbox"/> 5+	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	

**A.7. How familiar are you with Islamic equity financing? (Please tick)**

- Somewhat Familiar       Familiar       Very Familiar       Specialized

**Part B-Investor Approach to Investment:**

**B.1. What are the three most important source of information used prior to investment?**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. (Please explain, using the space above).

**B.2. Please indicate how much information is based on impersonal sources in comparison to personal sources, when deciding to invest? (Please tick)**

	None at all	Slight Extent	Certain Extent	Considerable Extent	Substantial Extent	Great Extent
<b>Impersonal sources</b> (e.g. documents, reports, press releases)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Personal Sources</b> (e.g. Calls/meetings of Islamic Financial Institution (IFI)-General Partner, personal network)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**B.3. What were the impersonal sources upon which investment decision was based on? Please provide up to 3 and comment.**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. (Please explain, using the space above).

**B.4.** What were the personal sources upon which investment decision was based on? Please provide up to 3 and comment.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. *(Please explain, using the space above).*

**B.5.** How easily was it to obtain market information on Islamic Private Equity market? *(Please tick)*

- With Difficulty     Somewhat Difficult     Somewhat Easy     Easy     Didn't Try

**B.6.** In promoting the Islamic economy and Islamic finance, do environmental, social and governance (ESG) issues effect your investment decisions? *(Please tick)*

- None at all                       Slight Extent                       Certain Extent  
 Considerable Extent             Substantial Extent                 Great Extent

**Part C- Investor-LP and Islamic Financial Institution-Private Equity Agreement:**

**C.1.** Were you provided with a full set of documents by the Islamic Financial Institution-GP (offering document, term sheet, and subscription form/agreement) prior to investing? *(Please tick)*

- Provided with full set of documents  
 Provided with term sheet and subscription form/agreement only  
 Provided with subscription form/agreement only  
 Other-Specify: \_\_\_\_\_

**C.2.** Do you read the offered/provided documents or do you rely on the Islamic Financial Institution (IFI) promoting the investment offer? *(Please tick)*

- Read the offered/provided documents personally  
 Have experts/advisors read and provide me with feedback  
 Rely on the promoting IFI information provided during meeting (based on trust)  
 Rely on network/relationships only (through friends and associates)

**C.3. Were the following principles discussed? Were they clear or misleading?**

*(Please tick the appropriate response for each)*

	In Detail	Some Detail	Briefly	<b>Please circle one</b>	Not Discussed
Alignment of interest	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Governance of investment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Transparency and Disclosure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Investment plan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Exit and/or Redemption strategy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
On-going reporting/update	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Rights and Obligations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Shari'ah non-compliance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>
Risk factors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Clear/Misleading	<input type="checkbox"/>

**C.4. Benchmark for considering information prior to investment as being sufficient was based on:** *(Please tick)*

- A**-Information provided       **B**- Trust in the Islamic Financial Institution/GP  
 **Both A & B**                       **Other- Specify:** \_\_\_\_\_

**C.5. If response to C.4. was based on Information, what source of information?** *(Please prioritize answer with 1 being most important)*

- |   |    |  |    |
|---|----|--|----|
| •Current events                                 | -- | •Investment prospects & opportunity          | -- |
| •Financial performance (historical & projected) | -- | •Management Team stability & experience      | -- |
| •Investor protection & clear investment rights  | -- | •Related underlying risk issues & mitigation | -- |
| •Regulatory requirements & obligations          | -- | •Investment terms & conditions               | -- |
| •Shari'ah pronouncement                         | -- | •Alignment of interest & transparency        | -- |
| •Applicable Law                                 | -- | •Investment consultant recommendation        | -- |
| •Policies & procedures for valuations and Fees  | -- | •Family & friends                            | -- |
| •Personal experience in Islamic private equity  | -- |  |    |
| • Other-Specify: _____                          |    |  |    |

**C.6. If response to C.4. was based on Trust, how much trust?** *(Please tick and explain selection)*

- High       High-Medium       Medium       Medium-Low       Low

Explain: \_\_\_\_\_

**C.7. Are you satisfied with the agreement/contract signed?** *(Please tick and explain selection)*

- Fully Satisfied       Fairly Satisfied       Satisfied       Somewhat Satisfied       Not Satisfied

Explain: \_\_\_\_\_

**C.8.** Were you offered the opportunity to be able to negotiate any of the contractual clauses in the investment contract that was offered? *(Please tick and explain selection)*

No       Yes      Explain: \_\_\_\_\_

---

**C.9.** How did you find the language of the agreement/contract signed?

*(Please tick and more than one can be selected)*

- Simple, easy to understand       Complex (not easy to understand what was happening)
- Comprehensive enough to protect rights and adequate covenants to address conflict of interest
- Not comprehensive enough to protect rights and no adequate covenants to address conflict of interest

**C.10.** Was subscribing and signing of the agreement independent of signing a proxy to the Islamic Financial Institution?

- Signing a proxy was optional and not a condition of subscribing and signing of the agreement
- Subscription and signing of the agreement was conditional to signing a proxy
- Other-Specify: \_\_\_\_\_

**C.11.** How was your capital/investment participation?

*(Please tick and if more than one investment please tick for each)*

Investment(s)	One off injection of capital	Multiple injection (draw down capital/capital call)
1	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/>	<input type="checkbox"/>

Other-Specify: \_\_\_\_\_

---

**C.12.** How much was the Islamic Financial Institution (IFI)- (GP) participation in the investment? *(Please tick)*  
*(If the IFI-GP participated, please state percentage and if more than one investment please provide for each)*

Investment(s)	Participated %	Did not Participate	Don't Know
1	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>

**Part D-Monitoring:**

**D.1.** How do you manage your relationship with the Islamic Financial Institution (GP)?

*(Please tick; if more than one investment please provide for each and explain selection)*

Investment(s)	No relationship	Manage	Explain
1	<input type="checkbox"/>	<input type="checkbox"/>	
2	<input type="checkbox"/>	<input type="checkbox"/>	
3	<input type="checkbox"/>	<input type="checkbox"/>	
4+	<input type="checkbox"/>	<input type="checkbox"/>	

Other-Explain: \_\_\_\_\_

\_\_\_\_\_

**D.2.** Were you permitted to vote on key issues? *(Please tick and more than one can be selected; if more than one investment please provide for each)*

Investment(s)	Vote on: Amendments to the agreement and/or investment strategy	Vote on: Dissolution of the partnership before the termination of the investment period	Vote on: Extension of the investment period	Vote on: Issues of conflict of interest	Vote on: Removal of the investment manager	Vote on: Other- <i>(Please Explain Below)</i>	Not Permitted to Vote
1	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other-Explain: \_\_\_\_\_

**D.3.** Did the Islamic Financial Institution (GP) establish and implement a clearly documented and defined process which facilitates investor consultation after investment, regarding matters relating to conflict of interest? *(Please tick and explain selection)*

No       Yes      Explain: \_\_\_\_\_

**D.4.** When it comes to investing in Islamic private equity, what are the risks that are of concern to you? *(Please tick)*

None       Have risks that are of concern, **they are:** *(Please state in order of priority)*

**D.5.** Were those risks in **D.4.** addressed in the documents provided to you? *(Please tick)*

No       Yes

**D.6.** What is your definition of *shari'ah* compliant?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**D.7.** How important is *shari'ah* risk to you? (Please tick)

- Very Important       Important       Somewhat Important       Not Important

**D.8.** What is your understanding of what happens when the Islamic equity investment is no longer *Shari'ah* compliant?

---

---

---

**D.9.** In pursuit of the investment being compatible with the principles of *Shari'ah*, in your point of view, which is/are the most important principle or principles? (Please tick and more than one can be selected) **The principle of:**

- Abiding by principles of profit and loss sharing
- Transaction have to be real and be certain and not based on uncertainty or speculation
- Prohibition in dealing in items, which are *Haram* and the requirement to deal only in *Halal* items
- Prohibition of *Riba*
- Requirement for fair and transparent dealings to ensure all partners are aware of their rights and obligations
- Abiding by *shari'ah* principles of clarity, and disclosing information, so as not to be manipulating.
- No unjust enrichment, equity and fairness to all parties
- The goal of the Islamic Financial Institution is not limited to the maximization of shareholders wealth, but also includes enhancement of the standard of living and welfare of the community

**D.10.** How do you make sure that the investment is maintaining *Shari'ah* compliance?

---

---

---

**D.11.** Are you aware if the investment is overseen by a *Shari'ah* board? (Please tick)

- Fully Aware       Somewhat Aware       Not Aware       No Idea

**D.12.** During your experience in Islamic private equity investment, have you thought that the whole investment venture process at any time had been perceptive to Ethical and or Legal issues? (Please tick and explain selection)

- Unethical Issues       Illegal Issues       Both       None

Explain: \_\_\_\_\_

---

**D.13.** On average, how often does your Islamic Financial Institution (GP) get in touch with you after having invested the capital/fund? *(Please tick and state frequency if Frequent is selected)*

Frequent                                       Occasional                                       None

(State Frequency: \_\_\_\_\_ )

**D.14.** If response to **D.13.** is None or Occasional, what do you think is the reason that the GP does not provide continual timely feedback on the investment? **Such action will:**

*(Please prioritize answer 1 to 5, with 1 being the first reason)*

- Jeopardies the GP's informational advantage --
- Undermine their authority --
- Endanger their position --
- Too costly --
- Other –Specify: -- \_\_\_\_\_

**D.15.** The information/feedback that you received: *(Please tick and more than one can be selected)*

- Reduces the need to monitor                       Enhances the trust in the GP
- You are willing to inject more capital/reinvest in the venture/investment

**Part E-Reporting requirements:**

**E.1.** Is the reporting feedback a provision in the main formal agreement/contract signed, or part of informal agreement made with the Islamic Financial Institution-GP? *(Please tick)*

- Part of the formal agreement/contract                       Part of the informal agreement/contract
- Other-specify: \_\_\_\_\_

**E.2.** How did you find the methodology of reporting of performance and progress of investment/project? *(Please tick)*     Standardized

- Standardized and consistent allowing for comparing performances
- Not standardized (differs every time)

**E.3.** Have you needed to or wanted to go back to the GP with questions or further information? *(Please tick and explain selection)*

- No                       Yes                      Explain: \_\_\_\_\_
- 

**E. 4.** Can the information received be easily analyzed with the industry performance? *(Please tick)*

- Easily Analyzed                       Somewhat Easy                       Not So Easy                       Not At All Easy



**E.5. What information would you like to see being reported?**

<hr/>	<hr/>
<hr/>	<hr/>
<hr/>	<hr/>

**Part F-Regulatory requirements:**

**F.1.** Are you aware if the Islamic Financial Institution (GP) had any regulatory requirements to meet? *(Please tick)*

- Fully Aware                       Somewhat Aware                       Not Aware

**F.2.** What regulatory requirements were you asked to abide by/to?

<hr/>	<hr/>
<hr/>	<hr/>
<hr/>	<hr/>

**F.3.** Do you think that regulatory requirements were enforced effectively? *(Please tick)*

- Fully Enforced       Somewhat Enforced       Not Enforced       No Idea

**Part G-Going Forward:**

**G.1.** Do you think that private equity investment has public consequences? Do you think that it has an indirect systemic impact? **Due to:** *(Please tick and more than one can be selected)*

- Is another form of providing finance/liquidity to the market parallel to banks and market exchanges
- Shortfall of investor protection and investor losses could have an impact on liquidity in the market
- Investor losses (from pension funds and insurance companies) may be indirectly born by individual savers and the wider public
- All the above
- None
- Other-*Specify:* \_\_\_\_\_

**G.2.** Do you think that regulating the agreement/contract and information disclosure (prior and or post investment) would be beneficial for the growth of the Islamic private equity industry? *(Please tick and explain)*

**G.2.i.** To regulate pre-investment would be:

- Beneficial to Industry       Not beneficial to Industry       Unsure       No Idea

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.2.ii.** To regulate post-investment would be:

- Beneficial to Industry       Not beneficial to Industry       Unsure       No Idea

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G3.** Who do you think should regulate? *(Please tick and explain)*

**G.3.i.** Pre-investment to be regulated/supervised by:

- Regulator     Industry Associations     Both     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.3.ii.** Post-investment to be regulated/supervised by:

- Regulator     Industry Associations     Both     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.4.** How should they regulate? *(Please tick and explain selection)*

- Obligatory Compliance     Comply or Explain Basis     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.5.** Are you aware of any industry associations? *(Please tick)*

- Yes       No       No idea      If yes, provide: **Name of Association(s):** \_\_\_\_\_

**G.6.** Are you a member? *(Please tick)*

- Yes       No       No idea      If yes, provide: **Type of Membership(s):** \_\_\_\_\_

**G.7.** Do you make use of their guidance? *(Please tick)*

- Yes       No       No idea      If yes, provide: **Type of Guidance(s):** \_\_\_\_\_

**G.8.** What do you think of having an Investors (LP) Advisory committee that represents the investors in the investment, to voice investors and focus on substance and efficiency issues; meet with Islamic Financial Intuitions (GP) regularly to discuss time-sensitive matters of importance?

*(Please tick and explain selection)*

Very Much Agree     Somewhat Agree     Agree     Not Agree     Rather be Independent

Explain: \_\_\_\_\_

**G.9.** What are the key issues facing Islamic private equity? *(Please prioritize answer, with 1 being the most important and please provide explanation each).*

	Priority	Explain
Economic environment	--	
Valuation	--	
Fees/Alignment of interest	--	
IFI-GP management approach	--	
Liquidity	--	
Transparency & investor communication	--	
Regulations	--	
Others, Specify:	--	

**G.10.** Did the investment in Islamic private equity meet your expectations? *(Please tick the appropriate response for each)*

	All	Some	Few	None
Meet expectation on procedures/approach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meet expectation on risk/returns	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meet expectation on <i>shari'ah</i> purposes/compliance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meet expectation on Islamic Financial Institution/General Partner-Tust	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**G.11.** Going forward do you expect to continue to invest in Islamic private equity form of investment? *(Please tick and explain selection)*

Plan to Continue     Undecided     No Plans to Continue

Explain: \_\_\_\_\_

**G.12.** Going forward you preference to investing in Islamic private equity investment would be:  
*(Please tick and explain selection)*

- Direct equity investment (partnership)
- Indirect equity investment (pooling into co-investment vehicle-SPV)
- Private equity funds of funds       Limited partnership       Other

Explain: \_\_\_\_\_

---

## **Durham Islamic Finance Programme**

---

### **Business School**

Dear Participant,

I am part time PhD candidate at the Durham University Business School, United Kingdom. The purpose of this study is to explore the relationship between the investors and Islamic private equity firms in the GCC. As empirical study is a key part of my PhD dissertation, I am conducting a survey of investors and private equity firms.

The questionnaire aims to provide insight into the investor's experience in Islamic private equity and provide information and recommendation on how the relationship between the investor and the Islamic private equity firm can be strengthened in terms of transparency, *Shari'ah*, and regulation. Therefore, I request you to kindly choose and answer the questions that correctly reflect your experience, as it will effect the results of the study.

You will be provided with the questionnaire before hand and then arrangements will be made for an interview at your convenience and time to go through the questionnaire and discuss related issues. Should you have any questions and or concerns regarding this study/questionnaire, you may e-mail me at: [m.a.al-mannai@durham.ac.uk](mailto:m.a.al-mannai@durham.ac.uk). A written summary of the outcome of the study will be made available to interested participants following the end of the thesis.

#### **Ethics and rights of the respondents**

While presently studying part time for my PhD, I currently am an employee of the Central Bank of Bahrain (where I am a Head in the Capital Markets Supervision Directorate).

I wish to stress to you that any information you give to me will be purely used for the purpose of research related to my PhD thesis. It will not under any circumstances be shared with or used by the Central Bank of Bahrain.

I also wish to stress to you that any information you give me will be kept strictly confidential at all times. Furthermore, the information provided will be used anonymously in my thesis and I will not use your name or any other details that would result in your identity being known.

The interviewee has the right not to answer any question for any reason.

The project has been given advisory approval by the Durham University Business School Sub-Committee for Ethics.

Thank you in advance for your co-operation, and you answering all questions is extremely important and highly appreciated.

For Researcher Use Only: \_\_\_\_\_

Case Identification No.: \_\_\_\_\_

Date: \_\_\_/\_\_\_/201....

**Questionnaire to Investors investing in CPE:**

**Part A- Investor Profile:**

**A.1.** You are an investor in private equity as a: *(Please tick)*

- |  |  |  |
|--|--|--|
| <input type="checkbox"/> High net worth individual | <input type="checkbox"/> Financial Institution | <input type="checkbox"/> Insurance Company |
| <input type="checkbox"/> Asset Manager             | <input type="checkbox"/> Sovereign Wealth Fund | <input type="checkbox"/> Government Entity |
| <input type="checkbox"/> Endowment                 | <input type="checkbox"/> Pension Fund          | <input type="checkbox"/> Family office     |
| <input type="checkbox"/> Consultant/Advisor        | <input type="checkbox"/> Other -Specify: _____ |  |

**A2.** Please specify your domicile: *(Please tick)*

- Bahrain     Kuwait     Qatar     Oman     Saudi Arabia     UAE

**A.3.** Your investments in private equity are/were carried out through: *(Please tick)*

- Direct equity investment (partnership)
- Indirect equity investment (pooling into co-investment vehicle-SPV)
- Private equity funds of funds
- Limited partnership (LP)

**A4.** Year of most recent investments in private equity: *(Please tick)*

- 2003-2005     2006-2008     2009-2011     2012-2014

**A.5.** Country, allocation, and type private equity investment: *(Please fill)*

<u>Country</u>	<u>% Allocation</u>	<u>Type</u> Start-up (SP), Capital growth (CG), Other (O)-Specify
Bahrain		
Kuwait		
Qatar		
Oman		
Saudi Arabia		
UAE		
Other – specify:		

**A.6.** Number of private equity investments made in the last 10 years? *(Please tick)*

Number of Investment(s)	Amount Invested (in US\$)	Management Fees paid (%) <i>(Please fill)</i>
<input type="checkbox"/> 1-2	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	
<input type="checkbox"/> 3-4	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	
<input type="checkbox"/> 5+	<input type="checkbox"/> Less 100,000 <input type="checkbox"/> 100,000-1m <input type="checkbox"/> 1m-5m <input type="checkbox"/> 5.1m-10m <input type="checkbox"/> 10m+	

**A.7.** How familiar are you with equity financing? *(Please tick)*

Somewhat Familiar    Familiar    Very Familiar    Specialized

**Part B-Investor Approach to Investment:**

**B.1.** What are the three most important source of information used prior to investment?

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. *(Please explain, using the space above).*

**B.2.** Please indicate how much information is based on impersonal sources in comparison to personal sources, when deciding to invest? *(Please tick)*

	None at all	Slight Extent	Certain Extent	Considerable Extent	Substantial Extent	Great Extent
<b>Impersonal sources</b> (e.g. documents, reports, press releases)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Personal Sources</b> (e.g. Calls/meetings of Islamic Financial Institution (IFI)-General Partner, personal network)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**B.3.** What were the impersonal sources upon which investment decision was based on? Please provide up to 3 and comment.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. *(Please explain, using the space above).*

**B.4.** What were the personal sources upon which investment decision was based on? Please provide up to 3 and comment.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

None at all. *(Please explain, using the space above).*

**B.5.** How easily was it to obtain market information on Private Equity market? *(Please tick)*

With Difficulty     Somewhat Difficult     Somewhat Easy     Easy     Didn't Try

**B.6.** In promoting the economy and finance, do environmental, social and governance (ESG) issues effect your investment decisions? *(Please tick)*

None at all                       Slight Extent                       Certain Extent  
 Considerable Extent             Substantial Extent                 Great Extent

**Part C- Investor-LP and Financial Institution-Private Equity Agreement:**

**C.1.** Were you provided with a full set of documents by the Financial Institution-GP (offering document, term sheet, and subscription form/agreement) prior to investing? *(Please tick)*

- Provided with full set of documents
- Provided with term sheet and subscription form/agreement only
- Provided with subscription form/agreement only
- Other-*Specify:* \_\_\_\_\_

**C.2.** Do you read the offered/provided documents or do you rely on the Financial Institution (FI) promoting the investment offer? *(Please tick)*

- Read the offered/provided documents personally
- Have experts/advisors read and provide me with feedback
- Rely on the promoting FI information provided during meeting (based on trust)
- Rely on network/relationships only (through friends and associates)



**C.3. Were the following principles discussed? (Please tick the appropriate response for each)**

	In Detail	Some Detail	Briefly	Not Discussed
Alignment of interest	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Governance of investment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency and Disclosure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Investment plan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Exit and/or Redemption strategy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
On-going reporting/update	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Rights and Obligations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Risk factors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**C.4. Benchmark for considering information prior to investment as being sufficient was based on: (Please tick)**

- A-**Information provided   
 **B-** Trust in the Financial Institution/GP  
 **Both A & B**                     
 **Other- Specify:** \_\_\_\_\_

**C.5. If response to C.4. was based on Information, what source of information? (Please select and prioritize answer with 1 being most important)**

- |   |    |  |    |
|---|----|--|----|
| •Current events                                 | -- | •Investment prospects & opportunity            | -- |
| •Financial performance (historical & projected) | -- | •Management Team stability & experience        | -- |
| •Investor protection & clear investment rights  | -- | •Related underlying risk issues & mitigation   | -- |
| •Regulatory requirements & obligations          | -- | •Investment terms & conditions                 | -- |
| •Alignment of interest & transparency           | -- | •Applicable Law                                | -- |
| •Investment consultant recommendation           | -- | •Policies & procedures for valuations and Fees | -- |
| •Family & friends                               | -- | •Personal experience in private equity         | -- |

• Other-Specify: \_\_\_\_\_

**C.6. If response to C.4. was based on Trust, how much trust? (Please tick and explain selection)**

- High   
 High-Medium   
 Medium   
 Medium-Low   
 Low

Explain: \_\_\_\_\_

**C.7. Are you satisfied with the agreement/contract signed? (Please tick and explain selection)**

- Fully Satisfied   
 Fairly Satisfied   
 Satisfied   
 Somewhat Satisfied   
 Not Satisfied

