APPLICATION OF IJTIHAD IN STOCK SCREENING PROCESS

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ABSTRACT

The emergence of Islamic economic system has brought about the need to apply Ijtihad in stock screening. It becomes inevitable because the conventional ways of stock trading is prohibited under Islamic Mua’malat. So, Islamic Capital Market has to be critically studied based on Islamic jurisprudence and Shari’ah provisions. The aim of this paper is to critique the application of Ijtihad in stock screening process under Islamic economic system.

INTRODUCTION

The Muslim World is contemporarily facing multifaceted challenges in various spheres of life. Among the most visible and impacting spheres is the economic and financial aspect, especially with the emergence of the Islamic Financial system in the 1970s. There is no doubt that the exponential rate of development of the Islamic financial system has brought to limelight many transient issues which the Shari’ah provisions are needed to resolve. This is because the challenges have continued to stare the face of the Ummah on daily basis. Thus, one of these financial challenges is the operation of an Islamic Capital Market (ICM) with its attendant issues such as share, bond, stock, stock screening, benchmarking, indexation etc. According to Ali (2005), capital markets generally play the vital role of mobilizing savings and allocating them for functional investment. He argues that the importance of capital markets in Islamic financial system is even more crucial and indispensable in view of the fact that Islam prohibits interest and encourages.

Needless to say that resolving these important issues from the Shari’ah perspective would clear the path and atmosphere for comfortable and satisfactory participation of Muslim professionals and investors. Since according to the Shari’ah, a Muslim should not participate in any activity which runs fowl to the teachings and dictates of Islam (Securities Commission Malaysia, 2009a). Therefore, the ability of the Ummah to recognize those contemporary or transient issues and make adequate Shari’ah legislations on them lies with the institution of Ijtihad (a dynamic process of rule making by competent Muslim scholars based on agreed principles).

As a matter of fact, the role of Ijtihad in providing the best ways out of these challenges underscore the significance and relevance of this noble institution in preserving the dynamic and timeliness features of
Islam. However, it must be stated that these rulings must be conducted by competent Muslim scholars in line with the general principles and provisions of the Qur’an and Sunnah; and also taking cognizance of the human interest (Masalih al-'ibad). According to Islamic Banking and Finance Institute (2009, p.107):

“"Ijtihad is important because of the “timeliness” nature of Islam, as a divinely revealed religion. The manner and context in which its contents had materialized for its continued relevance”.

Again, it further notes that: "Ijtihad is particularly needed in issues where textual evidence (Nusus) is absent. It is not an exaggeration to say that, except for a relatively limited number of case where the Qur’an and Sunnah offer ready-formulated legal judgements, the vast majority of branch cases (Furu’) are derived through the mechanisms of Ijtihad” (p.110). In view of these submissions, issues like benchmarking, indexation, stock screening etc. are important financial matters which must be legislated for through the mechanism of Ijtihad. And as rightly noted by Sadeghi (2008, p.17): “Islamic financial products could attract both Muslim savings, as well as conventional and other ethical based investors”. To this end, it can therefore be argued that Ijtihad is the mechanism which guarantees and preserves the continuous relevance and dynamism of the timeliness of Islam. Therefore, it is necessary to have a proper grasp and understanding of this important institution, which makes the relevance of Islam beyond the time-space factor.

UNDERSTANDING THE CONCEPTS OF IJTIHAD AND STOCK SCREENING

The Ummah was warned to avoid committing two major errors by Roger Garaudy (a revert and scholar). These two errors are: i. to avoid accepting everything western; and ii. to avoid rejecting everything western. Thus, the ability and strength of the Ummah to identify and decide appropriately on this overloaded timely caution lies largely in the proper and judicious use of the institution of Ijtihad to resolve various contemporary challenges. Therefore, Ijtihad linguistically means striving or self-exertion in any activity; while in the legal technical usage, it implies: “the total expenditure of effort by a jurist to infer with degree of probability, the rules of Shari’ah from detailed evidence in available sources” (Islamic Banking and Finance Institute, 2009, p.110). Also, according to Securities Commission Malaysia (2009a, p.39), it means: “a dynamic process of rule making based on agreed principles”.