Explain: \_\_\_\_\_

**C.8.** Were you offered the opportunity to be able to negotiate any of the contractual clauses in the investment contract that was offered? *(Please tick and explain selection)*

No       Yes      Explain: \_\_\_\_\_

---

**C.9.** How did you find the language of the agreement/contract signed?

*(Please tick)*

**C.9.i.**

Simple, easy to understand       Complex (not easy to understand what was happening)

**C.9.ii.**

Comprehensive enough to protect rights and adequate covenants to address conflict of interest  
 Not comprehensive enough to protect rights and no adequate covenants to address conflict of interest

**C.10.** Was subscribing and signing of the agreement independent of signing a proxy to the Financial Institution?

Signing a proxy was optional and not a condition of subscribing and signing of the agreement  
 Subscription and signing of the agreement was conditional to signing a proxy  
 Other-*Specify*: \_\_\_\_\_

**C.11.** How was your capital/investment participation?

*(Please tick and if you have more than one investment please tick for each)*

Investment(s)	One off injection of capital	Multiple injection (draw down capital/capital call)
1	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/>	<input type="checkbox"/>

Other-*Specify*: \_\_\_\_\_

---

**C.12.** How much was the Financial Institution (FI)- (GP) participation in the investment? *(Please tick)*

*(If the IFI-GP participated, please state percentage and if you have more than one investment please provide for each)*

Investment(s)	Participated %	Did not Participate	Don't Know
1	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/> -- %	<input type="checkbox"/>	<input type="checkbox"/>

**Part D-Monitoring:**

**D.1.** How do you manage your relationship with the Financial Institution (GP)?

*(Please tick; if you have more than one investment please provide for each and explain selection)*

Investment(s)	No relationship	Have relationship/Manage	Explain
1	<input type="checkbox"/>	<input type="checkbox"/>	
2	<input type="checkbox"/>	<input type="checkbox"/>	
3	<input type="checkbox"/>	<input type="checkbox"/>	
4+	<input type="checkbox"/>	<input type="checkbox"/>	

Other-Explain: \_\_\_\_\_

---

**D.2.** Were you permitted to vote on key issues? *(Please tick and if you have more than one investment please provide for each)*

Investment(s)	Vote on: Amendments to the agreement and/or investment strategy	Vote on: Dissolution of the partnership before the termination of the investment period	Vote on: Extension of the investment period	Vote on: Issues of conflict of interest	Vote on: Removal of the investment manager	Vote on: Other- <i>(Please Explain Below)</i>	Not Permitted to Vote
1	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4+	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Other-Explain: \_\_\_\_\_  
 \_\_\_\_\_

**D.3.** Did the Financial Institution (GP) establish and implement a clearly documented and defined process which facilitates investor consultation after investment, regarding matters relating to conflict of interest? *(Please tick and explain selection)*

No       Yes      Explain: \_\_\_\_\_  
 \_\_\_\_\_

**D.4.** When it comes to investing in private equity, what are the risks that are of concern to you? *(Please tick)*

None       Have risks that are of concern, **they are:** *(Please state in order of priority)*  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**D.5.** Were those risks in **D.4.** addressed in the documents provided to you? *(Please tick)*

No       Yes

**D.6.** On average, how often does your Financial Institution (GP) get in touch with you after having invested the capital/fund? *(Please tick and state frequency if Frequent is selected)*

Frequent       Occasional       None  
 (State Frequency: \_\_\_\_\_ )

**D.7.** If response to **D.6.** is None or Occasional, what do you think is the reason that the GP does not provide continual timely feedback on the investment? **Such action will:**

*(Please prioritize answer 1 to 5, with 1 being the first reason)*

- Jeopardies the GP's informational advantage --
- Undermine their authority --
- Endanger their position --
- Too costly --
- Other -Specify: \_\_\_\_\_ --

**D.8.** The information/feedback that you received: *(Please tick and more than one can be selected)*

- Reduces the need to monitor
- Enhances the trust in the GP
- You are willing to inject more capital/reinvest in the venture/investment

**Part E-Reporting requirements:**

**E.1.** Is the reporting feedback a provision in the main formal agreement/contract signed, or part of informal agreement made with the Financial Institution-GP? *(Please tick)*

- Part of the formal agreement/contract
- Part of the informal agreement/contract
- Other-specify: \_\_\_\_\_

**E.2.** How did you find the methodology of reporting of performance and progress of investment/project? *(Please tick)*

- Standardized and consistent allowing for comparing performances
- Not standardized (differs every time)

**E.3.** Have you needed to or wanted to go back to the GP with questions or further information?

*(Please tick and explain selection)*

- No
- Yes
- Explain: \_\_\_\_\_

**E. 4.** Can the information received be easily analyzed with the industry performance? *(Please tick)*

- Easily Analyzed
- Somewhat Easy
- Not So Easy
- Not At All Easy

**E.5.** What information would you like to see being reported?

_____	_____
_____	_____
_____	_____

**Part F-Regulatory requirements:**

**F.1.** Are you aware if the Financial Institution (GP) had any regulatory requirements to meet? *(Please tick)*

- Fully Aware                       Somewhat Aware                       Not Aware

**F.2.** What regulatory requirements were you asked to abide by/to?

_____	_____
_____	_____
_____	_____

**F.3.** Do you think that regulatory requirements were enforced effectively? *(Please tick)*

- Fully Enforced       Somewhat Enforced       Not Enforced       No Idea

**Part G-Going Forward:**

**G.1.** Do you think that private equity investment has public consequences? Do you think that it has an indirect systemic impact? **Due to:** *(Please tick and more than one can be selected)*

- Is another form of providing finance/liquidity to the market parallel to banks and market exchanges
- Shortfall of investor protection and investor losses could have an impact on liquidity in the market
- Investor losses (from pension funds and insurance companies) may be indirectly born by individual savers and the wider public
- All the above
- None
- Other-Specify: \_\_\_\_\_
- \_\_\_\_\_

**G.2.** Do you think that regulating the agreement/contract and information disclosure (prior and or post investment) would be beneficial for the growth of the Islamic private equity industry? *(Please tick and explain)*

**G.2.i.** To regulate pre-investment would be:

- Beneficial to Industry       Not beneficial to Industry       Unsure       No Idea

Explain: \_\_\_\_\_

\_\_\_\_\_

**G.2.ii.** To regulate post-investment would be:

- Beneficial to Industry       Not beneficial to Industry       Unsure       No Idea

Explain: \_\_\_\_\_

\_\_\_\_\_

**G3.** Who do you think should regulate? *(Please tick and explain)*

**G.3.i.** Pre-investment to be regulated/supervised by:

Regulator     Industry Associations     Both     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.3.ii.** Post-investment to be regulated/supervised by:

Regulator     Industry Associations     Both     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.4.** How should they regulate? *(Please tick and explain selection)*

Obligatory Compliance     Comply or Explain Basis     None     Other-Specify: \_\_\_\_\_

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.5.** Are you aware of any industry associations? *(Please tick)*

Yes     No    If yes, provide: **Name of Association(s):** \_\_\_\_\_

**G.6.** Are you a member? *(Please tick)*

Yes     No    If yes, provide: **Type of Membership(s):** \_\_\_\_\_

**G.7.** Do you make use of their guidance? *(Please tick)*

Yes     No    If yes, provide: **Type of Guidance(s):** \_\_\_\_\_

**G.8.** What do you think of having an Investors (LP) Advisory committee that represents the investors in the investment, to voice investors and focus on substance and efficiency issues; meet with Financial Intuitions (GP) regularly to discuss time-sensitive matters of importance?

*(Please tick and explain selection)*

Very Much Agree     Somewhat Agree     Agree     Not Agree     Rather be Independent

Explain: \_\_\_\_\_  
\_\_\_\_\_

**G.9.** What are the key issues facing private equity? *(Please select and prioritize answer, with 1 being the most important and please provide explanation each).*

	Priority	Explain
Economic environment	--	
Valuation	--	
Fees/Alignment of interest	--	
IFI-GP management approach	--	
Liquidity	--	
Transparency & investor communication	--	
Regulations	--	
Others, Specify:	--	

**G.10.** Did the investment in private equity meet your expectations? *(Please tick the appropriate response for each)*

	All	Some	Few	None
Meet expectation on procedures/approach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meet expectation on risk/returns	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meet expectation on Financial Institution/General Partner-Trust	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**G.11.** Going forward do you expect to continue to invest in private equity form of investment? *(Please tick and explain selection)*

- Plan to Continue
  Undecided
  No Plans to Continue

Explain: \_\_\_\_\_  
 \_\_\_\_\_

**G.12.** Going forward you preference to investing in private equity investment would be: *(Please tick and explain selection)*

- Direct equity investment (partnership)  
 Indirect equity investment (pooling into co-investment vehicle-SPV)  
 Private equity funds of funds
  Limited partnership
  Other

Explain: \_\_\_\_\_  
 \_\_\_\_\_



**Consent Form to IPE & CPE Investors:**

**CONSENT FORM**

**THE RELATIONSHIP BETWEEN THE INVESTOR AND PRIVATE EQUITY FIRMS IN THE GULF COOPERATION COUNCIL COUNTRIES**

Muna AlMannai, PhD candidate, Durham University Business School

- |  | <i>Please tick</i>       |                          |
|--|--------------------------|--------------------------|
|  | <b>Yes</b>               | <b>No</b>                |
| 1. I confirm that I have read and understood the information provided in the Information Sheet on the above study.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. I have had the opportunity to ask questions, and I have received satisfactory answers to all my questions.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. I understand that my participation is voluntary and I am free to withdraw at any time or not to answer any question without the need to justify my position, and without prejudice. | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. I understand that my name (and the name of my company, where applicable) will not be published, but what will be published will be the analyzed results in anonymous form.          | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. I agree to take part in the study.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. I agree to the interview being audi recorded.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. I understand that interview tapes and transcripts will be anonymised and will be held in strict confidence and in accordance with the Data Protection Act (1998).                   | <input type="checkbox"/> | <input type="checkbox"/> |
| 8. I agree to the use of anyonimised quotes in publications.   | <input type="checkbox"/> | <input type="checkbox"/> |

Name of interviewee/person making consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Name of Research/person taking consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

## Appendix 2: Islamic Financial Institution's Documents

### IFI Information Sheet:

## Durham Islamic Finance Programme

---

### Business School

Dear Participant,

I am part time PhD candidate at the Durham University Business School, United Kingdom. The purpose of this study is to explore the relationship between the investors and Islamic private equity firms in the GCC. As empirical study is a key part of my PhD dissertation, I am conducting a survey on investors and private equity firms.

The questions aim to provide insight into the investor's experience in Islamic private equity and provide information and recommendation on how the relationship between the investor and the Islamic private equity firm can be strengthened in terms of transparency, *Shari'ah*, and regulation. Therefore, I request you to kindly answer the questions that correctly reflect your experience, as it will effect the results of the study.

Arrangements will be made for an interview at your convenience and time to seek your input to some questions and discuss related issues. Should you have any questions and or concerns regarding this study/questions, you may e-mail me at [m.a.al-mannai@durham.ac.uk](mailto:m.a.al-mannai@durham.ac.uk). A written summary of the outcome of the study will be made available to interested participants following the end of the thesis.

### Ethics and rights of the respondents

While presently studying part time for my PhD, I currently am an employee of the Central Bank of Bahrain (where I am a Head in the Capital Markets Supervision Directorate).

I wish to stress to you that any information you give to me will be purely used for the purpose of research related to my PhD thesis. It will not under any circumstances be shared with or used by the Central Bank of Bahrain.

I also wish to stress to you that any information you give me will be kept strictly confidential at all times. Furthermore, the information provided will be used anonymously in my thesis and I will not use your name or any other details that would result in your identity being known.

The interviewee has the right not to answer any question for any reason.

The project has been given advisory approval by the Durham University Business School Sub-Committee for Ethics.

Thank you in advance for your co-operation, and you answering all questions is extremely important and highly appreciated.

For Researcher Use Only: \_\_\_\_\_

Case Identification No.: \_\_\_\_\_

Date: \_\_\_/\_\_\_/201....

## **IFI Interview Questions:**

### **The Relationship between the Investors and the Islamic Financial Institutions in the GCC investing Private Equity**

Questions to be addressed to Islamic Financial Institutions carrying out Islamic private equity/private placement, including real estate (IPE)

#### **Introduction**

##### **A. Islamic Financial Institution Profile**

1. What type of IFI are you?
  - Investment bank offering Islamic Private Equity (IPE)
  - Private equity firm
  - Other: *Specify*
2. Where are you located?
3. What is the sector/industry of your investments concentration?
4. What is the capital of your institution?
5. What is the size of the assets under management of your institution?

##### **B. Investment Approach**

1. How do you approach your potential investors? How do you decide which investor to approach?
2. What do you provide the potential investor with when approaching them for investment?
3. What is usually discussed during meetings and presentations?
4. Does the institution's representative promoting the investment have education and or training in Islamic financial products and contracts?
5. What steps are taken to ensure that the investor is well informed?

##### **C. Post Investment Relationship**

1. How is communication maintained between the institution and the investor, post investment?
2. What is the frequency of the information provided to the investor?
3. What information is provided to the investor and how?
4. Do visits take place to update the investor? Or is it just made through reporting?
5. If visits are made, who from within the institution makes the visits?

## D. Due Diligence, Transparency and Governance

1. Does your Due Diligence (DD) process cover the following:

Due Diligence	Yes	No
Financial DD		
Legal DD		
Regulatory DD		
Investment & Risk DD		
Shari'ah DD		
Commercial DD		
Management DD		
Macro-environment DD		
Social impact DD		
Other DD (Specify):		

2. How do you evaluate your risks?
3. What is the process of deciding on the level of your institution's investment participation?
4. What are the criteria used by the institution to make investment decisions?
5. What do you consider as being transparent? How do you know that it is maintained without any biasness, and disclosing favourable information verse unfavourable information?
6. How do you maintain the protection of investors' rights?
7. You are managers and most of the time are given or take proxy, how do you maintain investors' rights and deal with mitigating conflict of interest?
8. How do you maintain keeping to the business and the investment plan?
9. When given proxy, do you ever go back to the investor on any decisions to be made? If yes, when do you go back to the investor?
10. On exit, how is it conveyed to the investor? What detail is the investor provided with?

Details	Yes	No
Full sale and exit price received by IFI		
Only the amount the investor is entitled to		

## E. Shari'ah Compliance

1. Is there a *Shari'ah* department or a unit within the institution?
2. Is there a *Shari'ah* Compliance Officer? What is his/her role?
3. What do you consider as *shari'ah* risk for IPE? (*Please select, more than one can be selected*).

In pursuit of the investments being compatibility with the principles of *Shari'ah*-from your point of view- which is/are the most important principle or principles: The principle of:

- a. Profit and loss
- b. Transaction to be real and certain and not based on uncertainty or speculation
- c. Prohibition in dealing in items, which are *Haram* and the requirement to deal only in *Halal* items
- d. Prohibition of *Riba* and *gharar*
- e. Fair and transparent dealings to ensure all partners are aware of their rights and obligations
- f. Clarity and disclosure information, so as not to be manipulating.
- g. No unjust enrichment, equity and fairness to all parties
- h. Enhancement of the standard of living and welfare of the community in addition to the maximization of shareholders wealth.

4. What is the institution's process of monitoring the consistency of maintaining its *Shari'ah* compliance, how does it manage any *Shari'ah* compliance risk that may arise over time?

**F. *Shari'ah* Supervisory Board (SSB) Role**

1. What is the *Shari'ah* governance system of your institution?

Do you have	Yes	No	Reporting to who	Main Responsibilities
Internal <i>Shari'ah</i> compliance unit/department (independent from the business unit/department)				
Internal <i>Shari'ah</i> review/ audit unit/department				
<i>Shari'ah</i> Supervisory Board				
Outsourced: <i>(Specify)</i>				
Other: <i>(Specify)</i>				

2. What are the types of reports produced by the institution's *Shari'ah* governance system?

<i>Shari'ah</i> Governance	Type of Report Produced	Frequency	Who is distributed to
Internal <i>Shari'ah</i> compliance unit/department			
Internal <i>Shari'ah</i> review/ audit unit/department			
<i>Shari'ah</i> Supervisory Board (SSB)			
Outsourced: <i>(Specify)</i>			
Other: <i>(Specify)</i>			

3. What is the process in which the *Shari'ah* consultation and approval is obtained at your institution for:

- Initiation and idea generation Stage
- Finalization pre-launch stage

4. How is the SSB updated after the launch of the offer is closed?

5. What is your Institution's key on the independence of the SSB members?  
 6. Are any of the SSB members:

	Yes	No
On the board of directors of the institution		
On of the institution's board committees		
A Client of the institution		
A Shareholder of the institution		

7. Who appoints the SSB members? The BOD or the AGM?
8. What is the appointment term (length of appointment) of the SSB members?
9. Is there a set number of appointment terms that a SSB member can serve?
10. If yes to D.10. : How many consecutive terms can the SSB member serve?
11. If response to D.1. was “Outsourced” then: Is there a different SSB for every IPE investment or it is the same?

## **G. Regulatory Requirements**

1. Are there any regulatory requirements on your institution with regards to promoting and selling IPE?
2. Are there any on-going regulatory requirements with regards to disclosure and transparency that your institution requires to abide by, once the investment has been offered?
3. What is your opinion with regards to these regulations?
4. What are the regulations on capital? And what is your opinion on them?

## **General**

**IFI's Consent Form:**

**CONSENT FORM**

**THE RELATIONSHIP BETWEEN THE INVESTOR AND THE ISLAMIC FINANCIAL INSTITUTION IN THE GULF COOPERATION COUNCIL COUNTRIES INVESTING IN PRIVATE EQUITY**

Muna AlMannai, PhD candidate, Durham University Business School

*Please tick*

**Yes      No**

- |   |                          |                          |
|---|--------------------------|--------------------------|
| 9. I confirm that I have read and understood the information provided in the Information Sheet on the above study.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 10. I have had the opportunity to ask questions, and I have received satisfactory answers to all my questions.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 11. I understand that my participation is voluntary and I am free to withdraw at any time or not to answer any question without the need to justify my position, and without prejudice. | <input type="checkbox"/> | <input type="checkbox"/> |
| 12. I understand that my name (and the name of my company, where applicable) will not be published, but what will be published will be the analyzed results in anonymous form.          | <input type="checkbox"/> | <input type="checkbox"/> |
| 13. I agree to take part in the study.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 14. I agree to the interview being audi recorded.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 15. I understand that interview tapes and transcripts will be anonymised and will be held in strict confidence and in accordance with the Data Protection Act (1998).                   | <input type="checkbox"/> | <input type="checkbox"/> |
| 16. I agree to the use of anonymised quotes in publications.  | <input type="checkbox"/> | <input type="checkbox"/> |

Name of interviewee/person making consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Name of Research/person taking consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

## Appendix 3: Shari'ah Scholar's Documents

برنامج جامعة درهام للتمويل الإسلامي

كلية إدارة الأعمال

عزيزي المشارك،

أنا طالبة دكتوراة بدوام جزئي بجامعة درهام كلية إدارة الأعمال بالمملكة المتحدة، وتهدف هذه الدراسة إلى استكشاف العلاقة بين المستثمرين والمؤسسات المالية الإسلامية التي تستثمر في الملكيات والاكنتابات الخاصة في دول مجلس التعاون الخليجي. وبما أن الدراسة التجريبية تشكل جزءاً رئيساً من أطروحة الدكتوراة الخاصة بي، فأنا أجري مسحاً عن المستثمرين والمؤسسات المالية المعنية وأعضاء هيئة الرقابة الشرعية.

وتهدف المقابلة إلى إلقاء مزيد من الضوء حول تجربة المستثمرين في مجال الاستثمار في الملكيات والاكنتابات الخاصة وتوفير معلومات وتوصيات حول كيفية تقوية العلاقة بين المستثمر والمؤسسات المالية الإسلامية التي تستثمر في الملكيات الخاصة، فيما يتعلق بالشفافية والشريعة والانظمة. لذا أرجو التفضل بالاجابة على الاسئلة بحيث يعكس تجربتكم بدقة لمدى تأثيرها على نتائج الدراسة.

سيتم الترتيب لإجراء مقابلة في الوقت الذي يناسبكم لأخذ إجابتكم لبعض الأسئلة ومناقشة أمور ذات صلة. فإذا كان لديكم أية استفسارات أو تحفظات بشأن هذه الدراسة، يمكنكم إرسالها إليّ عبر عنوان بريدي الإلكتروني [m.a.al-mannai@durham.ac.uk](mailto:m.a.al-mannai@durham.ac.uk) كما سيتم توفير موجز عن نتائج الدراسة للمشاركين الراغبين بعد الانتهاء من هذه الأطروحة.

### مبادئ أخلاقية وحقوق المشاركين:

بينما أدرس حالياً بدوام جزئي لنيل درجة الدكتوراة، فإنني أعمل حالياً لدى مصرف البحرين المركزي (حيث أشغل منصب رئيس مبادرة مراقبة الأسواق المالية).

وأود أن أؤكد لكم بأن أية معلومات تقدمونها لي سوف يتم استخدامها فقط لغرض البحث الخاص بأطروحة الدكتوراة الخاصة بي، ولن يتم بأي حال من الأحوال مشاركتها مع أو استخدامها من قبل مصرف البحرين المركزي.

كما أود أن أؤكد لكم بأن أية معلومات تزودونني بها ستظل محفوظة قيد السرية التامة في كل الأوقات، بجانب أن المعلومات المقدمة سيتم استخدامها مجهولة المصدر في أطروحتي ولن أستخدم اسماءكم أو أية تفاصيل أخرى قد تفضي إلى كشف هوياتكم.

ولللشخص الذي يتم إجراء المقابلة معه الحق في عدم الرد على أي سؤال لأي سبب كان.

وقد حصل المشروع على الموافقة الاستشارية من قبل اللجنة الفرعية للمبادئ الأخلاقية لجامعة درهام كلية إدارة الأعمال.

أشكركم مسبقاً لتعاونكم وأجد تفضلكم بالرد على كافة الأسئلة غاية في الأهمية ويلقى مني أسمى آيات التقدير.

للاستخدام من قبل الباحث فقط: \_\_\_\_\_

رقم الحالة: \_\_\_\_\_



## Shari'ah Scholars Interview Questions:

### العلاقة بين المستثمر والمؤسسات المالية الاسلامية في دول مجلس التعاون الخليجي التي تستثمر في الملكيات والاكتتابات الخاصة

الأسئلة الموجهه إلى علماء الشريعة الاسلامية بهيئات الرقابة الشرعية بالمؤسسات المالية الاسلامية التي تستثمر في الملكيات والاكتتابات الخاصة بما في ذلك الاستثمار العقاري.

#### ١. معلومات تعريفية:

١. هل انت عضو بأي من هيئات الرقابة الشرعية؟
٢. أين تقيم؟
٣. كم عدد مجالس الرقابة الشرعية التي تتمتع بعضويتها؟
٤. في المتوسط، كم عدد أعضاء هيئة الرقابة الشرعية التي تنتمي إليها؟
٥. كعضو في هيئة الرقابة الشرعية، هل أنت:

	عضو بهيئة الرقابة الشرعية و.....	نعم	لا
أ.	عضو بهيئة إدارة المؤسسة المالية		
ب.	عضو بإحدى لجان مجلس إدارة المؤسسة المالية		
ج.	عميل للمؤسسة المالية		
د.	مساهم بالمؤسسة المالية		

#### ب. نطاق الصلاحيات والمسئوليات :

١. هل نص عقد تعيينك لهيئة الرقابة الشرعية على مهامك ومسئولياتك ونطاق الصلاحيات المتاحة لك؟
٢. حدد مهامك وصلاحياتك؟
٣. هل هنالك إجراءات تشغيلية واضحة؟ وهل التسلسل الهرمي للمراجعة ورفع التقارير واضحة؟
٤. لمن ترفع هيئة الرقابة الشرعية تقاريرها؟

٥. هل تتوفر الانظمة واللوائح والاجراءات الواضحة الخاصة بالآتي:

لا	نعم	القواعد واللوائح الخاصة بـ
		أ. عقد الاجتماعات
		ب. التدوين للمحاضر وعملية اتخاذ القرار
		ج. عمليات المراجعة والتقييم والمتابعة، بعد أن يتم طرح الاستثمارات (المنتج) على المستثمرين، للتأكد من توافقها واستدامتها مع مبادئ الشريعة
		د. التقارير وأنواعها

٦. من خلال معاملتك مع المؤسسة المالية، وبصفتك عضو في هيئة الرقابة الشرعية، كيف تحاول الاحتفاظ باستقلاليتك؟

٧. كعضو في هيئة رقابة شرعية، كيف تقوم بأداء المهام المطلوبه منك في ضوء مسؤولياتك؟

٨. وكيف تعمل على التوفيق ما بين متطلبات المهام المختلفة كعضو منتسب لأكثر من هيئة شرعية؟

ت. مهام هيئة الرقابة الشرعية

١. حدد نوع المعلومات التي يتم تزويدك بها من أجل القيام بمهامك ومسئولياتك على أكمل وجه؟

لا	نعم	يتم تزويدي الآتي:
		أ. مستندات الإفصاح
		ب. المستندات المالية
		ج. معلومات عن المنتج/الاستثمار
		د. تقرير تقييم المخاطر
		هـ. تقرير التدقيق الشرعي الداخلي
		و. تقرير التوافق مع مبادئ الشريعة الإسلامية
		ز. المستندات القانونية والرقابية
		ح. أخرى: أذكرها

٢. بالإضافة إلى ما سبق، هل تقوم بالمزيد من البحث والتقصي حول مقترح الاستثمار تحت الدراسة وطلب معلومات إضافية للتحقق من شرعيتها وتوافقها مع المبادئ الإسلامية؟ أذكر مثال على ذلك؟

٣. هل تقوم هيئة الرقابة الشرعية بمراجعة الاتي:

لا	نعم	الهيئة تراجع:
		أ. الاستثمارات (المنتج) المقترحه
		ب. الاستثمارات (المنتج) بعد طرحها
		ج. العقود/الاتفاقيات
		د. عقد التأسيس والنظام الأساسي
		هـ. الانظمة والإجراءات
		و. المعاملات المتضمنة في الميزانية العمومية وخارجها
		ز. تقرير المدقق الشرعي الداخلي
		ح. التقرير الخاص بالتوافق مع مبادئ الشريعة الإسلامية

٤. عندما تقوم هيئة الرقابة الشرعية بعملية مراجعة، ماذا تشتمل عملية المراجعة؟
٥. هل تفرض المؤسسة المالية أية قيود على هيئة الرقابة الشرعية في كيفية قيامها بعمليات المراجعة؟
٦. حدد أنواع التقارير التي تصدرها هيئة الرقابة الشرعية، ولمن يتم توفيرها؟
٧. حدد أنواع التقارير التي يتم تقديمها لهيئة الرقابة الشرعية؟ مع تحديد الجهة التي تقوم برفع هذه التقارير؟
٨. هل تقوم الهيئة بمراجعة تقرير المدقق الشرعي الداخلي للتأكد من توافقه مع مبادئ الشريعة الإسلامية؟

### ج. التوافق مع مبادئ الشريعة الإسلامية:

١. سعياً لشرعية الاستثمارات وتوافقها مع المبادئ الإسلامية، حدد -من وجهة نظرك الخاصة- المبدأ/المبادئ الأكثر أهمية من الاتي: يمكنك اختيار أكثر من اجابه

مبدأ.....

- أ. الالتزام بالربح والخسارة.
- ب. أن تكون المعاملة فعلية وليست صورية.
- ج. التعامل في الحلال فقط، وتحريم التعامل في الأصناف المحرمة.
- د. تحريم الربا والغرر.
- هـ. العدل والشفافية في المعاملات لضمان وعي كافة الشركاء بحقوقهم وواجباتهم.
- و. الوضوح والافصاح عن المعلومات للعملاء لتجنب التلاعب.
- ز. تحقيق العدل والمساواة لكافة الأطراف مع تجنب الثراء المحرم.
- ح. دعم مستوى المعيشة ورفاه المجتمع، إلى جانب زيادة ثروات المساهمين.
- ط. أخرى.

٢. أ. هل تعمل المؤسسة المالية على إخطار هيئة الرقابة الشرعية بالمخاطر المتوقعة أن تؤثر على توافق الاستثمارات مع مبادئ الشريعة الإسلامية؟
٢. ب. وهل أيضًا تعمل المؤسسة المالية على إخطار هيئة الرقابة الشرعية في حال تبين إنحراف الاستثمارات عن مسار توافقها مع مبادئ الشريعة الإسلامية؟
٣. في حال مواجهة المؤسسة المالية بعقبات، ما هو دور هيئة الرقابة الشرعية في هذه الحالة؟
٤. هل واجهت أي من الهيئات التي تنتمي لها أية عقبات تتعلق بتوافق الاستثمارات/المعاملات بمبادئ الشريعة الإسلامية خلال فترة العشرة الأعوام السابقة؟
٥. إذا كانت الإجابة بنعم على السؤال رقم (٤) هل تم توثيقها / رفع تقارير بشأنها؟
٦. وهل تم توفير هذه التقارير للمساهمين والمستثمرين والسلطات الرقابية المحلية؟

**Shari'ah Scholar's Consent Form:**

**نموذج الموافقة للدراسة**

الخاصة بإطروحة الدكتوراة حول العلاقة بين المستثمر والمؤسسات المالية الإسلامية في دول مجلس التعاون الخليجي  
التي تستثمر في الملكيات والاكتتابات الخاصة

منى المناعي- طالبة دكتوراة

جامعة درم كلية إدارة الأعمال

لا	نعم	يرجى من السادة الكرام تقديم الموافقة من عدمه للبنود الآتية، من خلال الإشارة في الخانه المخصصه لذلك ب(نعم) أو (لا):
		١. أؤكد بأنني قد اطلعت على المعلومات المقدمة في الورقة بعنوان: "معلومات حول الدراسة"، وفهمت محتواها.
		٢. قد أتاحت لي الفرصه لطرح أسئلتني وتلقيت الإجابات المرضية حولها.
		٣. أتفهم أن مشاركتي طوعية، وأن لي الحرية في الانسحاب وقتما أشاء، وفي عدم الرد على أي سؤال يطرح، ودون تقديم المبررات.
		٤. أفهم بأن اسمي واسم المؤسسة التي أتبع لها (أينما ينطبق) لن يتم نشره أيٍ منهما، وأن ما سننشر هي النتائج التحليلية للدراسة وبمصدر مجهول.
		٥. أوافق على المشاركة في الدراسة.
		٦. أوافق على تسجيل المقابلة.
		٧. أتفهم بأن أشرطة تسجيل المقابلة والمخطوطات سيتم حفظها قيد السرية التامة، وذلك بموجب قانون حماية البيانات، المملكة المتحدة لعام 1998.
		٨. أوافق على استخدام اقتباسات من المقابلة في المواد المنشورة، على أن تقيد كمعلومات مجهولة المصدر.

اسم المشارك والذي قدم الموافقة: \_\_\_\_\_

التاريخ: \_\_\_\_\_

التوقيع: \_\_\_\_\_

اسم الباحث والذي استلم الموافقة: \_\_\_\_\_

التاريخ: \_\_\_\_\_

التوقيع: \_\_\_\_\_

**Shari'ah Scholars Information Sheet-English Version:**

**Durham Islamic Finance Programme**

---

**Business School**

Dear Participant,

I am part time PhD candidate at the Durham University Business School, United Kingdom. The purpose of this study is to explore the relationship between the investors and Islamic private equity firms in the GCC. As empirical study is a key part of my PhD dissertation, I am conducting a survey on investors and private equity firms.

The questions aim to provide insight into the investor's experience in Islamic private equity and provide information and recommendation on how the relationship between the investor and the Islamic private equity firm can be strengthened in terms of transparency, *Shari'ah*, and regulation. Therefore, I request you to kindly answer the questions that correctly reflect your experience, as it will effect the results of the study.

Arrangements will be made for an interview at your convenience and time to seek your input to some questions and discuss related issues. Should you have any questions and or concerns regarding this study/questions, you may e-mail me at [m.a.al-mannai@durham.ac.uk](mailto:m.a.al-mannai@durham.ac.uk). A written summary of the outcome of the study will be made available to interested participants following the end of the thesis.

**Ethics and rights of the respondents**

While presently studying part time for my PhD, I currently am an employee of the Central Bank of Bahrain (where I am a Head in the Capital Markets Supervision Directorate).

I wish to stress to you that any information you give to me will be purely used for the purpose of research related to my PhD thesis. It will not under any circumstances be shared with or used by the Central Bank of Bahrain.

I also wish to stress to you that any information you give me will be kept strictly confidential at all times. Furthermore, the information provided will be used anonymously in my thesis and I will not use your name or any other details that would result in your identity being known.

The interviewee has the right not to answer any question for any reason.

The project has been given advisory approval by the Durham University Business School Sub-Committee for Ethics.

Thank you in advance for your co-operation, and you answering all questions is extremely important and highly appreciated.

For Researcher Use Only: \_\_\_\_\_

Case Identification No.: \_\_\_\_\_

Date: \_\_\_/\_\_\_/201....

**Shari'ah Scholars Interview Questions- English Version:**

**Questions to be addressed to Shari'ah Scholars on Shari'ah Supervisory Board (SSB) of Islamic Private Equity/private placement, including real estate investments (IPE)**

**A. Shari'ah Scholar Profile:**

1. Are you a member of Shari'ah Supervisory Board (SSB)?
2. Where are you located?
3. On how many SSB are you a member?
4. On average how many members are on the SSB that you are a member of?
5. Are you (as member of SSB):

<b>A member of SSB and</b>	<b>Yes</b>	<b>No</b>
On the board of directors of the institution		
On one of the institution's board committees		
A Client of the institution		
A Shareholder of the institution		

**B. Terms of Reference (TOR) and Responsibilities:**

1. Does the agreement of appointment that you sign, clearly state the TOR regarding your mandates and responsibilities?
2. What are your mandates and responsibilities?
3. Are there well-defined operating procedures and a clear line of reporting?
4. Who do you (as SSB) usually report to?
5. Are there clear set process, rules and by-laws related to the following?

<b>Rules &amp; By-Laws on</b>	<b>Yes</b>	<b>No</b>
Conduct of meeting		
Decision making process and recording		
Review process for on-going products/investments once offered to investors		
Reports made and their submission		

5. In your association with IFI as a member of SSB, how do you try and maintain your independence?
6. How do you as a member of the SSB operate with regards to meeting your duties and responsibilities (or TOR)?

**C. Function of SSB:**

1. What information are you provided with in order to perform your duties and responsibilities?

<b>Provided with</b>	<b>Yes</b>	<b>No</b>
Disclosure documents		
Financial statements		
Product/investment information		
Risk assessment report		
Internal <i>Shari'ah</i> audit report		
<i>Shari'ah</i> compliance report		
Legal & Regulatory documents		
Other: <i>Specify</i>		

2. Do you request additional information when performing your duties? Examples?

3. Does the SSB review the following:

<b>Review</b>	<b>Yes</b>	<b>No</b>
New Products/Transactions		
Developed Products/Transaction once launched		
Contracts/Agreements		
Memorandum and articles of association		
Policies and procedures		
On Balance Sheet & Off Balance Sheet transactions		
Internal <i>Shari'ah</i> audit report		
<i>Shari'ah</i> compliance report		

4. When a SSB performs a Review what does it involve?

5. Have there been any restrictions by the IFI on the SSB review?

6. As SSB what reports do you produce? And whom are they submitted to?

7. As SSB what reports are provided to you? And by whom from within the institution?

8. Does the SSB perform its own review on *Shari'ah* compliance of IFI or it relies on the auditor's review?



#### **D. *Shari'ah* Compliance:**

1. What do you consider as *shari'ah* risk for IPE? (*Please select, more than one can be selected*)

- Abiding by principles of *Shari'ah*
- Transaction have to be real and be certain and not based on uncertainty or speculation
- Prohibition in dealing in items, which are *Haram* and the requirement to deal only in *Halal* items
- Prohibition of *Riba* and *gharar*
- Requirement for fair and transparent dealings to ensure all partners are aware of their rights and obligations
- Abiding by *shari'ah* principles of clarity, and disclosing information, so as not to be manipulating.
- No unjust enrichment, equity and fairness to all parties
- The goal of the Islamic Financial Institution is not limited to the maximization of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community

2. Are you (SSB) informed of any *Shari'ah* compliance risk matters?

3. What is your (SSB) role when the management of IFI encounters hindrance from *shari'ah* principles during the implementation of the investment?

4. Have you (SSB) encountered any *Shari'ah* compliance issues in the last year or so?

5. If yes to D.4.: Have they been documented/reported?

6. If yes to D.4.: Have they been made available to shareholders, investors and local authorities?

**Shari'ah Scholars Consent Form- English Version:**

**CONSENT FORM**

**THE RELATIONSHIP BETWEEN THE INVESTOR AND THE ISLAMIC FINANCIAL INSTITUTION IN THE GULF COOPERATION COUNCIL COUNTRIES INVESTING IN PRIVATE EQUITY**

Muna AlMannai, PhD candidate, Durham University Business School

- |   | <i>Please tick</i>       |                          |
|---|--------------------------|--------------------------|
|   | <b>Yes</b>               | <b>No</b>                |
| 17. I confirm that I have read and understood the information provided in the Information Sheet on the above study.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 18. I have had the opportunity to ask questions, and I have received satisfactory answers to all my questions.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 19. I understand that my participation is voluntary and I am free to withdraw at any time or not to answer any question without the need to justify my position, and without prejudice. | <input type="checkbox"/> | <input type="checkbox"/> |
| 20. I understand that my name (and the name of my company, where applicable) will not be published, but what will be published will be the analyzed results in anonymous form.          | <input type="checkbox"/> | <input type="checkbox"/> |
| 21. I agree to take part in the study.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 22. I agree to the interview being audi recorded.   | <input type="checkbox"/> | <input type="checkbox"/> |
| 23. I understand that interview tapes and transcripts will be anonymised and will be held in strict confidence and in accordance with the Data Protection Act (1998).                   | <input type="checkbox"/> | <input type="checkbox"/> |
| 24. I agree to the use of anonymised quotes in publications.  | <input type="checkbox"/> | <input type="checkbox"/> |

Name of interviewee/person making consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Name of Research/person taking consent: *(BLOCK CAPITALS)*

\_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

## Appendix 4: Participating Islamic Financial Institution's and *Shari'ah* Scholar's Profile

### Islamic Financial Institution's Profile

Islamic Financial Institution (IFI)	Location	Type	Capital
IFI-01	Qatar	Private Equity Firm	US\$1m-100m
IFI-02	Kuwait	Investment Firm	US\$101-500m
IFI-03	Kuwait	Investment Firm	US\$101-500m
IFI-04	Kuwait	Investment Firm	US\$1m-100m
IFI-05	UAE	Investment Bank	US\$1m-100m
IFI-06	Bahrain	Investment Bank	US\$101-500m
IFI-07	UAE	Private Equity Firm	US\$501-1bn
IFI-08	Bahrain	Investment Bank	US\$101-500m
IFI-09	Oman	Investment Bank	US\$1m-100m
IFI-10	Bahrain	Investment Bank	US\$501-1bn
IFI-11	Bahrain	Investment Bank	US\$101-500m
IFI-12	Saudi Arabia	Investment Firm	US\$1m-100m
IFI-13	Saudi Arabia	Investment Firm	US\$101-500m
IFI-14	Saudi Arabia	Investment Firm	US\$101-500m
IFI-15	Bahrain	Investment Bank	US\$101-500m

### *Shari'ah* Scholar's Profile

<i>Shari'ah</i> Scholar (ShSc)	Location	Number of <i>Shari'ah</i> Supervisory Board (SSB)	Academia/ Independent
ShSc-01	Bahrain	10+	Independent
ShSc-02	Kuwait	5-10	Academia
ShSc-03	Kuwait	5-10 *	Independent
ShSc-04	Kuwait	5-10 *	Academia
ShSc-05	Kuwait	5-10 Banks***	Academia
ShSc-06	UAE	Less than 5 Banks***	Academia
ShSc-07	Bahrain	5 Locally	Independent
ShSc-08	Bahrain	5	Independent
ShSc-09	Bahrain	5-10	Independent
ShSc-10	Saudi Arabia	10+	Academia
ShSc-11	Qatar	5-10	Independent
ShSc-12	Kuwait	10 +	Independent
ShSc-13	Qatar	5-10	Independent

\*On SSB of the main IFI and its overseas branches and companies the IFI owns 100%.

\*\*\*Reference is to being a member on SSBs of IFIs, they could also be members of SSBs in other sectors.

## BIBLIOGRAPHY

AAOIFI. (2012). *Shari'a Standards* (1st ed.). Manama, Bahrain: Accounting and Auditing Organisation For Islamic Financial Institutions.

AAOIFI. (2008). *Shari'a Standards: For Islamic Financial Institutions*. Manama: Accounting and Auditing Organisation For Islamic Financial Institutions.

AAOIFI. (2015). *Shari'a Standards: For Islamic Financial Institutions*. Manama, Bahrain: Accounting and Auditing Organisation For Islamic Financial Institutions.

AAOIFI. (n.d.). *Governance Standard No. 8 Central Shari'ah Board-Exposure Draft (ver.7.0)*.

Abdlkhail, M., & Presley, J. R. (2002). How Informal Risk Capital Investors Manage Asymmetric Information in Profit/Loss-Sharing Contracts. In M. Iqbal & D. T. Llewellyn (Eds.), *Islamic Banking and Finance: New Perspectives on Profit-Sharing and Risk* (pp. 111–134). Cheltenham: Edward Elgar Publishing Limited.

Abdul Mannan, M. (2002). Comments on The Interface Between Islamic and Conventional Banking by Rodney Wilson. In M. Iqbal & D. T. Llewellyn (Eds.), *Islamic Banking and Finance: New Perspectives on Profit-Sharing and Risk* (pp. 213–215). Cheltenham.

Abdull Mutalip, A. L. (2011). Islamic Private Equity and Venture Capital. *Islamic Finance News*, (March), 19–20.

Abdull Mutalip, A. L. (n.d.). Islamic Venture Capital and Private Equity: Legal Issues and Challenges. *AZMI and Associates Advocates and Solicitors*. Malaysia.

Abdulla, D. (2007). Transparency and Market Discipline: Basel Pillar 3. In *Islamic Finance: The Regulatory Challenge* (pp. 366–378). Singapore: John Wiley & Sons (Asia) Pte Ltd.

Abuznaid, S. (2006). Islam and Management: What Can Be Learned? *Thunderbird International Business Review*, 48(1), 125–139. <http://doi.org/10.1002/tie>

Adawiah, E. R. (2012). Legal Framework and Governance For Islamic Financial Services. Retrieved from [http://irep.iiium.edu.my/27143/1/LEGAL\\_FRAMEWORK\\_%26\\_GOVERNANCE\\_FOR\\_ISLAMIC\\_FINANCIAL\\_SERVICES\\_-\\_DR\\_ENGKU.pdf](http://irep.iiium.edu.my/27143/1/LEGAL_FRAMEWORK_%26_GOVERNANCE_FOR_ISLAMIC_FINANCIAL_SERVICES_-_DR_ENGKU.pdf)

Aggarwal, R. K., & Yousef, T. (2000). Islamic Banks and Investment Financing. *Journal of Money, Credit and Banking*, 32(1), 93–120. <http://doi.org/10.2307/2601094>

Aghion, P., & Bolton, P. (1992). Incomplete Approach to Contracts Financial Contracting. *The Review of Economic Studies*, 59(3), 473–494.

Aghion, P., & Hermalin, B. (1990). Legal Restrictions on Private Contracts Can Enhance Efficiency. *Journal of Law, Economics & Organization*, 6(2), 381–409.

Aghion, P., & Tirole, J. (1997). Formal and Real Authority in Organizations. *Journal of Political Economy*, 105(1), 1–29.

Ahmed, H. (2011a). Islamic Law and Finance: Concepts and Principles. In *Product Development in Islamic Banks* (pp. 17–52). Edinburgh: Edinburgh University Press Ltd.