Khan (2006, p.2) submits that: “"Ijtihad is about freedom of thought, rational thinking and the quest for truth through epistemology covering science, rationalism, human experience, critical thinking and so on". From the foregoing definitions, it becomes clearer that Ijtihad is an intellectual and legal mechanism which seeks to make discoveries from Islamic texts, human experience and apply them to daily life experiences be it economic, social, educational, political etc.; and a scholar who engages in it is called a MUJTAHID.
Nevertheless, the opposite of *ijtihad* is *taqleed* (irrational imitation), which is totally unacceptable in Islam. Importantly therefore, *ijtihad* is not a source of law but rather a mechanism for the derivation of laws through intellectual reasoning and legal deduction with application of these derivable laws to set of facts awaiting decision (Nyazee, 2002).

However, the various manifestations of *ijtihad* are *ijma* (Consensus), *Qiyas* (Analogical reasoning and deduction), *Istihsan* (Preferability), *Istishab* (Presumability), *Masalih Mursalah* (Public interest) etc. while the major sources of law in Islam are the Qur’an and the Sunnah. Furthermore, *ijtihad* is divided into two i.e. Individual and Collective *ijtihad*. By individual *ijtihad*, it refers to a situation where a *Mujtahid* makes *qiyas* and pronouncements/rulings on any issue; whereas collective *ijtihad* refers to collective rulings by a group of *Mujtahidun* or competent scholars on issues, especially complex ones such as practices of Islamic Capital Market (ICM) like benchmarking, stock screening etc. However, the process of rule making in contemporary Muslim World has been institutionalized in the form of collective *ijtihad* as evidenced in the Fiqh Academy (*Majma’al Fiqhi*) of Organization of the Islamic Conference (OIC) and the Shari’ah Advisory Council (SAC) of the Securities Commission Malaysia established on the 16th May, 1996, which has been performing creditably well in regulating the ICM. Importantly, among the Golden rules for the exercising of *ijtihad* are: “No ijtihad in the existence of a legal text” (Saad, 2003, p.1) and that “Knowledge is the key to the door of ijtihad” (Al-Beirawi, 2004, p.12).

Since among the challenging issues in the ICM which *ijtihad* is expected to provide solutions to is stock screening, it is therefore necessary to understand what is meant by this concept. According to Alhabshi (n.d.), stock screening is “a process of determining whether a stock or security is Shari’ah-compliant or not”. In line with the requirements of the Islamic finance industry, the screening is part and parcel of ensuring that the transaction does not contain any prohibited elements that make it Shari’ah non-compliant (Alhabshi, n.d.; & Bain, 2009). This is important because for a Muslim, it is a grave sin for one to consume or invest in unlawful or prohibited commodity or venture. As a matter of fact, stock screening implies the scrutiny of any good or product of a company participating in the ICM and also the terms and modes of financing its activities. Thus, with a stock screening process based on the Shari’ah, the probability is very high that Islamic financial products would tend to attract both Muslim savings as well as conventional and ethical based investors (Sadeghi, 2008).

From the foregoing submissions, it is clear that the essence of stock screening is to protect Muslim professionals and investors from falling into the pit of prohibitions in view of its grave consequences on them and the society. Therefore, it could be argued that *ijtihad* is extremely useful in guiding the Ummah and thus keeping pace with modern development. As a matter of fact, the various *ahadith* of the Prophet (PBUH) which approved this institution becomes very instructive at this juncture to be noted: “If a judge...
passes judgement and makes Ijtihad and he is right then he will have two rewards. And if he makes a mistake he will have one” (cited by Al-Beirawi, 2004). In the same vein, when the Prophet sent Mu’az Ibn Jabal to Yemen as a Governor, he asked him: “By what will you pass judgement? He said: By the Book of Allah. The Prophet (saw) said: if you do not find it there? He said: By the Sunnah of the Messenger of Allah (saw). He said: And if you do not find it? He said: “I will exercise my own Ijtihad”. He (saw) said: “Praise be to Allah who has made the messenger of the Messenger of Allah to accord with what Allah and His Messenger loves” (cited by Al-Beirawi, 2004). These sayings are in essence demonstrating the significance and approval of Ijtihad in the affairs of the Ummah. Moreover, examples of great scholars who exercised Ijtihad to solve problems of their time abound apart from the renowned Imams of the four schools of thought. Among these scholars are Ibn Taymiyyah, his student Ibn Qayyim, Muhammad Abduh (Grand Mufti of Al-Azhar), Muhammad ash-Shaukani etc. and even now in our contemporary time we have Dr Yusuf Al-Qardawi.