Ahmed, H. (2004). An Islamic Framework of the Venture Capital Cycle. In *International Seminar on "Non-Bank Financial Institutions: Islamic Alternatives"* (pp. 1–23). Kuala Lumpur.

- Ahmed, H. (2003). The Role of Islamic Financial Institutions in Financing Microenterprises: Theory and Practice. *Forum on Islamic Economics and Finance Held in Amman Jordan during September, 27–29*.
- Ahmed, H. (2012). Islamic Law, Investors' Rights and Corporate Finance. *Journal of Corporate Law Studies*, 12(2), 367–392.
- Ahmed, H. (2005). Operational Structure For Islamic Equity Finance: Lessons From Venture Capital. *Islamic Research and Training Institute*, 1–42.
- Ahmed, H. (2011b). Maqasid Al-Shari'ah and Islamic Financial Products: A Framework For Assessment. *ISRA International Journal of Islamic Finance*, 3(1), 149–160.
- Ahmed, H. (2006). Islamic Law, Adaptability and Financial Development. *Islamic Economics Studies*, 13(2), 79–101.
- Al-Bassam, W. M., Ntim, C. G., Opong, K. K., & Downs, Y. (2015). Corporate Boards and Ownership Structure as Antecedents of Corporate Governance Disclosure in Saudi Arabian Publicly Listed Corporations. *Business & Society*. <http://doi.org/10.1177/0007650315610611>
- Al-Dhareer, S. (1997). *Al-Gharar: In Contracts and Its Effect on Contemporary Transactions* (No. 16). Jeddah: Islamic Research and Training Institute (IRTI).
- Al-Najjar, N. I. (1995). Incomplete Contracts and the Governance of Complex Contractual Relationships. *The American Economic Review*, 85(2), 432–436.
- Al-Saati, A.-R. (2003). The Permissible Gharar (Risk) in Classical Islamic Jurisprudence. *Islamic Economics*, 16(2), 3–19.
- Al-Sabuni, A. (1972). *Muhadarat fi Al-Shari'ah Al-Islamiya*.
- Al-Shatibi, A. I. (2007). *Al-Muwafaqate fe 'Asool Al-Shari'ah*. Beirut: Al-Maktaba Al-Assrya.
- Al-Zarqa, M. A. (2009). Monopoly and Monopolistic Markets. In *Encyclopedia of Islamic Economics*, 97–105.
- Albassam, W. M. (2014). *Corporate Governance, Voluntary Disclosure and Financial Performance: An Empirical Analysis of Saudi Listed Firms Using A Mixed-Methods Research Design*.
- Albrecht, C. (n.d.). Contingency Tables and the Chi Square Statistic - Interpreting Computer Printouts and Constructing Tables. Utah State University.
- AlGhazali, A. (2007). *Muqadimah Al-Shari'ah Al-Islamiya: Dirasah fi Alfiqh Al-Islami wa Abraz Qawa'ad wa Nathriatth Alkubra*. Cairo: Dar AlNahda AlArabiah.
- AlHassni, I. (2005). *Nazariyat Al-Maqasid 'inda Al Imam Muhammed AlTa'her Ibn A'shur*. Virginia: The International Institute of Islamic Thought.
- Ali, M. (Ed.). (1995). *Encyclopaedia of Islamic Banking and Insurance*. London: Institute of Islamic Banking and Insurance.
- Ali, S. A. (Ed.). (2008). *Islamic Capital Markets: Products, Regulation & Development*. Islamic Development Bank, Islamic Research and Training Institute.
- Alim, E. A. (2014). *Global Leaders in Islamic Finance: Industry Milestones and Reflections*. Singapore: Wiley & Sons Singapore Pte. Ltd.

- Aljifri, K., Khandelwal, S. K., Kluwer, W., & Services, F. (2013). Financial Contracts in Conventional and Islamic Financial Institutions: An Agency Theory Perspective. *Review of Business and Financial Studies*, 4(2), 79–88.
- AlSa'aed, A. (n.d.). R'ayat Almaslaha wa Dawr Almafsada. *Adwa'a Al-Shari'ah*, (10).
- AlShaibi, N. (2012). The New QFMA Regulations Impact on Securities Markets in Qatar. In *the Euromoney Qatar Conference*. Qatar Financial Markets Authority, Qatar.
- AlTamimi. (2014). UAE New Companies Law: A Comparative View. *Al Tamimi & Co.*
- AlTamimi & Co. (2014). Qatar Financial Centre Special Company Regulations: Getting Better All the Time. *AlTamimi & Co.*
- Andenas, M., & Chiu, I. H.-Y. (2014). *The Foundations and Future of Financial Regulation: Governance For Responsibility*. Oxon: Routledge-Taylor & Francis Group.
- Anson, M. J. P. (2004). Trends in Private Equity. *The Journal of Wealth Management*, 7(3), 84–91. <http://doi.org/10.3905/jwm.2004.450963>
- Archer, S., & Abdul Karim, R. A. (Eds.). (2007). *Islamic Finance: The Regulatory Challenge*. Singapore: John Wiley & Sons (Asia) Pte Ltd.
- Arrow, K. J. (1974). *The Limits of Organization. The Fels lectures on public policy analysis* (Vol. 1). Norton.
- Arshad, N. C., & Ismail, A. G. (2010). Shariah parameters For Musharakah Contract: A Comment. *International Journal of Business and Social Science*, 1(1), 145–162.
- Arshad, N. C., & Ismail, A. G. (2011). Regulation on the Paramaterized of Mudharabah Contract: A Critical Analysis. *International Journal of Economics and Research*, 2(3), 157–189. Retrieved from <http://www.ijeronline.com>
- Arya, A., Glover, J. C., & Sivaramakrishnan, K. (1997). The Interaction between Decision and Control Problems and the Value of Information. *The Accounting Review*, 72(4), 561–574. Retrieved from <http://www.jstor.org/stable/248175>
- Asad, Z. (2008). Islamic Economics: A Survey of the Literature. *University of Birmingham: Religions & Development Research Programme, Working Pap* (22).
- Ashur, M. A.-T. (2006). *Ibn Ashur: Treatise on Maqasid al-Shari'ah*. Washington, D.C.: The International Institute of Islamic Thought.
- Askari, H., & Vi, A. (2005). The Principle Foundations of an Islamic Economy. *BNL Quarterly Review*, 59(235), 187–205.
- Askari, H., Iqbal, Z., Krichene, N., & Mirakhor, A. (2013). Understanding Islam: Development, Economics and Fiance. *Munich Personal RePEc Archive*, (56016). Retrieved from <http://mpa.ub.uni-muenchen.de/56016>.
- Aspers, P. (2004). Empirical Phenomenology: An Approach For Qualitative Research. *London School of Economics and Political Science Methodology Institute*, (9), 1–15.
- Asutay, M. (2011). *PhD Research Support Workshop Programme-Research Methodology*. Durham: The University of Durham.
- Asutay, M. (2011). *PhD Research Support Workshop Programme-Research Method*. Durham: The University of Durham.

Asutay, M. (n.d.). Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Finance: Examining the Overpowering of Homoislamicus by Homoeconomicus, 1–17.

Atai, A. (2010). Overview of Islamic Financial Investments. In *Philosophical Foundation of Law and Finance* (pp. 1–10). London. Retrieved from SSRN 1671584.

Atia, J. A. M. (2011). *Nahwa Tafa'el Maqasid Al-Shari'ah*. Virginia: The International Institute of Islamic Thought.

Atkinson, R., & Flint, J. (2001). Social Research Update. *Sociology at Surrey - University of Surrey*, (33).

Atkinson, R., & Flint, J. (2001). Social Research Update. *Sociology at Surrey - University of Surrey, Summer* (33).

Auda, J. (2008). *Maqasid Al-Shariah as Philosophy of Islamic Law: A Systems Approach*. Virginia: The International Institute of Islamic Thought.

Avellaneda, S. D. (2006). Good Governance, Institutions and Economic Development Beyond the Conventional Wisdom. In *Forum de Recerca, Departament de Ciències Polítiques i Social, Univeritat Popeu Faba, Baecelona* (pp. 1–35). Barcelona, Spain.

Ayub, M. (2008). *Understanding Islamic Finance*. West Sussex: John Wiley & Sons, Ltd.

Azorín, J. M., & Cameron, R. (2010). The Application of Mixed Methods in Organisational Research: A Literature Review. *The Electronic Journal of Business Research Methods*, 8(2), 95–105.

Bedoui, H. E., & Mansour, W. (2015). Performance and Maqasid al-Shari'ah's Pentagon-Shaped Ethical Measurement. *Science and Engineering Ethics*, 555–576. <http://doi.org/10.1007/s11948-014-9561-9>

Bahrain Central Bank. Collective Investment Undertakings: Shari'a Compliant CIUs Module - Rulebook Volume 7 (2012). Manama: Bahrain Central Bank.

Bahrain Central Bank. Forming of the Central Shari'a Supervisory Board Resolution 3/2016 (2016). Manama: Bahrain Central Bank.

Bahrain Central Bank. Collective Investment Undertakings: Corporate Governance Module - Rulebook Volume 7 (2012). Manama: Bahrain Central Bank.

Bahrain Central Bank. Protective Cell Companies Law 22/2016, Bahrain Central Law 1–43 (2016). Manama: Bahrain Central Bank.

Bahrain Central Bank. Collective Investment Undertakings: Private Investment Undertakings Module - Rulebook Volume 7 (2012). Manama: Bahrain Central Bank.

Bahrain Central Bank. Capital Markets: Offering of Securities Module - Rulebook Volume 6 (2013). Manama: Bahrain Central Bank.

Bahrain Central Bank. Limited Investment Partnerships Law 18/2016 (2016). Manama: Central Bank of Bahrain.

Bahrain Central Bank. (2012). Consultation: Restricted Investment Accounts - Volume 2 Islamic Bank Licensees - Industry Comments. Manama: Bahrain Central Bank.

Bahrain Central Bank. The Establishment of a Centralized Shari'a Supervisory Board - Resolution 20/2015 (2015). Manama: Bahrain Central Bank.

Bahrain Central Bank. Collective Investment Undertakings: Executive summary - Rulebook Volume 7 (2012). Manama: Bahrain Central Bank.

- Bahrain Central Bank. Islamic Banks: Licensing Requirements Module - Rulebook Volume 2 (2006). Manama: Bahrain Central Bank.
- Bahrain Ministry of Industry and Commerce. The Commercial Companies Law Decree 21/2001 (2001). Manama: Ministry of Industry and Commerce.
- Bahrain Ministry of Industry and Commerce. Corporate Governance Code (2010). Manama: Ministry of Industry and Commerce.
- Baker, G., Gibbons, R., & Murphy, K. J. (1999). Informal Authority in Organizations. *Journal of Law, Economics, & Organization*, 15(1).
- Baker, M. D. (2006). Islamic Private Equity Derivatives Structured Products and Investments. Amanie Business Solutions.
- Balala, M.-H. (2012). *Islamic Finance and Law: Theory and Practice in a Globalized World*. Islamic Finance and Law: Theory and Practice in a Globalized World. USA: International Library of Economics.
- Baldwin, R., Cave, M., & Martin, L. (2013). *Understanding Regulations: Theory, Strategy, and Practice* (2nd ed.). Oxford: Oxford University Press.
- Band, D. (1992). Corporate Governance: Why Agency Theory is Not Enough. *European Management Journal*, 10(4), 453–459. [http://doi.org/10.1016/0263-2373\(92\)90011-R](http://doi.org/10.1016/0263-2373(92)90011-R)
- Barua, S. K., Varma, J. R., & Venkiteswarn, N. (1991). Regulatory Framework for Mutual Funds. *Economic and Political Weekly*, 26(21), 55–59.
- Baza, A. (2008). *Masaleh AlInsan: Muqarabah Maqasidiah*. Virginia: The International Institute of Islamic Thought.
- Bebchuk, L., & Neeman, Z. (2008). Investor Protection and Interest Group Politics. *Review of Financial Studies* (discussion paper No. 603), 1–43. Retrieved from <http://ssrn.com/abstract=1030355>
- Beccerra, M., & Gupta, A. K. (1999). Trust Within the Organization: Integrating the Trust Literature with Agency Theory and Transaction Costs Economics. *Public Administration Quarterly*, 23(2), 177–203.
- Berg, S. (2000). Developments in Best-Practice Regulation: Principles, Processes, and Performance. *Elsevier Science Inc.*, 6190(July), 11–18.
- Berglof, E. (1994). A Control Theory of Venture Capital Finance. *Oxford Journals*, 10(2), 247–267. Retrieved from <http://www.jstor.org/stable/764967>
- Bester, H. (2008). Externalities, Communication and the Allocation of Decision Rights. *Economic Theory*, 41(2), 269–296. <http://doi.org/10.1007/s00199-008-0395-z>
- Beuselinck, C., Deloof, M., & Manigart, S. (2008). Private Equity Investments and Disclosure Policy. *European Accounting Review*, 17(4), 607–639. <http://doi.org/10.1080/09638180802327057>
- Beuselinck, C., & Manigart, S. (2007). Financial Reporting Quality in Private Equity Backed Companies: The Impact of Ownership Concentration. *Small Business Economics*, 29(3), 261–274. <http://doi.org/10.1007/sl>
- Bhaskar, V., & Van Damme, E. (2002). Moral Hazard and Private Monitoring. *Journal of Economic Theory*, 102(1), 16–39. Retrieved from <http://discovery.ucl.ac.uk/12736/>
- Bigley, G. A., & Pearce, J. L. (1998). Straining For Shared Meaning in Organization Science: Problems of Trust and Distrust. *Academy of Management*, 23(3), 405–421.



- Billah, M. M. (2006). *Shar'iah Standards of Business Contracts*. Kuala Lumpur: A.S. Noordeen.
- BIS. (2010). *Microfinance Activities and the Core Principles For Effective Banking Supervision*. Bank of International Settlement - Basel Committee on Banking Supervision.
- Black, B. S., & Gilson, R. J. (1998). Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets. *Journal of Financial Economics*, 47, 243–277.
- Black, J. (2002). Critical Reflections on Regulation. *Australian Journal of Legal Philosophy*, 27, 1–36.
- Bloomberg, L. D., & Volpe, M. (2016). *Completing Your Qualitative Dissertation: A Road Map From Beginning to End* (3rd ed.). California: SAGE Publications.
- Blundell-Wignall, A., Atkinson, P., & Lee, S. H. (2008). The Current Financial Crisis: Causes and Policy Issues. *Financial Market Trends-OECD*.
- Bolton, P., & Dewatripont, M. (2010). *Contract Theory* (7th ed.). Massachusetts: Massachusetts Institute of Technology Press.
- Bose, S., & Mcgee, R. W. (2008). *Islamic Investment Funds: An Analysis of Risk and Returns*. Florida.
- Bottazzi, L., Rin, M. Da., & Hellmann, T. (2008). What is The Role of Legal Systems in Financial Intermediation? Theory and Evidence. *Social Science Research Network*.
- Boycko, M., Shleifer, A., & Vishny, R. W. (1996). A Theory of Privatization. *The Economic Journal*, 106 (March), 309–319.
- Bradford, T., & Smith, R. C. (1997). Private Equity: Sources and Uses. *Journal of Applied Corporate Finance*, 10(1), 89–98.
- Bruton, G. D., Chahine, S., & Filatotchev, I. (2009). Founders, Private Equity Investors, and Underpricing in Entrepreneurial IPOs. *Entrepreneurship: Theory and Practice*, 33(4), 909–928. <http://doi.org/10.1111/j.1540-6520.2009.00309.x>
- Bryman, A. (2012). *Social Research Methods* (4th ed.). Oxford: Oxford University Press.
- Butterworth, R. (2001). *Hoshin Kanri: An Exploratory Study at Nissan Yamato Engineering Ltd*. University of Durham.
- BVCA. (2008). *The Impact of Private Equity as a UK Financial Service*. London: British Private Equity & Venture Capital Association.
- BVCA. (2010). *A Guide to Private Equity*. London: British Private Equity & Venture Capital Association.
- Caldwell, C., Karri, R., & Vollmar, P. (2006). Principal Theory and Principle Theory: Ethical Governance from the Follower's Perspective. *Journal of Business Ethics*, 66(2), 207–223. <http://doi.org/10.1007/s10551-005-5586-y>
- Carpenter, D., & Moss, D. A. (2013). *Preventing Regulatory Capture: Special Interest and Influence and How to Limit It*. (D. Carpenter & D. A. Moss, Eds.) Cambridge University Press.
- Caselli, S., Garcia-Appendini, E., & Ippolito, F. (2012). Contracts and Returns in Private Equity Investments. *Journal of Financial Intermediation*, (March 2010), 1–35. <http://doi.org/10.1016/j.jfi.2012.08.002>
- Cendrowski, H., Martin, J. P., Petro, L. W., & Wadecki, A. A. (2008). *Private Equity: History, Governance and Operations*. New Jersey: John Wiley & Sons, Inc.

- Cestone, G. (2001). Venture Capital Meets Contract Theory: Risky Claims or Formal Control? *Centre For Economic Policy Research, CEPR Discu* (3462), 1–31.
- Chang, C. J., & Yen, S. (2007). The Effects of Moral Development and Adverse Selection Conditions on Managers' Project Continuance Decisions: A Study in the Pacific-Rim Region. *Journal of Business Ethics*, 76(3), 347–360. <http://doi.org/10.1007/s10551-006-9286-z>
- Chapra, M. (2007). Ethics and Economics in Islam and the West. *Islamika*, (December), 1–32. Retrieved from <http://scholar.google.com/scholar?hl=en&btnG=Search&q=intitle:ETHICS+AND+ECONOMICS+IN+ISLAM#2>
- Chapra, M. U. (2008). *The Islamic Vision of Development in the Light of the Maqāsid Al-Shari'ah*. Jeddah: IDB Islamic Research and Training Institute.
- Chapra, M. U. (1995). *Islam and the Economic Challenge*. Leicester: Islamic Foundation.
- Chapra, M. U. (2000). Is it Necessary to Have Islamic Economics? *The Journal of Socio-Economics*, 29(1), 21–37. [http://doi.org/10.1016/S1053-5357\(00\)00051-2](http://doi.org/10.1016/S1053-5357(00)00051-2)
- Chapra, M. U., & Ahmed, H. (2002). Corporate Governance in Islamic Financial Institutions. *Occasional Paper No. 6, Jeddah, September*. <http://doi.org/10.1787/9789264189300-en>
- Chapra, M. U. (1996). *What is Islamic Economics? IDB Prize Winners' Lecture Series No.9* (1st ed.). Jeddah: Islamic Research and Training Institute Islamic Development Bank, Jeddah, Saudi Arabia.
- Chapra, M. U. (n.d.). What is Islamic Economics?
- Chapra, M. U. (2004). Islamic Economics: What It Is and How It Developed. *EH.Net Encyclopaedia*, 1–21. Retrieved from <http://eh.net/encyclopedia/article/chapra.islamicistry> &
- Chapra, M. U. (2009). The Nature and Significance of Islamic Economics.
- Chartered Accountants of Canada. (2010). *Environmental, Social and Governance (ESG) Issues in Institutional Investor Decision Making*. The Canadian Institute of Chartered Accountants. Toronto: The Canadian Institute of Chartered Accountants.
- Chatti, M. A., & Yousfi, O. (2011). Islamic Private Equity. In CPI-Financial (Ed.), *Opportunities in Islamic Finance Unconventional Answers to The Credit Crisis*.
- Chatti, M. A., & Yousfi, O. (2013). Conventional Versus Islamic Private Equity. *The World Financial Review*.
- Chatti, M. A., & Yousfi, O. (2010). Islamic Private Equity. *Munich Personal RePEc Archive*, (28705), 1–17.
- Chemmanur, T. J., & Chen, Z. (2001). Angels, Venture Capitalists, and Entrepreneurs: A Dynamic Model of Private Equity Financing. *Boston College Unpublished Manuscript*, 1–54. Retrieved from <http://www.kier.kyoto-u.ac.jp/~osano/chemmanur.pdf>
- Chen, W.-P., Chung, H., Lee, C., & Liao, W.-L. (2007). Corporate Governance and Equity Liquidity: An Analysis of S&P Transparency and Disclosure Ranking. *Corporate Governance - An International Review*, 15(4), 644–660.
- Chung, T.-Y. (1991). Incomplete Contracts, Specific Investments, and Risk Sharing. *The Review of Economic Studies*, 58(5), 1031–1042.
- Cinotti, B. F. M. (1933). U.S. Private Equity Funds: Selected Regulatory and Tax Issues. *Alt Assets*.

- Cizakca, M. (2014). IFSB Summit, Knowledge Sharing Partner Session: “New Markets and Frontiers For Islamic Finance: Innovation and the Regulatory Perimeter”, to be convened on May 20. Retrieved from <https://inceif.academia.edu/MuratCizakca>
- Cizakca, M. (2016). Risk Sharing and Risk Shifting. *Islamic Banker*, (April). Retrieved from <http://www.islamicbanker.com/ib/murat-cizakca/419>
- Clark, I. (2009). Owners and Managers: Disconnecting Managerial Capitalism? Understanding the Private-Equity Business Model. *Work, Employment & Society*, 23(4), 775–786. <http://doi.org/10.1177/0950017009344920>
- Clark, T., & Foster, L. (n.d.). *Chi-Square: Introducing the “Goodness of Fit” Test and the “Test of Association.”* University of Sheffield - Department of Sociological Studies.
- Clegg, S. (1981). Organization and Control. *Administrative Science Quarterly*, 26(4), 545–562. Retrieved from <http://www.jstor.org/stable/2392339>
- Coffee, J. C. (2000). Convergence and Its Critics: What are the Preconditions to the Separation of Ownership and Control? *The Center For Law and Economic Studies - Columbia Law School*, (179), 1–57. Retrieved from [http://papers.ssrn.com/paper.taf?abstract\\_id=241782](http://papers.ssrn.com/paper.taf?abstract_id=241782)
- Coffee, J. C. (1999). *The Future as History: The Prospects For Global Convergence in Corporate Governance and its Implications* (No. 144). *The Centre For Law and Economic Studies - Columbia Law School* (Vol. 7201). New York.
- Conglomerates, J. F. on F. (1999). Document jointly released by: Basel Committee on Banking Supervision, the International Organisation of Securities Commission and the International Association of Insurance Supervisors. In *Supervision of Financial Conglomerates*.
- Conklin, T. A. (1969). *Method or Madness: Transcendental Phenomenology as Knowledge Creator*.
- Cortina, J. M. (1993). What is Coefficient Alpha? An Examination of Theory and Applications. *Journal of Applied Psychology*, 78(1), 98–104. <http://doi.org/10.1037/0021-9010.78.1.98>
- Crawford, I. M. (1997). Level of Measurements and Scaling. In *Marketing Research and Information Systems* (pp. 21–31). Food and Agriculture Organization of the United Nations.
- Crémer, J. (2010). Arm’s-Length Relationships Without Moral Hazard. *Journal of the European Economic Association*, 8(April-May), 377–387.
- Crémer, J. (2010). Arm’s-Length Relationships Without Moral Hazard. *Journal of the European Economic Association*, 8(April-May), 377–387.
- Creswell, J. W., & Clark, V. L. P. (n.d.). *Principles of Qualitative Research : Designing a Qualitative Study*. Lincoln: Office of Qualitative & Mixed Methods Research, University of Nebraska.
- Creswell, J. W. (2007). *Qualitative Inquiry and Research Design: Choosing Among Five Approaches* (2nd ed.). California: SAGE Publications Inc.
- Creswell, J. W., & Clark, V. L. P. (2006). Understanding Mixed Methods Research. In *Designing and Conducting Mixed Methods Research* (pp. 1–19). California: SAGE Publications Inc.
- Cronqvist, H., & Nilsson, M. (2004). The Choice Between Rights Offerings and Private Equity Placements. *Journal of Financial Economics*, 78(2), 375–407. Retrieved from <http://www.sciencedirect.com/science/article/pii/S0304405X05000796>

- Cull, R., Demirgüç-kunt, A., & Morduch, J. (2009). Does Regulatory Supervision Curtail Microfinance Profitability and Outreach? *The World Bank, Policy Research Working Paper 4748*, (June), 1–41.
- Cumming, D., & Johan, S. (2005). *Is it the Law or the Lawyers? Investment Fund Covenants Across Countries-Discussion Paper*. Tilburg University.
- Cumming, D. J., & MacIntosh, J. G. (2006). Crowding Out Private Equity: Canadian Evidence. *Journal of Business Venturing*, 21(5), 569–609. <http://doi.org/10.1016/j.jbusvent.2005.06.002>
- Cumming, D., & Johan, S. (2007). Regulatory Harmonization and the Development of Private Equity Markets. *Journal of Banking & Finance*, 31(10), 3218–3250. <http://doi.org/10.1016/j.jbankfin.2007.01.010>.
- Cumming, D. J., & Johan, S. A. (2009). *Venture Capital and Private Equity Contracting: An International Perspective*. London: Academic Press.
- Cumming, D. (Ed.). (2010). *Private Equity: Fund Types, Risk and Returns, and Regulations*. New Jersey: John Wiley & Sons, Inc.
- Cumming, D., & Walz, U. (2010). Private Equity Returns and Disclosure Around the World. *Journal of International Business Studies*, 41(4), 727–754.
- Cumming, D., & Zambelli, S. (2013). Private Equity Performance Under Extreme Regulation. *Journal of Banking and Finance*, 37(5), 1508–1523. <http://doi.org/10.1016/j.jbankfin.2012.04.002>
- D & P LLP. (2009). *Regulation of EU Private Equity and Hedge Fund Managers Ahead-But Not Any Time Soon*. Debevoise & Plimpton LLP.
- Das, T. K., & Teng, B.-S. (1998). Between Trust and Control: Developing Confidence in Partner Cooperation in Alliances. *Academy of Management*, 23(3), 491–512.
- Dassler, T. (2006). Combining Theories of Regulation: Proposing a Framework For Analysing Regulatory Systems Worldwide. *Utilities Policy*, 14(1), 31–43. <http://doi.org/10.1016/j.jup.2004.12.001>
- Davidoff, S. M. (2009). The Failure of Private Equity. *Southern California Law Review*, 481–546. Retrieved from <http://ssrn.com/abstract=1148178>
- Davis, G. F. (1991). Agents Without Principles? The Spread of the Poison Pill through the Network Intercompany. *Administrative Science Quarterly*, 36(4), 583–613.
- Dawson, C. (2013). *Introduction to Research Methods: A Practical Guide For Anyone Undertaking a Research Project* (4th ed.). Oxford: How To Books Ltd.
- de Hoyos, M., & Barnes, S.-A. (2008). Analysing Interview Data. *Warwick Institute For Employment Research*. <http://doi.org/10.1046/j.1365-2648.1995.22050993.x>
- de Larosière, J., Balcerowicz, L., Issuing, O., Masera, R., Nyberg, L., Perez, J., & Ruding, O. (2009). *The de Larosière Group Report*. Brussels.
- Deloitte Touche. (2010). *Islamic Finance at Deloitte: No Interest But Plenty of Attention*. Luxembourg.
- Demsetz, H. (1983). The Structure of Ownership and the Theory of the Firm. *Journal of Law & Economics*, XXVI, 375–390.
- Ding, B., & Wermers, R. (2009). *Mutual Fund Performance and Governance Structure: The Role of Portfolio Managers and Boards of Directors*. UCONN-School of Business.

- Doney, P. M., Cannon, J. P., & Mullen, M. R. (1998). Understanding the Influence of National Culture on the Development of Trust. *Academy of Management*, 23(3), 601–620.
- Dunn, O. J. (1964). Multiple Comparisons Using Rank Sums. *American Statistical Association*, 6(3), 241–252.
- Durrani, M., & Boocock, G. (2006). Business Ethics and Venture Capital in Islam. In *Venture Capital Islamic Finance and SMEs* (2010th ed., pp. 148–195). Hampshire: Palgrave Macmillan.
- Dusuki, A. W. (2006). Stakeholders' Expectation Towards Corporate Social. In *International Accounting Conference III (INTAC 3)* (pp. 1–26). Kuala Lumpur.
- Dusuki, A. W. D. (2008). *Islamic Finance: An Old Skeleton in a Modern Dress*. Kuala Lumpur: ISRA.
- Dybvig, P. H., Farnsworth, H. K., & Carpenter, J. N. (2010). Portfolio Performance and Agency. *The Review of Financial Studies*, 23(1), 1–23.
- Ebrahim, A. F. (n.d.). *Islamic Economic Principles*. Mayfair, Johannesburg.
- Eccles, R. G., & Williamson, O. E. (1987). The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting. *Administrative Science Quarterly*, 32(4), 602. <http://doi.org/10.2307/2392889>
- Eid, F. (2006). Private Equity Finance as a Growth Engine: What it Means For Emerging Markets. *Business Economics*, (July), 7–22.
- Eisinga, R., Grotenhuis, M. Te, & Pelzer, B. (2013). The Reliability of a Two-Item Scale: Pearson, Cronbach, or Spearman-Brown? *International Journal of Public Health*, 58(4), 637–642. <http://doi.org/10.1007/s00038-012-0416-3>
- El-Ashker, A. A. F., & Wilson, R. J. A. (2006). *Islamic Economics: A Short History*. Leiden: E. J. Brill.
- El-Gamal, M. Z. (n.d.). *Possibility of Cooperation Between Islamic Banks and Conventional Banks*. Cairo: Misr University For Science and Technology.
- El-Gamal, M. A. (n.d.). *Limits and Dangers of Shari'a Arbitrage*. Retrieved May 24, 2013, from <http://www.ruf.rice.edu/~elgamal/files/Arbitrage.pdf>
- El-Gamal, M. A. (2001). An Economic Explication of the Prohibition of Riba in Classical Islamic Jurisprudence, (May), 1–20.
- El-Hawary, D. A., Grais, W., & Iqbal, Z. (2006). Regulating Islamic Financial Institutions: The Nature of the Regulated. In *Islamic Financial Architecture: Risk Management and Financial Stability* (pp. 53–92). Saudi Arabia: Islamic Development Bank, Islamic Research and Training Institute.
- El-Hawary, D., Grais, W., & Iqbal, Z. (2007). Diversity in the Regulation of Islamic Financial Institutions. *The Quarterly Review of Economics and Finance*, 46(5), 778–800. <http://doi.org/10.1016/j.qref.2006.08.010>
- Elsiefy, E., Scholar, V., Legal, I., Program, S., Khalifa, H. Bin, Scholar, V., & Program, L. S. (2014). Fundamental Requirements for Building an Islamic Venture Capital Model. *Accounting and Finance Research*, 3(1), 55–66. <http://doi.org/10.5430/afr.v3n1p55>.
- Elzon, V. (2011). Private Equity Regulation: What's Private Equity Got to Do With it? *Review of Banking & Financial Law*, 30.

- Emirates Investment Bank. (2016). *GCC Wealth Insight*.
- EMPEA. (2015). *Private Equity in the Middle East and North Africa - Special Report*. Washington, D.C.
- ESME. (2008). *Differences Between the Definitions of “Qualified Investor” in the Prospectus Directive and “Professional Client” and “Eligible Counterparty” in MiFID - Is Alignment Needed? European Securities Markets Expert Group* (Vol. 3). European Securities Markets Expert Group.
- European Commission. (2011). *A New European Regime For Venture Capital - Consultation Document*.
- European Commission. (2007). Call For Evidence Regarding Private Placement Regimes in the EU - Summary of Stakeholders’ Responses. *Financial Services Policy and Financial Markets - European Commission*, (September), 1–13.
- European Commission. (2008). *Executive Summary to the Impact Assessment Report - Private Placement*. Brussels.
- European Union. Directive 2011/61/EU of The European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010 (2011).
- EVCA. (2005). Private Equity and Generational Change: The Contribution of Private Equity to the Succession of Family Businesses in Europe. *European Private Equity & Venture Capital Association*, (March), 1–40.
- EVCA. (2007). Guide on Private Equity and Venture Capital For Entrepreneurs. European Private Equity & Venture Capital Association.
- EVCA. (2005). Private Equity and Generational Change: the Contribution of Private Equity to the Succession of Family Businesses in Europe. *European Private Equity & Venture Capital Association*, (March), 1–40.
- EVCA. (2005). *EVCA Governing Principles* (Vol. 2003). European Private Equity & Venture Capital Association.
- EVCA. (2013). *Professional Standards For The Private Equity and Venture Capital Industry - Handbook*. European Private Equity & Venture Capital Association.
- Ewan, C., Campbell, S., Nick, G., Plahe, H., & Rashid, O. (2010). Briefing Note UAE Corporate Governance Regime. *Linklaters*, (February), 1–8.
- Fahmy, E., Yusof, E., Kashoogie, J., & Kamal, A. (2009). Islamic Finance: Debt Versus Equity Financing in the Light of Maqasid al-Shari’ah. *Munich Personal RePEc Archive*, (20722).
- Fakhro, A., Kahaleh, M., Lahoud, R., Contributor, P., Corporation, G. C., & Units, E. M. (2011). Harvesting Strategies For Private Equity Investments in the MENA Region (May).
- Fallon, M. J. O., Butterfield, K. D., & Butter, K. D. (2012). Review of The Empirical Decision-Making Literature: 1996-2003, 59(4), 375–413. <http://doi.org/10.1007/s10551-005-2929-7>
- Fama, E. F., & Jensen, M. C. (1983a). Agency Problems and Residual Claims. *The Journal of Law & Economics*, 26(2), 327–349.
- Fama, E. F., & Jensen, M. C. (1983b). Separation of Ownership and Control. *The Journal of Law & Economics*, 26(2), 301–325.

- Fang, H., & Moscarini, G. (2005). Moral Hazard. *Journal of Monetary Economics*, 52(4), 749–777. <http://doi.org/10.1016/j.jmoneco.2005.02.001>
- Farooq, M. O. (2007). Partnership, Equity-Financing and Islamic Finance: Whither Profit-Loss-Sharing. *Review of Islamic Economics*, 11(Special), 67–88.
- FASB. (1978). *Statement of Financial Accounting Standards No. 24*. Financial Accounting Standards Board.
- Fathnezhad, F. (2010). Kuwait: Requirements For Obtaining Approval of a Private Placement Memorandum From the Capital Markets Authority. *ALTamimi & Co.*
- Febianto, I. (2011). Shariah Compliant Model of Business Entities. *World Journal of Social Science*, (Forthcoming).
- FEE. (2004). *The FEE Study: Mandatory Rotation of Audit Firms*. Bruxelles. Retrieved from <https://www.icaew.com/~media/Files/Library/collections/ICAEWarchive/mandatory-rotation-of-audit-firms-review-of-current-requirements-research-and-publications.pdf>
- Fehr, E., Hart, O., & Zehnder, C. (2008). *Contracts as Reference Points - Experimental Evidence* (No. 3889). *SSRN Electronic Journal*. Retrieved from <http://www.ssrn.com/abstract=1356654>
- Feinberg, J. (1972). Justice, Fairness and Rationality: A Theory of Justice by John Rawls. *The Yale Journal Law Journal Company, Inc.*, 81(5), 1004–1031.
- Fenn, G. E. W. F., Iang, N. E. L., & Rowse, S. T. P. (1997). The Private Equity Market: An Overveiw. *Financial Markets, Institutions & Instruments*, 6(4), 1–106.
- Fenn, G. E. W. F., Liang, N., Prowse, S., Iang, N. E. L., & Rowse, S. T. P. (1997). The Private Equity Market: An Overview. *Financial Markets, Institutions & Instruments*, 6(4), 1–106. <http://doi.org/10.1111/1468-0416.00012>
- Fenn, G. W., & Liang, N. (1998). New Resources and New Ideas: Private Equity For Small Businesses. *Journal of Banking & Finance*, 22, 1077–1084.
- Fiordelisi, F. (2007). Shareholder Value Efficiency in European Banking. *Journal of Banking & Finance*, 31, 2151–2171. <http://doi.org/10.1016/j.jbankfin.2006.10.021>
- Folger, R., & Greenberg, J. (1985). Procedural Justice: An Interpretive Analysis of Personnel Systems. *Research in Personnel and Human Resources Management*, 3, 141–183.
- Folta, T. B., & Janney, J. J. (2004). Strategic Benefits to Firms Issuing Private Equity Placements. *Strategic Management Journal*, 25(3), 223–242. Retrieved from <http://www.jstor.org/stable/20142115>
- Frazer, M. L. (2007). John Rawls: Between Two Enlightenments. *Political Theory*, 35(6), 756–780. Retrieved from <http://www.jstor.org/stable/20452599>
- Fried, V. H., & Hisrich, R. D. (1994). Toward a Model of Venture Investment Decision Making. *Financial Management*, 23(3), 28–37. Retrieved from <http://www.jstor.org/stable/3665619>
- FSA. (2006). *Private Equity: A Discussion of Risk and Regulatory Engagement - Discussion Paper*.
- Fuchs, W. (2007). Contracting with Repeated Moral Hazard and Private Evaluations. *American Economic Review*, 97(4), 1432–1448. <http://doi.org/10.1257/000282807783286739>

- Funds@ work (2009). Shariah Scholars in the GCC – A Network Analytic Perspective, (September), 1–29.
- Gait, A., & Worthington, A. C. (2007). *A Primer on Islamic Finance: Definitions, Sources, Principles and Methods* (07/05). Australia.
- Ghoul, W. A. (2011). The Dilemma Facing Islamic Finance and Lessons Learned From The Global Financial Crisis. *Journal of Islamic Economics, Banking and Finance*, 7(1), 57–76.
- GIFR. (2011). Shari'a Governance. In *Global Islamic Finance Report* (Vol. 1, pp. 217–227).
- Gill, P., Stewart, K., Treasure, E., & Chadwick, B. (2008). Methods of Data Collection in Qualitative Research: Interviews and Focus Groups. *British Dental Journal*, 204(6), 291–5. <http://doi.org/10.1038/bdj.2008.192>
- Gilligan, J., & Wright, M. (2008). *Private Equity Demystified: An Explanatory Guide*. Corporate Finance. London.
- Ginena, K., & Hamid, A. (2015). *Foundations of Shari'ah Governance of Islamic Banks*. West Sussex: John Wiley & Sons, Ltd.
- Glaser, B. (2013). Grounded Theory Methodology. In *Introducing Qualitative Research in Psychology* (pp. 69–82). Retrieved from [www.mheducation.co.uk/openup/chapters/9780335244492.pdf%0A](http://www.mheducation.co.uk/openup/chapters/9780335244492.pdf%0A)
- Gliem, J. A., & Gliem, R. R. (2003). Calculating, Interpreting, and Reporting Cronbach's Alpha Reliability Coefficient For Likert-Type Scales. In *Midwest Research to Practice Conference in Adult, Continuing, and Community Education* (pp. 82–88). <http://doi.org/10.1109/PROC.1975.9792>
- Goddard, A. (2009). *The Walker Guidelines For Disclosure and Transparency in Private Equity: Report and Accounts Checklist For Portfolio Companies*. bvca. London.
- Metrick, A., & Yasuda, A. (2010). The Economics of Private Equity Funds. *The Society for Financial Studies*, (203), 752–775. <http://doi.org/10.1093/rfs/hhq020>.
- Gompers, P., & Lerner, J. (1999). An Analysis of Compensation in the U.S. Venture Capital Partnership. *Journal of Financial Economics*, 51, 3–44.
- Gompers, P., & Lerner, J. (1996). The Use of Covenants: An Empirical Analysis of Venture Partnership Agreements. *Journal of Law & Economics*, 39(2), 463–498.
- Gompers, P., & Xuan, Y. (2006). The Role of Venture Capitalists in the Acquisition of Private Companies. *Unpublished Working Paper*. Harvard University, 1–51. Retrieved from [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=563822](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=563822)
- Gompers, P., Kaplan, S., Mukharlyamov, V. (2015). What Do Private Equity Firms Say They Do? *Harvard Business School*. Working Paper 15-081.
- Graham, J. (2005). Smart Regulation Has Not Been Adequately Scrutinized by Scientists or the Public. *CMAJ: Canadian Medical Association Journal*, 173(12), 1469–1470.
- Grais, W., & Pellegrini, M. (2006). *Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options* (No. WPS4054). Retrieved from <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-4052>
- Granovetter, M. (1985). Economic Action and Social Structure: The Problem of Embeddedness. *American Journal of Sociology*, 91(3), 481. <http://doi.org/10.1086/228311>



- Gras, S. N. (n.d.). Internationalization of Islamic Financial Institutions: Challenges and Paths to Solution.
- Green, S. B., Lissitz, R. W., & Mulaik, S. A. (1977). Limitations of Coefficient Alpha as an Index of Test Unidimensionality. *Educational and Psychological Measurement*, 37(4), 827–838. <http://doi.org/10.1177/001316447703700403>
- Groenewald, T. (2004). A Phenomenological Research Design Illustrated. *International Journal of Qualitative Methods*, 3(1), 1–26.
- Grossman, S. J., & Hart, O. D. (1986). The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration. *Journal of Political Economy*, 94(4), 691–719. <http://doi.org/10.1086/261404>
- Guang-Ming, Z. (2011). Principal-Agent Model and Risk Analysis under Asymmetric Information Condition. In *2011 International Conference on Management Science & Engineering (18th)* (pp. 187–191). Roma.
- Guastella, A., & Menghi, A. (2017). *GCC Market Overview and Economic Outlook 2017: A Challenging Transformation Ahead to Achieve Desirable Growth*.
- Guerra-Pujol, F. E. (2011). Corporate Governance and the Risk-Regulation Game: A Game-Theoretic Analysis of Risk Regulation. *Social Science Research Network*.
- Gunningham, N. (2003). Compliance, Enforcement and Innovation. *OECD*, 1–8.
- Gunningham, N., & Sinclair, D. (1998). Designing Smart Regulation. In *Economic Aspects of Environmental Compliance Assurance, OECD Global Forum on Sustainable Development* (pp. 1–19).
- Hafeez, M. M. (2013). An Analysis of Corporate Governance in Islamic and Western Perspectives. *International Journal of Business, Economics and Law*, 2(3), 98–103.
- Hall, M. J. B., Dar, H. A., & Muljawan, D. (2000). A Capital Adequacy Framework For Islamic Banks: The Need to Reconcile Deposits' Risk Aversion with Managers' Risk Taking. In *the Fifth Harvard University Forum on Islamic Finance: Dynamics and Development* (pp. 21–42). Cambridge, Massachusetts: Center For Middle Eastern Studies, Harvard University.
- Hamza, H. (2013). Shari'a Governance in Islamic Banks: Effectiveness and Supervision Model. *International Journal of Islamic and Middle Eastern Finance and Management*, 6(3), 226–237. <http://doi.org/10.1108/IMEFM-02-2013-0021>
- Hardie, A. R., & Rabooy, M. (1991). Risk, Piety, and the Islamic Investor. *British Journal of Middle Eastern Studies*, 18(1), 52–66. Retrieved from <http://www.jstor.org/stable/195381>
- Haron, S., & Azmi, W. N. W. (2009). *Islamic Finance and Banking System: Philosophies, Principles & Practices*. Selangor: McGraw-Hill Education.
- Harris, L. (2010). A Critical Theory of Private Equity. *Delaware Journal of Corporate Law*, 35(1), 1–35. Retrieved from [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1557360](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1557360)
- Harris, M., & Raviv, A. (1979). Optimal Incentive Contracts with Imperfect Information. *Journal of Economic Theory*, 259(20), 231–259.
- Hart, O. D. (1988). Incomplete Contracts and the Theory of the Firm. *Journal of Law & Economics*, 4(1), 119–139.