CRITERIA FOR SCREENING (QUALITATIVE AND QUANTITATIVE)
The screening of Shari’ah-compliant stocks, particularly in Malaysia is centrally done by the SAC of the Securities Commission based on Ijtihad (reasoning from the source of Shari’ah by qualified Shari’ah scholars). Thus, the SAC issues the list of permissible stocks to the public twice a year. And the screening criteria being used are mainly based on the activity or income (business and the financial ratios) of the company. However, both the Kuala Lumpur Shari’ah Index (KLSI) and Dow Jones Islamic Market Index (DJIMI) have the same approach to the first level of screening which is based on core business. Therefore, the screening criteria, which include Core and Mixed activities, are also refer to the Qualitative and Quantitative criteria respectively according to the Securities Commission Malaysia (2009b) and Nisar (2005). Therefore, qualitative criteria are regarded as the first level of screening and it involves the screening of the businesses that are illegal and disapproved by the Shari’ah. Thus, the core activities of the company must be Shari’ah-compliant; and companies with the following as their core activities are excluded:

A. Core Activities
By this, it implies that companies whose core/main activities are not Shari’ah-compliant. These business activities are: Financial services based on riba (interest); gambling (maisir), manufacture or sale of non-halal products or related products; conventional insurance; entertainment activities that are un-Islamic; manufacture or sale of tobacco-based products or related products; stock-broking or share trading in Shari’ah non-approved securities; and other activities deemed non-permissible according to Shari’ah.

B. Mixed Activities
The SAC considers two additional criteria for companies dealing in activities comprising both permissible and non-permissible and they are:

i. The public perception or image of the company must be good; and

ii. The core activities of the company are important and considered maslahah (in the public interest) to the Ummah (nation) and the country, and the non-permissible element is very small and involves matters such as umum balwa (common plight and difficult to avoid), uruf (custom), and the rights of the non-Muslim community which are accepted by Islam.

However, the second important level of screening involves the quantitative screening methodology, which is also refers to the Benchmarks of Tolerance (applicable in the screening of mixed activities). Thus, if the contributions emanating from the turnover or profit before tax from non-permissible activities of a company exceed the benchmark, no doubt the securities of such a company are classified as Shari’ah non-approved. These benchmarks are:

i. The Five-Percent Benchmark: It is used to assess the level of mixed contributions from the activities that are clearly prohibited such as riba (interest-based companies like conventional banks), gambling, liquor and pork.

ii. The Ten-Percent Benchmark: This is used to assess the level of mixed contributions from the activities that involve the element of “umum balwa” which is a prohibited element affecting most people and difficult to avoid. For example, interest income from fixed deposits in conventional banks.

iii. The Twenty-Percent Benchmark: This benchmark is used to assess the level of contribution from mixed rental payment from Shari’ah non-compliant activities such as the rental payment from the premise that involved gambling, sale of liquor etc.

iv. The Twenty-Five Percent Benchmark: This benchmark is used to assess the level of mixed contributions from the activities that are generally permissible according to Shari’ah and have an element of maslahah to the public, but there are other elements that may affect the Shari’ah status of these activities. Examples like hotel and resort operations, share trading, stock-broking and others belong to this category. These activities may also involve other activities that are deemed non-permissible according to the Shari’ah.

There is no doubt that all these criteria and benchmarks established by the SAC are products of ijtihad, which demonstrate a product of collective knowledge and wisdom on the part of the scholars. This outcome must have gone a long way in facilitating the ways and manners the ICM operates. No wonder Sadeghi (2008, p.17) notes that: “The accreditation of stocks by SAC from the first time conveyed certain information about the longevity and future prospects of the firms that weren’t publicly available to the market before”. However, the basis and justifications for the establishment of the benchmarks is not the
subject of this paper because this has already been provided by SAC in its resolutions (see Securities Commission Malaysia, 2009b, p.21). Meanwhile, a notable area of divergence in the stock screening process emanates in the criteria adopted by stock exchange players in mixed activity businesses. For instance, the KLSI, DJIMI and Meezan Islamic Fund differ in the levels of benchmarks for tolerance. According to Ali (2005), in the case of KLSI, only income statement benchmarks are used and debt or liquidity ratio benchmarks are not given preference whereas DJIMI and Meezan make debt and liquidity ratio among major benchmarks.