- Hart, O., & Moore, J. (1999). Foundations of Incomplete Contracts. *The Review of Economic Studies*, 66(1), 115–138.
- Hart, O., & Moore, J. (1990). Property Rights and the Nature of the Firm. *Journal of Political Economy*, 98(6), 1119–1158. <http://doi.org/10.1086/261729>
- Harvard Business School of Education. (n.d.). Foundations of Qualitative Research in Education. Retrieved June 24, 2014, from [isites.harvard.edu](http://isites.harvard.edu)
- Hasan, Z. (2010). Islamic Finance: Structure-Objective Mismatch and its Consequences. *Munich Personal RePEc Archive-MPRA*, (21726), 1–23.
- Hasan, Z. (2014). In search of the perceptions of the *Shari'ah* scholars on *Shari'ah* governance system. *International Journal of Islamic and Middle Eastern Finance and Management*, 7(1), 22–36. <http://doi.org/10.1108/IMEFM-07-2012-0059>
- Hassan, M. K., Kayed, R., & Oseni, U. (2013). *Introduction to Islamic Banking and Finance: Principles and Practice*. Essex: Pearson Education Limited.
- Hawary, D. El, Grais, W., & Iqbal, Z. (2004). *Regulating Islamic Financial Institutions: The Nature of the Regulated* (Policy Research No. WPS 3227). Washington, D.C.
- Heading, D. (2008). What is Research? Durham: Durham University.
- Helms, J. E., Henze, K. T., Sass, T. L., & Mifsud, V. A. (2006). Treating Cronbach's Alpha Reliability Coefficients as Data in Counselling Research. *The Counselling Psychologist*, 34(5), 630–660. <http://doi.org/10.1177/0011000006288308>
- Hennink, M., Hutter, I., & Baily, A. (2013). *Qualitative Research Methods*. London: SAGE Publications Ltd.
- Herbert Smith Freehills Corp. (2013). MAS Publishes Amendments to the Rules Governing Collective Investment Schemes and Closed-Ended Funds in Singapore. Singapore.
- Hermalin, B. E., & Katz, M. L. (1991). Moral Hazard and Verifiability: The Effects of Renegotiation in Agency. *Econometrica*, 59(6), 1735–1753.
- Hesse-Biber, S. N., & Leavy, P. (2011). *The Practice of Qualitative Research* (2nd ed.). California: SAGE Publications Inc.
- Hesse, H., Jobst, A. A., Solé, J., & Introduction, I. (2008). Trends and Challenges in Islamic Finance. *World Economics*, 9(2), 175–194.
- Higson, C., & Stucke, R. (2012). The Performance of Private Equity.
- Hirshleifer, D., & Suh, Y. (1992). Risk, Managerial Effort, and Project Choice. *Journal of Financial Intermediation*, 345, 308–345.
- HM Treasury. (2013). Contractual Schemes For Collective Investment: Summary of Consultation Responses and Government Response. London: HM Treasury.
- Ho, V. H. (2012). *Corporate Governance as Risk Regulation in China: A Comparative View of Risk Oversight, Risk Management, and Accountability*. University of Kanas School of Law Working Paper.

- Holden, M. T., & Lynch, P. (2004). Choosing the Appropriate Methodology: Understanding Research Philosophy. *The Marketing Review*, 4(4), 397–409. <http://doi.org/10.1362/1469347042772428>
- Holmstrom, B. (1979). Moral Hazard and Observability. *The Bell Journal of Economics*, 10(1), 74–91.
- Hussain, S. (2007). *Corporate Governance: Middle Eastern Perspective*. Manama: Ministry of Information, Publication & Press Directorate.
- Hussey, J., & Collis, J. (1997). *Business Research: A Practical Guide For Undergraduate and Postgraduate Students*. Basingstoke: Macmillan Business.
- Ibn Ashoor, M. (1978). *Maqasid Al-Shari'ah Al-Islamiya*. Tunisia: Tunisia Distribution Company.
- IFSB. Guiding Principles on Corporate Governance For Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions And Islamic Mutual Funds) - IFSB-3 (2006). Kuala Lumpur.
- IFSB. Guiding Principles on Disclosure Requirements (Sukuk and Islamic Collective Investment Schemes) -IFSB 19 (2017). Kuala Lumpur.
- IFSB. Guiding Principles on Governance For Collective Investment Schemes - IFSB-6 (2009). Kuala Lumpur.
- IFSB. Disclosures to Promote Transparency and Market Discipline For Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions And Islamic Mutual Funds) - IFSB-4 (2007). Kuala Lumpur.
- IFSB. Guiding Principles on Sharia'ah Governance Systems For Institutions Offering Islamic Financial Services - IFSB 10 (2009). Kuala Lumpur.
- IFSB. Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds) - IFSB-5 (2007). Kuala Lumpur.
- IFSB. Guiding Principles on Conduct of Business For Institutions Offering Islamic Financial Services - IFSB-9 (2009). Kuala Lumpur.
- Ilpa. (2016a). *Due Diligence Questionnaire*. Canada: Ilpa Institutional Limited Partners Association.
- Ilpa. (2016b). *Institutional Limited Partners Association: Quarterly Reporting Standards Best Practices (Version 1.1)*. Ilpa Institutional Limited Partners Association. Canada: Institutional Limited Partners Association.
- Ilpa. (2011a). *Institutional Limited Partners Association: Quarterly Reporting Standards Best Practices (Version 1.0)*. Ilpa Institutional Limited Partners Association. Canada: Institutional Limited Partners Association.
- Ilpa. (2011b). Private Equity Principles. *Ilpa Institutional Limited Partners Association*, (January), 1–24.
- Inkpen, A. C., & Currall, S. C. (2004). The Coevolution of Trust, Control, and Learning in Joint Ventures. *Organization Science*, 15(5), 586–599.
- International, F. H., Mack, N., Woodson, C., & Development, U. S. A. For I. (2005). Qualitative Research Methods Overview. In *Qualitative Research Methods: A Data Collector's Field Guide* (pp. 1–12). Family Health International.

- IOSCO. (2008). *Technical Committee of the International Organization of Securities Commissions: Private Equity - Final Report*.
- IOSCO. (2004). *Report of The Islamic Capital Market Task Force of the International Organization of Securities Commissions: Fact Finding Report*.
- IOSCO. (2003). *Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation* (Vol. 138).
- IOSCO. (2009). *Private Equity Conflicts of Interest: Consultation Report*.
- Iqbal, M., Ali, S. S., & Muljawan, D. (2007). *Advances in Islamic Economics and Finance. Proceedings of 6th International Conference on Islamic Economics and Finance* (2007th ed., Vol. 1). Islamic Research and Training Institute, Jeddah, Saudi Arabia. <http://doi.org/10.1007/s12350-011-9489-2>.
- Iqbal, M., & Llewellyn, D. T. (2002). *Islamic Banking and Finance: New Perspectives on Profit-Sharing and Risk*. (M. Iqbal & D. T. Llewellyn, Eds.). Cheltenham: Edward Elgar Publishing Limited.
- Iqbal, Z., & Mirakhor, A. (Eds.). (2013). *Economic Development and Islamic Finance*. Washington, D.C.: The World Bank.
- IRTI-IDB. (2010). Islamic Economic Studies. *Islamic Economics Studies*, 17(2), 1–152.
- Islahi, A. A. (1984). *Economic Thought of Ibn Al-Qayyim*. King Abdulaziz University Press.
- Islamic Path. (n.d.). Pillars of Islam “Islamic Path”. Retrieved from <http://islamicpath.org/pillars-of-islam/>
- Ismail, B. (2013). Private Equity in the Middle East. *King & Wood Mallesons LLP*, (December), 1–2.
- ISRA & Thomson Reuters. (2016). *Islamic Commercial Law Report 2016: An Annual Publication Assessing the Key Issues and Trends in Islamic Commercial Law For the Broader Islamic Finance Industry*.
- Jaffer, S. (Ed.). (2010). *Islamic Investment Banking: Emerging Trends, Developments and Opportunities*. London: Euromoney Institutional Investor PLC.
- Jaffer, S. (2006). *Islamic Asset Management: Forming the Future For Shari'a Compliant Investment Strategies*. London: Euromoney Books.
- Janney, J. J., & Folta, T. B. (2006). Moderating effects of investor experience on the signalling value of private equity placements. *Journal of Business Venturing*, 21(1), 27–44. <http://doi.org/10.1016/j.jbusvent.2005.02.008>
- Jennings, R. W. (1958). The Role of the States in Corporate Regulation and Investor Protection. *Law and Contemporary Problems*, 23(2), 193–230. <http://doi.org/10.2307/1190440>
- Jensen, M. C. (1983). Organization Theory Methodology. *The Accounting Review*, 58(2), 319–339.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *SSRN Electronic Journal*. Retrieved from <http://ssrn.com/abstract=94043>
- Jodi Tamkin Borhan. (2004). The Agent-Manager’s Conduct of Mudharabah Contract in Islamic Commercial Law. *Journal Syariah*, 12(1), 1–20. Retrieved from <http://myais.fsktm.um.edu.my/7658/>

- Johnson, N. B., & Droege, S. (2004). Reflections on the Generalization of Agency Theory: Cross-Cultural Considerations. *Human Resource Management Review*, 14(3), 325–335. <http://doi.org/10.1016/j.hrmr.2004.06.003>
- Johnson, S., & Al-mana, A. (2012). Insight: Capital Markets Qatar Financial Markets Authority Adopts New Regulation For Offering and Listing Securities on the Second Market. *White & Case*, (February), 2–3.
- Kahf, M. (2004). Outlines of a Brief Framework of Tawwarruq (Cash Procurement) and Securitization In Shariah and Islamic Banking. In *AAOIFI Seminar in Bahrain*. Manama.
- Kahf, M., & Khan, T. (1992). Principles of Islamic Finance: A Survey.
- Kamali, M. H. (2015). *Maqasid al Shariah: The Objectives of Islamic Law*.
- Kaplan, S., & Schoar, A. (2003). *Private Equity Performance: Returns Persistence and Capital* (NBER Working Paper Series 9807). Cambridge, Massachusetts. Retrieved from <http://www.nber.org/paper/w9807>.
- Kaplan, N., & Stromberg, P. (2004). Characteristics, Contracts, and Actions: Evidence from Venture Capitalist Analyses. *The Journal of Finance*, 59(5), 2177–2210.
- Kaplan, S. (2009). The Future of Private Equity. *Journal of Applied Corporate Finance*, 21(3), 8–20. <http://doi.org/10.1111/j.1745-6622.2009.00235.x>.
- Karake-Shalhoub, Z. (2008). Private Equity, Islamic Finance, and Sovereign Wealth Funds in the MENA Region. *Thunderbird International Business Review*, 50(6), 359–368. <http://doi.org/10.1002/tie>
- Kasim, N., NuHtay, S. N., & Salman, S. A. (2013). Comparative Analysis on AAOIFI, IFSB and BNM Shari'ah Governance. *International Journal of Business and Social Science*, 4(15), 220–227. Retrieved from [http://ijbssnet.com/journals/Vol\\_4\\_No\\_15\\_Special\\_Issue\\_November\\_2013/28.pdf](http://ijbssnet.com/journals/Vol_4_No_15_Special_Issue_November_2013/28.pdf)
- Katz, A. W. (2004). The Economics of Form and Substance in Contract Interpretation. *Columbia Law Review*, 104(2), 496–538.
- Kawaf, J., & Miller, N. D. (2008). Islamic Private Equity Funds. In R. Ali (Ed.), *Islamic Finance: A Practical Guide* (pp. 41–54). London: Global Business Publishing Ltd.
- Kaya, A. (2010). When Does It Pay to Get Informed? *International Economics Review*, 51(2), 533–551.
- Keller, N. H. M. (2002). *Al-Maqasid: Nawaw's Manual of Islam*. Maryland, USA: Amana Publications.
- Kemmerer, A., & Weidig, T. (2005). Reporting Value to the Private Equity Fund Investor. *SSRN Electronic Journal*, 1–49. <http://doi.org/10.2139/ssrn.762305>
- Keptner, K. M. (2011). Mixed Methods Design: A Beginner's Guide. *The Qualitative Report*, 16(2), 593–595.
- Key, J. (n.d.). Research Design in Occupational Education - Module S7 - Chi Square.
- Khan, M. F. (2007). Setting Standards For Shariah Application in the Islamic Financial Industry. *Thunderbird International Business Review*, 49(3), 285–307. <http://doi.org/10.1002/tie>
- Khan, T., & Ahmed, H. (2001). *Risk Management: An Analysis of Issues in Islamic Financial Industry*. Jeddah: Islamic Development Bank, Islamic Research and Training Institute.

- Khan, T., & Muljawan, D. (Eds.). (2006). *Islamic Financial Architecture: Risk Management and Financial Stability*. Saudi Arabia: Islamic Development Bank, Islamic Research and Training Institute.
- Khan, Z. A. (n.d.). Islamic Private Equity and Venture Finance. Retrieved December 9, 2011, from <http://ziaahmedkhan.hubpages.com/hub/islamic-private-equity>
- Khan, Z. A. (2011). Islamic Private Equity and Venture Finance. Retrieved from [ziaahmedkhan.hubpages.com-Islamic\\_Private\\_Equity\\_and\\_Venture\\_Finance](http://ziaahmedkhan.hubpages.com-Islamic_Private_Equity_and_Venture_Finance) copy.pdf
- Kiesling, L. (2013). What is Regulatory Capture? *Knowledge Problem*.
- Kim, W. C., & Mauborgne, R. (1998). Procedural Justice, Strategic Decision Making, and the Knowledge Economy. *Strategic Management Journal*, 19(4), 323–338.
- Kiser, E. (1999). Comparing Varieties of Agency Theory in Economics, Political Science, and Sociology: An Illustration from State Policy Implementation. *American Sociological Association*, 17, 146–170.
- Klein, B. (1983). Contracting Costs and Residual Claims: The Separation of Ownership and Control. *Journal of Law & Economics*, 26, 367–374.
- Koffee-Financial. (n.d.). Understanding Mutual Funds.
- Komala, G. (2016). The Performance of Private Equity Investments in India, 21(6), 9–12. <http://doi.org/10.9790/0837-2106030912>.
- Kotrlik, J. W., & Williams, H. A. (2003). The Incorporation of Effect Size in Information Technology, Learning, and Performance Research. *Information Technology, Learning, and Performance Journal*, 21(1), 1–7. <http://doi.org/10.1.1.331.4489>
- Krishnamurthy, S., Spindt, P., Subramaniam, V., & Woidtke, T. (2005). Does Investor Identity Matter in Equity Issues? Evidence from Private Placements. *Journal of Financial Intermediation*, 14(2), 210–238. <http://doi.org/10.1016/j.jfi.2004.01.001>
- Kulik, B. W. (2005). Agency Theory, Reasoning and Culture at Enron: In Search of a Solution. *Journal of Business Ethics*, 59(4), 347–360. <http://doi.org/10.1007/s10551-004-7308-2>
- Kuran, T. (2003). The Islamic Commercial Crisis: Institutional Roots of Economics in the Middle East Underdevelopment. *Journal of Economic History*, 63(2), 414–446. Retrieved from <http://www.jstor.org/stable/3132442>
- Kuran, T. (1995). Islamic Economics and the Islamic Subeconomy. *The Journal of Economic Perspectives*, 9(4), 155–173.
- Kut, C., & Smolarski, J. (2006). Risk Management in Private Equity Funds: A Comparative Study of Indian and Franco-German Funds. *Journal of Developmental Entrepreneurship*, 11(1), 35. <http://doi.org/10.1142/S1084946706000258>
- Kuttner, P., Threlkeld, A., & Haste, H. (2008). Foundations of Qualitative Research in Education. Retrieved June 8, 2004, from [www.isites.harvard.edu/icb/icb.do?keyword](http://www.isites.harvard.edu/icb/icb.do?keyword)
- Kuwait Capital Markets Authority. Corporate Governance - Resolution 25/2013 (2013). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules on Investment in Funds-Cash - Resolution 9/2012 (2012). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules on Investments in Real Estate Funds - Resolution 8/2012 (2012). Kuwait: Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules on Investment in Funds of Debt Instruments - Resolution 2/2013 (2013). Kuwait: Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules of Establishing Investment Funds Overseas - Resolution 7/2010 (2010). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules on Investments in Private Ownership Funds - Resolution 3/2013 (2013). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Corporate Governance Template - Circular 6/2013 (2013). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. (2013). Rules For the Review and External Auditing For Licensees in Accordance with Sharia'ah Principles. Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Regulations on Investment in Holding Funds - Resolution-4/2013 (2013). Kuwait Capital Markets Authority.

Kuwait Capital Markets Authority. Rules on Investments in Funds of Securities - Resolution 3/2012 (2012). Kuwait Capital Markets Authority.

Kuwait Central Bank. Instructions Concerning the Organization of Islamic Banks' Financial Investment Policy - Instructions No.2/IBS/143/2003 (2003). Kuwait Central Bank.

Kuwait Central Bank. Shari'ah Governance Instructions For Islamic Banks - Board Resolution 20/12/2016 (2016). Kuwait.

Kuwait Central Bank. (1968). *Manual*. Kuwait: Kuwait Central Bank.

Kuwait Central Bank. Law-Organizing Bank Business (1968). Kuwait: Central Bank of Kuwait.

Kuwait Central Bank. Instructions Concerning the Rules and Conditions For the Appointment and Responsibilities of the Shareea' Supervisory Board in Islamic Banks - Instructions No.2/IBS/100/2003 (2003). Kuwait.

Kuwait Ministry of Commerce and Industry. Commercial Company Law Decree 25/2012 (2012). Kuwait: Ministry of Commerce and Industry.

Laerd Statistics. (2015). Mann-Whitney U Test Using SPSS Statistics - Statistical Tutorials and Software. Retrieved February 24, 2017, from <http://statistics.laerd.com/>

Laerd Statistics. (2015). Kruskal-Wallis H Test Using SPSS Statistics - Statistical Tutorial and Software. Retrieved February 24, 2017, from <https://statistics.laerd.com/>

Laerd Statistics. (2015). Chi-Square Testing Using SPSS Statistics - Statistical Tutorial and Software. Retrieved May 16, 2017, from <http://statistics.laerd.com/>

- Laffont, J.-J., & Martimort, D. (2002). *The Theory of Incentives: The Principal-Agent Model* (10th ed.). New Jersey: Princeton University Press, Princeton.
- Laldin, M. A. (2008a). *Introduction to Shari'ah and Islamic Jurisprudence*. Kuala Lumpur: CERT Publications Sdn. Bhd.
- Laldin, M. A. (2008b). The Shari'ah Objectives (Maqasid) of Financial Contracts and Islamic Banking. In *Fundamentals and Practices in Islamic Finance* (Contempor, pp. 71–91). Kuala Lumpur: IRSA.
- Latham & Watkins. (2011). Kuwait's New Capital Markets Regime: The Impact on Collective Investment Funds. *Latham & Watkins - Client Alert*, (1240), 1–4.
- Laureate Education Inc. (2013). *Phenomenological Research: Program Transcript*. Laureate Education, Inc.
- Leifer, R., & Mills, P. K. (1996). An Information Processing Approach For Deciding Upon Control Strategies and Reducing Control Loss in Emerging Organizations. *Journal of Management*, 22(1), 113–137. <http://doi.org/10.1177/014920639602200105>
- Lerner, J. (1997). *Venture Capital and Private Equity: A Course Overview*. *Venture Capital*.
- Lerner, J. (2001). *Venture Capital and Private Equity: A Course Overview* (updated 2001). *SSRN Electronic Journal*.
- Lerner, J., & Schoar, A. (2004). *Transaction Structures in the Developing World: Evidence from Private Equity* (No. WPS 10348). *NBER Working Paper*. Cambridge, Massachusetts.
- Lerner, J., & Schoar, A. (n.d.). *Private Equity in Developing World: The Determinants of Transaction Structures*. *Russell. The Journal of The Bertrand Russell Archives*.
- Lerner, J., & Schoar, A. (2004). *Private Equity in the Developing World: The Determinants of Transaction Structure*. *Chemistry & amp*. Retrieved from <http://onlinelibrary.wiley.com/doi/10.1002/cbdv.200490137/abstract>
- Lerner, J., & Schoar, A. (2005). Does Legal Enforcement Affect Financial Transactions? The Contractual Channel in Private Equity. *The Quarterly Journal of Economics*, (February), 223–246.
- Lester, C., & Fuller, C. (2013). *UAE Issues New Draft Commercial Companies Law*. *Latham & Watkins - Client Alert*.
- Lester, S. (1999). *An Introduction to Phenomenological Research*. *Stan Lester Developments*. Taunton. Retrieved from [www.sld.demon.co.uk/resmethy.pdf](http://www.sld.demon.co.uk/resmethy.pdf)
- Leventhal, G. S. (1976). What Should Be Done with Equity Theory? New Approaches to the Study of Fairness in Social Relationships. *National Science Foundation, Washington, D.C.*, 1–50.
- Li, F., Minnis, M., Nagar, V., & Rajan, M. (2009). *Formal and Real Authority in Organizations: An Empirical Assessment*.
- Li, J. S. (2003). Relation-Based Versus Rule-Based Governance: An Explanation of the East Asian Miracle and Asian Crisis. *Review of International Economics*, 11(4), 651–673.
- Lin, C. (2013). Revealing the “Essence” of Things: Using Phenomenology in LIS Research. *Qualitative and Quantitative Methods in Libraries (QQML)*, (4), 469–478.