Nevertheless, it must be stated that divergence in rule making is not strange to Islam and should therefore not serve as any basis for Muslim disunity. The Securities Commission Malaysia (2009, p.43) makes this clear when it submits that: “Pluralism of *ijtihad* and fatwa is an integral element of Islamic law development which finds support from the Sunnah as well as the practice of Muslims from the era of *Sahabah* (companions of the Prophet)”.

**THE NEED FOR THE APPLICATION OF *IJTIHAD***

The need for the application of *ijtihad* cannot be over-emphasized in view of its strategic importance in preserving the dynamism and relevance of Islam beyond the time-space factor, and more especially in providing necessary and adequate solutions to the various contemporary challenges in the Muslim world. This underscores the significance of the benchmarking standards set by SAC and the overall stock screening process, which represent products of collective knowledge and wisdom of the scholars in the council. Al-Beirawi (2004, p.1) notes that: “If Islam were unable to handle the complexities of contemporary life, it may indeed produce an outdated medieval system, causing its adherents to deny the fruits of current modernity”. However, the submission of Khan (2006, p.4) seems to elucidate the above observation when he posits that: “Thus, a broad vision of *ijtihad* ensures that Islam and Muslim communities continue to reform in positive ways without losing the connection to Divine revelation and traditional culture. Muslims must continue to embrace this spirit of inquiry and desire for all forms of knowledge in order to revitalize and restore Islamic civilization”. The two quotations above are simply calling the attention of the Ummah to the severe danger of being intellectually and legally stagnant and static; in view of the fact that Islam is a religion of vitality and dynamism, which should purposefully and adequately provides solutions to contemporary challenges of humanity. Therefore, the application of *ijtihad* in the stock screening process is a sub-set of the enormous challenges confronting the Ummah. As such, competent Muslim scholars who are qualified to exercise *ijtihad* must perform it for the protection of the Ummah from intellectual, cultural and civilization onslaughts of non-Muslim societies. Al-Beirawi (2004) further argues that *ijtihad* is *Fard al-Kifayah* (obligation of sufficiency) on the Ummah and as a matter of fact, no age or generation must be devoid of the presence of a *mujtahid* otherwise all members of the Ummah shall be deemed sinful.
However, it must be noted that *ijtihad* could best be exercised collectively in view of the complexity of the challenges and problems confronting the Ummah, especially in the emerging field of Islamic banking and finance, which stock screening happens to be one of its operational procedures. Furthermore, in view of the institutionalization of collective *ijtihad* as evidenced in Fiqh Academy and SAC, it makes the process of rule making more productive and acceptable to the generality; since two good heads are better than one. To this end, the role being played by the Fiqh Academy of the OIC and the Shari’ah Advisory Council (SAC) of the Securities Commission Malaysia must be commended in lifting the sinfulness of the Ummah and especially saving the Ummah from becoming copycats and blind imitators (*Muqalidun*).

**CONCLUSION**

From the foregoing discussions and submissions, it is clear that the role of *ijtihad* in the development of Muslim societies is of strategic importance because it is the mechanism for preserving the continuous relevance and dynamism of Islam beyond the time-space factor. Therefore, contemporary challenges in whatever form and shape must never be hindrances to the modern relevance and development of Muslim societies. As a matter of fact, the application of *ijtihad* in the stock screening process of ICM is a must if the Ummah must reap the fruits of modernity in the financial sector. More so that the world is seriously searching for an alternative economic and financial system that will rescue the global economic system from the greed of its operators, this presupposes the fact that the Ummah must provide a sound intellectual and legal foundation through the institution of *ijtihad* for a sustainable globally amiable economic and financial system. Al-Beirawi (2004, p.1) submission is more apt when he states that: “Ijihad tackles contemporary problems using Islam’s original principles and rules; it does not demand their alteration but their application”.

**REFERENCES**