- Lins, K. V. (2002). *Equity Ownership and Firm Value in Emerging Markets*. *Journal of Financial and Quantitative Analysis*. Cambridge Univ Press. Retrieved from <http://journals.cambridge.org/production/action/cjoGetFulltext?fulltextid=4207184>
- Maghrebi, N., & Mirakhor, A. (2015). Risk Sharing and Shared Prosperity in Islamic Finance. *Islamic Economic Studies*, 23(2), 85–115. <http://doi.org/10.12816/0015021>.
- Malaysia Securities Commission. Guidelines and Best Practices on Islamic Venture Capital (2008). Kuala Lumpur: Malaysia Securities Commission.
- Malaysia Securities Commission. Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations (2015). Kuala Lumpur: Malaysia Securities Commission.
- Malik, M. (2015). Al-Maqasid al-Shari'ah: The Comprehensive Objectives of Shari'ah. In *Maqasid Syariah in a Constitutional Democracy* (Vol. 1). Malaysia.
- Manigart, S., Korsgaard, A. A., Folger, R., & Sapienza, H. J. (2002). *The Impact of Trust on Private Equity Contracts* (No. 2002/1). *Vlerick Leuven Gent Management School* (Vol. Vlerick Wo). Gent.
- Marson, D., & Sundararajan, V. (2006). Unique Risks of Islamic Banks: Implications For Systemic Stability. In *Islamic Financial Architecture: Risk Management and Financial Stability* (pp. 93–108). Saudi Arabia: Islamic Development Bank, Islamic Research and Training Institute.
- Martin, A. R., Diaz, M. R., & San Roman, J. A. (2014). Measure of the Mining Image. *Resources Policy*, 41(1), 23–30. <http://doi.org/10.1016/j.resourpol.2014.01.004>
- Maskin, E., & Tirole, J. (1999). Unforeseen Contingencies and Incomplete Contracts. *The Review of Economic Studies*, 66(1), 83–114.
- Maurer, B. (2002). Anthropological and Accounting Knowledge in Islamic Banking and Finance: Rethinking Critical Accounts. *Journal of the Royal Anthropological Institute*, 8(4), 645–667. Retrieved from <http://www.jstor.org/stable/3134937>
- McCahery, J. A., & Vermeulen, E. P. M. (2012). Private Equity Regulation: A Comparative Analysis. *Journal of Management & Governance*, 16(2), 197–233. <http://doi.org/10.1007/s10997-010-9139-0>
- McCahery, J., & Vermeulen, E. P. M. (2008). The First Pillar: Company Law - One Size Fits All Vehicles For Non-Listed Companies. In *Corporate Governance of Non-Listed Companies* (pp. 172–191). Oxford: Oxford University Press.
- McCahery, J., & Vermeulen, E. P. M. (2008). *Corporate Governance of Non-Listed Companies*. Oxford: Oxford University Press.
- McCreedy, C. (2008). Private Equity: Progress on Disclosure and Transparency (Walker Guidelines). British Venture Capital Association.
- Mehri, M. (2012). Agency Problems in Venture Capital Contracts: Islamic Profit Sharing Ratio as a Screening Device. *SSRN Electronic Journal*, (November), 1–33.
- Meissner, H., Creswell, J., Klassen, A. C., Clark, V. L. P., & Smith, K. C. (2011). *Best Practices For Mixed Methods Research in the Health Sciences*. UK.
- MENA. (2013). *Small and Medium Sized Enterprises in the GCC: Can Private Equity Capital Fill the Financing Gap?*

- MENA. (2010). *MENA Private Equity Association, Private Equity & Venture Capital in the Middle East Annual Report*.
- MENA. (2012). *Venture Capital Legal Documentation in the Middle East and North Africa: A Guide to Help Entrepreneurs Understand the Legal Documentation Process Involved in a Venture Capital Deal in MENA*.
- MENA. (2013). *MENA Private Equity Association 3rd Venture Capital in the Middle East and North Africa Report - 2013 Update and 2012 Year in Review. The Journal of Infectious Diseases* (Vol. 209).
- MENA Private Equity Association. (2015). *10th Annual MENA Private Equity and Venture Capital Report 2015*.
- MENA Private Equity Association. (2016). *Private Equity and Venture Capital in the MENA region 2016*.
- MENA. (n.d.). Country UAE - Forms of Company. MENA Private Equity Association.
- MENA. (n.d.). Venture Capital Investment: Summary of Terms For Proposed Venture Capital Financing - Template. MENA Private Equity Association.
- Metrick, A., & Yasuda, A. (2010). The Economics of Private Equity Funds. *The Society for Financial Studies*, (203), 752–775. <http://doi.org/10.1093/rfs/hhq020>.
- Millson, R., & Ward, M. (2005). Corporate governance criteria as applied in private equity investments. *South African Journal of Business Management*, 36(1), 73–83.
- Mirakhor, A. (2010). Whither Islamic Finance? Risk Sharing in An Age of Crises. In *Developing Scientific Methodology on Shariah Governance for Positioning Islamic Finance Globally* (pp. 1–29).
- Mirza, M., & Baydoun, N. (1999). Do Islamic Societies Need Their Own Accounting and Reporting Standards? *Journal of the Academy of Business Administration*, 4(2), 39–45.
- Mishjin, F. S., & Eakins, S. G. (2009). The Mutual Fund Industry. In *Financial Markets and Institutions* (6th ed.). Pearson Prentice Hall.
- Mitnick, B. (1984). Agency Problems and Political Institutions. In *Annual Research Conference of the Association For Public Policy Analysis and Management (November)*. New Orleans.
- Mitnick, B. M. (1975). The Theory of Agency: The Policing “Paradox” and Regulatory Behavior. *Public Choice*, 24, 27–42. Retrieved from <http://www.jstor.org/stable/30022842>
- Mohamed Ibrahim, S. H., & Momin, E. (2015). Towards Achieving a Maqasid Shari’ah Oriented Islamic Banking. In *10th International Conference on Islamic Economics and Finance*. Retrieved from <http://conference.qfis.edu.qa/app/media/11313>
- Mohammed, N. (1988). Principles of Islamic Contract Law. *Journal of Law & Religion*, 6(1), 115–130. Retrieved from <http://www.joster.org/stable/10051062>
- Moran, P. (2005). Structural vs. Relational Embeddedness: Social Capital and Managerial Performance. *Strategic Management Journal*, 26(12), 1129–1151.
- Morris, P., & Phalippou, L. (2012). A New Approach to Regulate Private Equity. *Journal of Corporate Law Studies*, 12(April), 59–84.

- Morrison, P. L. (1937). The Interest of the Investor in Accounting Principles. *The Accounting Review*, 12(1), 37–42. Retrieved from <http://www.jstor.org/stable/239027>
- Morth, U. (Ed.). (2004). *Soft Law in Governance and Regulation: An Interdisciplinary Analysis*. Cheltenham: Edward Elgar Publishing Limited.
- Moustakas, C. (1994). *Phenomenological Research Methods*. California: SAGE Publications Inc.
- Moustakas, C. (n.d.). Outline Summary of the Phenomenological Model.
- Msatfa, A. (n.d.). Tawarruq at a Glance Organized. *Q Finance*, 1–4.
- Muljawan, D. (2006). An Analysis of Potential Systemic Costs in an Islamic Banking System. In *Islamic Financial Architecture: Risk Management and Financial Stability* (pp. 209–245). Saudi Arabia: Islamic Development Bank, Islamic Research and Training Institute.
- Müller, K. (2008). *Investing in Private Equity Partnership: The Role of Monitoring and Reporting* (1st ed.). Frankfurt: Gabler Edition Wissenschaft.
- Nakata, C. (2009). *Beyond Hofstede: Culture Frameworks For Global Marketing and Management*. (C. Nakata, Ed.) (2009th ed.). Palgrave Macmillan, Basingstoke, Hampshire.
- Naqvi, S. N. H. (1981). *Ethics and Economics: An Islamic Synthesis*. Leicester: The Islamic Foundation.
- Naughton, S., & Naughton, T. (2000). Religion, Ethics and Stock Trading: The Case of an Islamic Equities Market. *Journal of Business Ethics*, 23, 145–159.
- Naumann, S. E., & Bennett, N. (2012). A Case For Procedural Development and Justice Climate: Test of a Multi-level Model, 43(5), 881–889.
- Naurin, D. (2007). Transparency, Publicity, Accountability: The Missing Links. In *Swiss Political Science Review* (pp. 1–12). Retrieved from [http://www.mzes.uni-mannheim.de/projekte/typo3/site/fileadmin/research\\_groups/2/Uppsala2007/Paper\\_Naurin\\_II.pdf](http://www.mzes.uni-mannheim.de/projekte/typo3/site/fileadmin/research_groups/2/Uppsala2007/Paper_Naurin_II.pdf)
- Nehad, A., & Khanfar, A. (2016). A Critical Analysis of the Concept of Gharar in Islamic Financial Contracts: Different Perspective. *Journal of Economic Cooperation and Development*, 37(1), 1–23.
- New Horizon. (2013). *Global Perspective on Islamic Banking & Insurance*. New Horizon.
- Nix, P., & Chen, J. (2013). *The Role of Institutional Investors in Corporate Governance: An Empirical Study*. Basingstoke: Palgrave Macmillan.
- Nyazee, I. (1997). Islamic Law of Business Organization: Partnerships, Islamabad. *International Institute of Islamic Thought and Islamic Research Institute*, 12, 75–81.
- O’Brain, J. (2007). *Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation*. (J. O’Brian, Ed.). London: Imperial Collage Press, London, UK.
- OECD. (2007). *The Role of Private Pools of Capital in Corporate Governance: Summary And Main Findings About The Role of Private Equity Firms and “Activist” Funds*.
- OECD. (2004). Governance of Collective Investment Schemes (CIS) - Discussion Draft For Comment. *OECD*.

- OECD. (2006). *Corporate Governance of Non-Listed Companies in Emerging Markets*. OECD Publishing.
- Olejnik, S., & Algina, J. (2000). Measures of Effect Size For Comparative Studies: Applications, Interpretations, and Limitations. *Contemporary Educational Psychology*, 25(3), 241–286. <http://doi.org/10.1006/ceps.2000.1040>
- Oman Capital Markets Authority. The Capital Market Law - Royal Decree 80/98 (1998). Oman: Oman Capital Market Authority.
- Oman Central Bank. Islamic Banking Regulatory Framework. Oman: Oman Central Bank.
- Oman Ministry of Commerce and Industry. Company law - Decree 4/1974 (1974). Oman: Oman Ministry of Commerce and Industry.
- Oman Ministry of Commerce and Industry. Changes to the Company law - Decree 99/2005 (2005). Oman: Oman Ministry of Commerce and Industry.
- Oppenheim, A. N. (2001). *Questionnaire Design Interviewing and Attitude*. New York: Continuum.
- Organisation of Islamic Cooperation. (2009). OIC Fiqh Academy Rule Organised Tawarruq Impermissible in 2009. Retrieved May 11, 2013, from <http://www.isra.my/fatwas/topics/treasury/interbank/tawarruq/item/262-oic-fiqh-academy-ruled-organised-tawarruq-impermissible-in-2009.html>
- Ou-Yang, H. (2003). Optimal Contracts in a Continuous-Time Delegated Portfolio Management Problem. *The Review of Financial Studies*, 16(1), 173–208.
- Paldi, C. (n.d.). KFH - Case Study of Issues of Financial Reporting of the Islamic Banks.
- Pallant, J. (2013). *A Step by Step Guide to Data Analysis Using IBM SPSS* (5th ed.). London: McGraw-Hill.
- Panayides, P. (2013). Coefficient Alpha: Interpret with Caution. *Europe's Journal of Psychology*, 9(4), 687–696. <http://doi.org/10.5964/ejop.v9i4.653>
- Paraskeva, N. (2011). Regulatory Round-Up - U.S. Rules to Know 2012. Thomson Reuters.
- Parker, C., Kuuttiniem, K., Klaasen, B., Hill, J., & Jacobs, S. (2000). Reducing the Risk of Policy Failure: Challenges For Regulatory Compliance. *OECD*, 1–91.
- Parkhe, A. (1993). Strategic Alliance Structuring: A Game Theoretic and Transaction Cost Examination of Interfirm Cooperation. *Academy of Management Journal*, 36(4), 794–829. <http://doi.org/10.2307/256759>
- Patton, M. Q. (2003). Qualitative Evaluation Checklist.
- Patton, M. Q. (2001). *Qualitative Evaluation and Research Methods*. *Qualitative Evaluation and Research Methods* (2nd ed.). California: SAGE Publications Inc.
- Pei, D. (2010). Incomplete Contracts: Foundations and Applications. *Munich Personal RePEc Archive*, (23650), 1–32. Retrieved from <http://mpa.ub.uni-muenchen.de/23650/>
- Peng, M. W. (2003). Institutional Transitions and Strategic Choices. *Academy of Management Review*, 28(2), 275–296.
- Perrow, C. (1986). Complex Organizations: A Critical Essay. In *American Journal of Political Science* (3rd ed., Vol. 7, p. 307). New York: McGraw-Hill. <http://doi.org/10.2307/1318250>

- Personal, M., & Archive, R. (2011). Corporate Governance and Capital Flow. *Canadian Journal of Regional Science*, (29486). <http://doi.org/10.1227/01.NEU.0000349921.14519.2A>
- Phalippou, L. (2007). Investing in Private Equity Funds: A Survey. *The Research Foundation of CFA Institute*, 1–22.
- Phalippou, L. (2009). Beware of Venturing into Private Equity. *American Economic Review*, 23(1), 147–166.
- Phalippou, L. (2011). Why is the Evidence on Private Equity Performance So Confusing? *Social Science Research Network*.
- Phalippou, L. (2012). *A Comment on Recent Evidence on Private Equity Performance* (No. 2012.OMI05). Oxford.
- Piper, N. (2009). Assessing The Potential For Shari’ah-Compliant Project Finance in India. *Columbia Journal of Transnational Law*, (47), 419–445.
- Pistor, K. (2002). The Standardization of Law and its Effect on Developing Economies. *The American Journal of Comparative Law*, 50(1), 97–130.
- Pitchford, R. (1998). Moral Hazard and Limited Liability: The Real Effects of Contract Bargaining. *Economic Letters*, 61, 251–259.
- Pozen, R. C. (2000). *The Mutual Fund Business* (3rd ed.). Massachusetts: The MIT Press.
- Prequin alternative assets intelligent data. (2017). *Prequin Global Private Equity & Venture Capital Report*.
- Presley, J. R., & Sessions, J. G. (1994). Islamic Economics: The Emergence New Paradigm. *The Economic Journal*, 104(424), 584–596.
- Press, B., & Cliffs, E. (1992). Organizations: Authority and Power. *Elsevier Science Electronic Journal*.
- PRI. (2013). *PRI Reporting Framework 2013/14 Direct-Private Equity. Principles For Responsible Investment* (Vol. 44). London: PRI Association.
- PRI. (2013). Environmental, Social, and Corporate Governance (ESG) Disclosure Framework For Private Equity. *PRI Association*, (March), 1–5.
- PRI & UNEP. (n.d.). Responsible Investment in Private Equity: A Guide For Limited Partners. *PRI Association*, 1–16.
- PRI, UNEP, & UN. (2011). *Responsible Investment in Private Equity: A Guide For Limited Partners. PRI Association* (2nd ed.). London: Principles For Responsible Investment & UNEP Finance Initiative & UN Global Compact.
- Primeaux, P., Karri, R., & Caldwell, C. (2003). Cultural Insights to Justice: A Theoretical Perspective Through a Subjective Lens. *Journal of Business Ethics*, 46(2), 187–199.
- Private Equity Council. (n.d.). *Guidelines For Responsible Investment*.
- Private Equity International. (2003). Middle Eastern Equity. *Private Equity International*.
- PWC. (2011). *A Closer Look: The Dodd-Frank Wall Street Reform and Consumer Protection Act*. USA.

PWC. (2012). *Compliance Program Requirements For Private Equity Fund Advisers. FS Regulatory Brief.*

PWC. (2009). *Shariah-Compliant Funds: A Whole New World of Investment.*

PWC. (2011). *Improving Transparency and Disclosure Good Practice Reporting by Portfolio Companies.*

Qatar Central Bank. Directives on Investment Companies - Other Directives (2010). Doha: Qatar Central Bank.

Qatar Central Bank. Qatar Central Bank Law - Law 33/2006 (2006). Doha: Qatar Central Bank.

Qatar Central Bank. Directives on Investment Companies - Investment Companies' Activities and Mechanism of Evaluating Investment Performance (2010). Doha: Qatar Central Bank.

Qatar Central Bank. Qatar Central Bank Law and Regulating Financial Institutions - Law 13/2012 (2012). Doha: Qatar Central Bank.

Qatar Central Bank. Corporate Governance For Banks and Financial Institutions - Directives (2008). Doha: Qatar Central Bank.

Qatar Central Bank. Directives on Investment Companies - Management of Investment Companies (2012). Doha: Qatar Central Bank.

Qatar Central Bank. Offering and Listing of Securities Rulebook: Second Market. Doha: Qatar Financial Markets Authority.

Qatar Central Bank. Directives on Investment Companies - Offering and Marketing Accounts, Portfolios and Investment Funds (2010). Doha: Qatar Central Bank.

Qatar Central Bank. Directives on Investment Companies - Definitions (2010). Doha: Qatar Central Bank.

Qatar Central Bank. (2011). Directory of Finance Companies in Qatar 2011. Doha: Qatar Central Bank.

Qatar Central Bank. Directives on Investment Companies: Supervision on Investment Companies (2010). Doha: Qatar Central Bank.

Qatar Central Bank. Directives on Investment Companies - Licensing (2010). Doha: Qatar Central Bank.

Qatar Financial Centre. Financial Services Regulations (2010). Doha: Qatar Financial Centre.

Qatar Financial Centre. Special Company Regulations - Resolution 15/2012 (2012). Doha: Qatar Financial Centre.

Qatar Financial Centre Regulatory Authority. Private Placement Schemes Rules 2010 (PRIV) Version 1 (2010). Doha: Qatar Financial Centre Regulatory Authority.

Qatar Financial Centre Regulatory Authority. Islamic Finance Rules 2005 (ISFI) (2005). Doha: Qatar Financial Centre Regulatory Authority.

Qatar Financial Centre Regulatory Authority. (n.d.). *A Guide to the QFC Collective Investment Schemes Regime.* Doha: Qatar Financial Centre Regulatory Authority.

Qatar Financial Centre Regulatory Authority. Private Placement Schemes Rules 2010 (PRIV) Version 2 (2010). Doha: Qatar Financial Centre Regulatory Authority.

- Qatar Financial Markets Authority. Establishment of Qatar Financial Markets Authority - Decree 8/2012 (2012). Doha: Qatar Financial Markets Authority.
- Qatar Financial Markets Authority. Offering and Listing Rulebook: Main Market (2010). Doha: Qatar Financial Markets Authority.
- Raddon, A. (2012). *Early Stage Research Training: Epistemology and Ontology in Social Research*. Leicester: University of Leicester.
- Ramachandran, S. (1989). Banking Regulations and Islamic Finance. *Economic And Political Weekly*, 24(51/52), 2835–2840. Retrieved from <http://www.jstor.org/stable/4395747>
- Rammal, H. G. (2006). The Importance of Shari’ah Supervision in Islamic Financial Institutions. *Corporate Ownership and Control*, 3(3), 204–208.
- Rawls, J. (2005). *A Theory of Justice*. Cambridge: Harvard University Press.
- Rehman, S. S., & Askari, H. (2010). An Economic Islamicity Index (EI 2). *Global Economy Journal*, 10(3).
- Rehman, S. S. (2010). How Islamic are Islamic Countries? *Global Economy Journal*, 10(2), 1–40.
- Reiche, S. (1999). *Foundation of Incomplete Contracting in a Model of Asymmetric Information and Renegotiation*.
- Reidenbach, R. E., & Robin, D. P. (1990). Toward The Development of a Multidimensional Scale For Improving Evaluations of Business Ethics. *Journal of Business Ethics*, 9(8), 639–653. <http://doi.org/10.1007/BF00383391>
- Reybold, L. E., Lammert, J. D., & Stribling, S. M. (2013). Participant Selection as a Conscious Research Method: Thinking Forward and the Deliberation of “Emergent” Findings. *Qualitative Research*, 13(6), 699–716. <http://doi.org/10.1177/1468794112465634>
- Ribstein, L. E. (1995). The Constitutional Conception of the Corporation. *Supreme Court Economic Review*, 4, 95–140. Retrieved from <http://www.jstor.org/stable/1147081>
- Ricardo-Campbell, R. (1983). Comments on the Structure of Ownership and the Theory of the Firm. *Journal of Law & Economics*, XXVI, 391–393.
- Rice, M. P., O’Connor, G. C., Leifer, R., McDermott, C. M., & Standish-Kuon, T. (2000). Corporate Venture Capital Models For Promoting Radical Innovation. *Journal of Marketing Theory and Practice*, 8(3), 1–10. Retrieved from <http://www.jstor.org/stable/10.2307/40469997>
- Rin, M. Da, & Phalippou, L. (2010). *On the Heterogeneity of Private Equity Investors*.
- Riordan, M. H. (1990). What Is Vertical Integration? The Firm as a Nexus of Treaties, 94–111.
- Rmenyi, D., Williams, B., Arthur, M., & Ethne, S. (1998). *Doing Business and Management: An Introduction to Process and Method*. London: SAGE Publications Ltd.
- Rogers, J., Prentice, A., Watson, D., Yang, J., Daniel, F., Ratcliffe, C., & Hyde, J. (2012). The Alternative Investment Fund Managers Directive (“AIFMD”). *Taylor Wessing LLP*, 44(0).
- Rosenberg, D. (2002). Venture Capital Limited Partnerships: A Study in Freedom of Contract. *Columbia Business Law Review*, 2, 363–398.

- Rosly, S. A., & Omar, M. A. (1999). Islamic Convertible Bonds: An Alternative to Bay'al al-'Inah and Discounted Bay Al-Dayn Islamic Bonds For Global Islamic Capital Market. In *Third Harvard University Forum on Islamic Finance: Local Challenges, Global Opportunities* (pp. 179–189). Cambridge, Massachusetts.
- Ross, S. A. (1973). The Economic Theory of Agency: The Principal's Problem. *The American Economic Review*, 63(2), 134–139.
- Ryan, G. W., & Bernard, H. R. (2003). Techniques to Identify Themes. *Field Methods*, 15(1), 85–109. <http://doi.org/10.1177/1525822X02239569>
- Saam, N. J. (2007). Asymmetry in Information Versus Asymmetry in Power: Implicit Assumptions of Agency Theory? *Journal of Socio-Economics*, 36(6), 825–840. <http://doi.org/10.1016/j.socec.2007.01.018>
- Sabel, C. F. (1993). Studied Trust: Building New Forms of Cooperation in a Volatile Economy. *Human Relations*, 46(9), 1133–1170. <http://doi.org/10.1177/001872679304600907>
- Safieddine, A. (2009). Islamic Financial Institutions and Corporate Governance: New Insights For Agency Theory. *Corporate Governance: An International Review*, 17(2), 142–158. <http://doi.org/10.1111/j.1467-8683.2009.00729.x>
- Saladana, J. (2016). *The Coding Manual* (3rd ed.). London: SAGE Publications Ltd.
- Samuelson, P., & Nordhaus, W. D. (2005). The Fundamentals of Economics. In *Economics*. New York, USA: McGraw-Hill Irwin.
- Sapienza, H. J., & Korsgaard, M. A. (1996). Procedural Justice in Entrepreneur-Investor Relations. *Academy of Management Journal*, 39(3), 544–574. <http://doi.org/10.2307/256655>
- Sappington, D. (1983). Limited Liability Contracts between Principal and Agent. *Journal of Economic Theory*, 29, 1–21.
- Sapuan, N. M. (2016). An Evolution of Mudarabah Contract: A Viewpoint From Classical and Contemporary Islamic Scholars. *Procedia Economics and Finance*, 35(October 2015), 349–358. [http://doi.org/10.1016/S2212-5671\(16\)00043-5](http://doi.org/10.1016/S2212-5671(16)00043-5)
- Sarantakos, S. (1998). The research process. In *Social Research* (pp. 96–115). London: Macmillan Education UK. [http://doi.org/10.1007/978-1-349-14884-4\\_4](http://doi.org/10.1007/978-1-349-14884-4_4)
- Sarker, A. A. (1999). Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm. *International Journal of Islamic Financial Services*, 1(2), 12–26.
- Saudi Arabia. Directive to Banks on Subscription into Shareholding Companies - Circular. Riyadh: Saudi Arabia Monetary Agency.
- Saudi Arabia. Capital Market Authority Corporate Governance Regulations - Royal Decree M/30 dated 2006 (2010). Saudi Arabia Capital Markets Authority.
- Saudi Arabia Capital Market Authority. Capital Market Law. Riyadh: Saudi Arabia Capital Markets Authority.
- Saudi Arabia Capital Markets Authority. Investment Funds Regulations (2006). Riyadh: Saudi Arabia Capital Markets Authority.



Saudi Arabia Capital Markets Authority. Offering of Securities Regulations - Board Resolution 1-28-2008 (2008). Riyadh: Saudi Arabia Capital Markets Authority.

Saudi Arabia Capital Markets Authority. Regulations For Investment Funds and Collective Schemes - Circular June 1993 (1993). Saudi Arabia Capital Markets Authority.

Saudi Arabia Capital Markets Authority. Regulations and Rules of the Capital Market Authority: Glossary-Board Resolution 1-24-2012 (2012). Riyadh: Saudi Arabia Capital Markets Authority.

Saudi Arabia Monetary Agency. Circular - Regulations For Investment Funds and Collective Investment Schemes (1993). Riyadh: Saudi Arabia Monetary Agency.

Saudi Arabia Monetary Agency. Principles of Corporate Governance For Banks Operating in Saudi Arabia (2012). Riyadh: Saudi Arabia Monetary Agency.

Saudi Arabia Monetary Agency. Banning Control Law - Royal Decree M/5-Dated 1966 (1966). Riyadh: Saudi Arabia Monetary Agency.

Saudi Arabia Monetary Agency. Monetary Agency Law - Royal Decree 23/1957 (1957). Riyadh: Saudi Arabia Monetary Agency.

Saunders, M., Lewis, P., & Thornhill, A. (2009). *Research Methods For Business Students* (5th ed.). Essex: Pearson Education Limited.

Scandlyn, J. (2012). *Phenomenology and Grounded Theory*. Denver: University of Colorado Denver.

Schmitz, P. W. (2001). The Hold-Up Problem and Incomplete Contracts: A Survey of Recent Topics in Contract Theory. *Bulletin of Economic Research*, 53(1), 1–31. <http://doi.org/10.1111/1467-8586.00114>

Schneider, K., & Honey, V. (2011). Kuwait's Capital Markets Regime: The Impact on Issues Relating Specifically to Investment. *Country Focus Legal*, 18–20.

Scholar, J. B. (1996). Private Placements: A Regulatory Black Hole. *Social Science Research Network*, 35, 151–198.

Scholer, K. (2007). Private Equity - the Role of the FSA. *Kaye Scholer News Settler Client Alert*.

Schonfeld, V. E., Kerwin, T. M. J., & Kerwin, M. J. (1993). Organization of a Mutual Fund. *American Bar Association*, 49(1), 107–161.

Schreier, M. (2012). *Qualitative Content Analysis in Practice* (1st ed.). London: SAGE Publications Ltd.

Sera, & Dow Jones. (2008). *The New Mainstream: Islamic Private Equity and Competitiveness. Sera Bank in partnership with Dow Jones Private Equity*. Dow Jones & Company, Inc.

Seratakis, A. (2013). A Comparative Examination of Private Equity in the United States and Europe: Accounting For The Past and Predicting the Future of European Private Equity. *Fordham Journal of Corporate & Financial Law*, 18, 613–667.

Seratakis, A. (2013). A Comparative Examination of Private Equity in the United States and Europe: Accounting For The Past and Predicting the Future of European Private Equity. *Fordham Journal of Corporate & Financial Law*, 18, 613–667.

- Seretakis, A. (2012). The new EU Directive on the Regulation of Private Equity. *The Columbia Journal of European Law*, 18(10).
- Sethu, G. (2006). Governance of Mutual Funds and The Institution of Trustee. *Economic And Political Weekly*, 41(15), 1413–1416.
- Shamsuddin, Z., & Ismail, A. G. (2013). Agency Theory in Explaining Islamic Financial Contracts. *Middle-East Journal of Scientific Research*, 15(4), 530–545. <http://doi.org/10.5829/idosi.mejsr.2013.15.4.2361>
- Shanliang, L., & Chunhua, W. (2006). Linear Incentive Contract For Principal-Agent Problem with Asymmetric Information and Moral Hazard. *APCCAS 2006 - 2006 IEEE Asia Pacific Conference on Circuits and Systems*, (x), 634–637. <http://doi.org/10.1109/APCCAS.2006.342068>
- Shapiro, S. P. (1987). The Social Control of Impersonal Trust. *American Journal of Sociology*, 93(3), 623–658.
- Shapiro, S. P. (2005). Agency Theory. *Annual Review of Sociology*, 31(1), 263–284. <http://doi.org/10.1146/annurev.soc.31.041304.122159>
- Sharpe, D. (2015). Your Chi-Square Test is Statistically Significant: Now What? *Practical Assessment Research & Evaluation*, 20, 241–286.
- Siddiqi, M. N. (2007). Economics of Tawarruq: How its Mafasid overwhelm the Masalih. In *Tawarruq: A Methodological Issue in Shari'a-Compliant Finance* (pp. 1–7).
- Siddiqi, M. N. (1988). *Muslim Economic Thinking: A Survey of Contemporary Literature*. Leicester: The Islamic Foundation.
- Siddiqui, A. (2008). Financial Contracts, Risk and Performance of Islamic Banking. *Managerial Finance*, 34(10), 680–694. <http://doi.org/10.1108/03074350810891001>
- Siddiqui, S. (2010). *Shari'a-Compliant Private Equity: A Primer For the Executive*. London: Euromoney Institutional Investor PLC.
- Siddiqi, M. N. (n.d.). Islamic Finance and Beyond: Premises and Promises of Islamic Economics.
- Simon, H. A., Racionales, L. O. S. P., Las, E. N., & Sociales, C. (1989). Laissez-Faire, 1–18.
- Simon, M. K., & Goes, J. (2011). *What is Phenomenological Research?* Retrieved from [www.dissertationrecipes.com](http://www.dissertationrecipes.com)
- Sitkin, S. B., & Roth, N. L. (1993). Explaining the Limited Effectiveness of Legalistic “Remedies” For Trust/Distrust. *Organization Science*, 4(3), 367–392. <http://doi.org/10.1287/orsc.4.3.367>
- Smith, D. K. (2012). Governing the Corporation: The Role of “Soft Regulation.” *UNSW Law Journal*, 35(1), 378–403.
- Socialism, N., & Feldman, S. (1993). Authority: Delegation.
- Sokolowshy, J. (2009). Interview on Islamic Economics and Finance For Business Islamica.
- Solnik, B., & McLeavey, D. (2003). *International Investments* (5th ed.). USA: Pearson Addison Wesley.

- Spindler, J. C. (2009). How Private Is Private Equity, and at What Cost? *The University of Chicago Law Review*, 76(1), 311–334.
- Spindler, J. C. (2009). How Private is Private? *Regulation*, Winter, 38–43.  
<http://doi.org/10.1017/CBO9781107415324.004>
- Steinberger, P. J. (1989). A Fallacy in Rawls's Theory of Justice. *Cambridge University Press*, 51(1), 55–69.  
 Retrieved from <http://www.jstor.org/stable/1407444>
- Stern, J., & Holder, S. (1999). Regulatory Governance: Criteria For Assessing the Performance of Regulatory Systems and Application to Infrastructure Industries in the Developing Countries of Asia. *Utilities Policy*, 8, 33–50.
- Stowell, D. (2010). *An Introduction to Investment Banks, Hedge Funds & Private Equity: The New Paradigm* (10th ed.). Burlington, USA: Academic Press.
- Stratgy &. (2010). *Private Equity in the Middle East: A Rising Contender in Emerging Markets*. Retrieved from <https://www.strategyand.pwc.com/media/file/Private-equity-in-the-Middle-East.pdf>, accessed 17/5/2016.
- Strulovici, B. (2011). Renegotiation-Proof Contracts with Moral Hazard and Persistent Private Information.
- Sultan, S. A. M. (2009). *A Mini Guide to Shari'ah Audit: For Islamic Financial Institutions - A Primer*. Kuala Lumpur: CERT Publications Sdn. Bhd.
- Sulzbach, D. M., & Masterson, P. T. (2008). Offering Alternative Investment Strategies in a Mutual Fund Structure: Practical Considerations. *The Investment Lawyer*, 15(10).
- Sung, J. (2001). Optimal Contracts under Moral Hazard and Adverse Selection: a Continuous-Time Approach. In *EFA 2001 Barcelona meetings* (pp. 1–47). Retrieved from SSRN: <http://ssrn.com/abstract=274543>
- Sztompka, P. (2003). *Trust: A Sociological Theory*. *Contemporary Sociology* (2003rd ed., Vol. 30). Cambridge: Cambridge University Press (Virtual Publishing). <http://doi.org/10.2307/3089802>
- Sztompka, P. (1997). *Trust, Distrust and the Paradox of Democracy* (No. P97-3).
- Talmor, E., & Vasvari, F. (2011). *International Private Equity* (First). West Sussex: John Wiley & Sons, Ltd.
- Tappeiner, F., Howorth, C., Achleitner, A.-K., & Schraml, S. (2012). Demand For Private Equity Minority Investments: A study of Large Family Firms. *Journal of Family Business Strategy*, 3(1), 38–51.  
<http://doi.org/10.1016/j.jfbs.2012.01.001>
- Tashakkori, A., & Teddlie, C. (2003). *Hand Book of Mixed Methods in Social and Behavioral Research*. Thousand Oaks: Sage.
- The World Bank. (2002). *Overview Building Institutions For Markets*. *World Development Bank Report 2002*. Washington, D.C.
- The World Bank. (2002). Financial Systems. In *World Development Report 2002* (pp. 76–96). Washington, D.C.
- The World Bank. (2002). Regulation of Infrastructure. In *World Development Report 2002* (pp. 151–167). Washington, D.C.

The World Bank. (2002). Norms and Networks. In *World Development Report 2002* (pp. 171–179). Washington, D.C.

The World Bank. (2002). The Judicial System. In *World Development Report 2002* (pp. 118–132). Washington, D.C.

The World Bank. (2017). *World Development Report: Governance and Law*. Washington, D.C.

Thomas, A., Cox, S., & Kraty, B. (2005). *Structuring Islamic Finance Transactions* (B. Kraty, S. Cox, & T. Abdulkader, Eds.). London: Euromoney Books.

Thompson, R. (2008). *Real Venture Capital: Building International Businesses* (3rd ed.). UK: Palgrave Macmillan, Basingstoke, Hampshire.

Tirole, J. (1999). Incomplete Contracts: Where Do We Stand? *Econometrica*, 67(4), 741–781.

Trochim, W. M. (2006). The Research Methods Knowledge Base. Retrieved July 19, 2014, from [www.socialresearchmethods.net/kb](http://www.socialresearchmethods.net/kb)

Turner, J. L. (2014). *Using Statistics in Small-Scale Language Education Research: Focus on Non-Parametric Data*. New York: Routledge.

Turner, J. H. (1988). *A Theory of Social Interaction*. California: Stanford University Press.

Tuttle, B., Harrell, A., & Harrison, P. (1997). Moral Hazard, Ethical Considerations, and the Decision to Implement Information System. *Journal of Management Information Systems*, 13(4), 7–27.

UAE Central Bank. Islamic Banks, Financial Institutions and Investment Companies - Federal Law 6/1985 (1985). UAE Central Bank.

UAE Central Bank. Central Bank, The Monetary System and Organization of Banking Law - Union Law 10/1980 (1980). UAE Central Bank.

UAE Central Bank. Corporate Governance Guidelines For UAE Bank Directors - Draft (2006). UAE Central Bank.

UAE Ministry of Economy. Governance Rules and Corporate Discipline Standards - Ministerial Resolution 518/2009 (2009). UAE Ministry of Economy.

UAE Ministry of Economy. (n.d.). UAE - Procedures and Fees Guide For Investment Projects in UAE. *UAE Ministry of Economy*.

UAE Ministry of Economy. Governance Rules and Corporate Discipline Standards - Ministerial Resolution 518/2009 (Arabic) (2009). UAE Ministry of Economy.

UAE Ministry of Economy. Commercial Companies Law as Amended by Federal Law 13/1988 (1988). Abu Dhabi: UAE Ministry of Economy.

UAE Securities & Commodities Authority. Regulations on Mutual Funds - Board Decision 37/2012 (2012). UAE Securities & Commodities Authority.

UAE Securities & Commodities Authority. Regulations on Mutual Funds - Board Decision 9/2016 (2016). UAE Securities & Commodities Authority.

- UAE Securities & Commodities Authority. Regulations on Venture Capital Controls - Administrative Decision 3/R.T. (2017) (Arabic) (2017). UAE.
- UAE Securities & Commodities Authority. Regulations on Venture Capital Controls - Administrative Decision 3/R.T. (2017) (English) (2017). UAE.
- UAE Securities & Commodities Authority. Listing of Securities and Commodities - Decision 12/2000 (2000). UAE Securities & Commodities Authority.
- UAE Securities & Commodities Authority. (n.d.). 10 Years of Serving Investors. *UAE Securities & Commodities Authority*.
- UAE Securities & Commodities Authority. The Emirates Securities and Commodities Authority and Market Law - Federal Law 4/2000 (2000). Abu Dhabi: UAE Securities & Commodities Authority.
- UAE Securities & Commodities Authority. Regulations on Private Equity Funds Controls - Administrative Decision 2/R.T. (2017) (English) (2017). UAE.
- UAE Securities & Commodities Authority. Regulations on Private Equity Funds Controls - Administrative Decision 2/R.T. (2017) (Arabic) (2017).
- UAE Securities & Commodities Authority. Trading of Rights Issue Regulations - Board Decision 38/2013 (2013). Abu Dhabi: UAE Securities & Commodities Authority.
- UKIFC, & ISRA. (2016). *External Shari'ah Audit Report*. UK Islamic Financial Council and International Shari'ah Research Academy For Islamic Finance.
- UIHaque, N., & Mirakhor, A. (1986). *Optimal profit-sharing contracts and investment in an interest-free Islamic economy*. *IMF Working Paper* (Vol. WP/86/12).
- UNEP. (2009). *Fiduciary Responsibility Legal and Practical Aspects*. *UNEP Finance Initiative*. Genève.
- University, D. (2015). Ethics Form B: Review Checklist, 1–6.
- Usmani, M. T. (2008). *An Introduction to Islamic Finance*. New Delhi: Idara Isha'at-E-Diniyat (P) Ltd.
- Valenzuela, D., & Shrivastava, P. (n.d.). Interview as a Method For Qualitative Research. Southern Cross University and the Southern Cross Institute of Action Research (SCIAR).
- Vogt, W. P. (2005). *Dictionary of Statistics and Methodology: A Non-technical Guide For the Social Sciences* (3rd ed.). California: SAGE Publications Inc.
- Wainwright, F. (2003). Note on Limited Partnership Agreements. Dartmouth: Center For Private Equity and Entrepreneurship, Tuck School of Business.
- Walker, D. (2007). *Guidelines For Disclosure and Transparency in Private Equity*.
- Waterman, R. W., & Meier, K. J. (1998). Principal-Agent Models: An Expansion? *Journal of Public Administration, Research & Theory*, 8, 173–202.
- Weaver, B. (2008). Chapter 2: Analysis of categorical data. Retrieved March 27, 2017, from [www.angelfire.com/wv/bwhomedir/notes/categorical.pdf](http://www.angelfire.com/wv/bwhomedir/notes/categorical.pdf)

- Wikipedia. (n.d.). Procedural justice. Retrieved from [http://en.wikipedia.org/wiki/Procedural\\_justice](http://en.wikipedia.org/wiki/Procedural_justice)
- Williamson, O. E. (2005). The Economics of Governance. *The American Economic Review*, 95(2), 1–18.
- Williamson, O. E. (1975). *Markets and Hierarchies: Analysis and Anti-trust Implications*. (F. P. Ny, Ed.). New York (Vol. 86). Free Press. <http://doi.org/10.2307/2230812>
- Wilson, R. (2009). *The Development of Islamic Finance in The GCC - Working Paper, Kuwait Programme on Development, Governance And Globalisation in the Gulf States*.
- Wouters, P. (2009). Islamic Private Equity Funds. *EUREKAHEDGE*, 1–16. Retrieved from [www.eurekahedge.com](http://www.eurekahedge.com)
- Wright, M., Amess, K., Weir, C., & Girma, S. (2009). Private Equity and Corporate Governance: Retrospect and Prospect. *Corporate Governance An International Review*, 17(3), 353–375. <http://doi.org/10.1111/j.1467-8683.2009.00744.x>
- Wright, P., Mukherji, A., & Kroll, M. J. (2001). A re-examination of Agency Theory Assumptions: Extensions and Extrapolations. *Journal of Socio-Economics*, 30(5), 413–429. [http://doi.org/10.1016/S1053-5357\(01\)00102-0](http://doi.org/10.1016/S1053-5357(01)00102-0)
- Wruck, K. H. (2008). Private Equity, Corporate Governance, and the Reinvention of the Market For Corporate Control. *Journal of Applied Corporate Finance*, 20(3), 8–21. <http://doi.org/10.1111/j.1745-6622.2008.00190.x>
- Yanaga, M. (n.d.). Islamic Finance: The Status Quo and Challenges. Retrieved from [www.sakura.cc.tsukuba.ac.jp/~kigyoho/islamic.pdf](http://www.sakura.cc.tsukuba.ac.jp/~kigyoho/islamic.pdf)
- Yauch, C. A., & Steudel, H. J. (2003). Complementary Use of Qualitative and Quantitative Cultural Assessment Methods. *Organizational Research Methods*, 6(4), 465–481. <http://doi.org/10.1177/1094428103257362>
- Young, M. N., Peng, M. W., Ahlstrom, D., Bruton, G. D., & Jiang, Y. (2008). Corporate Governance in Emerging Economies: A Review of the Principal – Principal Perspective. *Journal of Management Studies*, 45(1), 196–220.
- Yousfi, O. (2012). Do PLS Financing Methods Solve Asymmetric Information?, 1–10. Retrieved from SSRN 2025077.
- Yousfi, O. (2013). Does PLS Solve Moral Hazard Problems? *Journal of Islamic Economics, Banking and Finance*, 9(3), 1–14.
- Yousfi, O. (2012). Islamic Private Equity: What Is New?, 1–26. Retrieved from SSRN1985389.
- Yunis, H. (2006). Growth of Private Equity Funds Using Islamic Finance. *Islamic Finance News Guide*, 67–69.
- Yusof, E. F. E., Kashoogie, J., & Kamal, A. K. (2009). Islamic Finance: Debt Versus Equity Financing in the Light of Maqasid Al-Shari'ah. *Munich Personal RePEc Archive*, (20722), 1–20.
- Zacharakis, A. L., McMullen, J. S., & Shepherd, D. A. (2007). Venture Capitalists' Decision Policies Across Three Countries: An Institutional Theory Perspective. *Journal of International Business Studies*, 38(5), 691–708.
- Zaher, T. S., & Hassan, M. K. (2001). A Comparative Literature Survey of Islamic Finance and Banking. *Financial Markets, Institutions {&} Instruments*, 10(4), 155–199.
- Zarka, M. (2011). Zarka-Fiqh Foundations For Islamic Economics. Sura Sharia Consultancy.

Zhang, X., & Zhang, C. (2009). Study on Private Equity Investment Risk Avoiding Base on Principle-Agent. In *IITA International Conference on Services Science, Management and Engineering* (pp. 388–391). Ieee. <http://doi.org/10.1109/SSME.2009.144>

Zhang, X., & Zhang, Z. (2007). A Venture Investment Principal-Agent Model Base on Game Theory. In *2007 IEEE International Conference on Automation and Logistics* (pp. 1028–1032). Jinan, China: Ieee. <http://doi.org/10.1109/ICAL.2007.4338718>

Zhang, X.-B., Zhang, Z., & Chen, Z. (2007). A Principal-Agent Problem. In *IEEE International Conference on Grey Systems and Intelligent Services* (pp. 1293–1296). Nanjing.

Zhao, Y., & Lu, Y. (2008, July). Principal-Agent Theory in Venture Business. In *2008 Chinese Control and Decision Conference* (pp. 2808–2813). Ieee. <http://doi.org/10.1109/CCDC.2008.4597838>

Zhou, J. Q., & Peng, M. W. (2009). Relational Exchanges Versus Arm's-Length Transactions During Institutional Transitions. *Asia Pacific Journal of Management*, 27(3), 355–370. <http://doi.org/10.1007/s10490-009-9142-7>

Zuckerman, H. (1977). Deviant Behavior and Social Control in Science. In E. Sagarin (Ed.), *Deviance and Social Change* (pp. 87–138). California: Sage.