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Islamic Principles of Investment: Ethical Foundations and Their Application in Contemporary Finance

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Abstract

Islamic investment is governed by a distinct set of ethical and legal principles derived from Shariah, which differentiate it fundamentally from conventional investment practices. This study aims to examine the core principles underlying Islamic investment and their application within contemporary financial instruments. Using a descriptive, normative-philosophical literature study, the study identifies five foundational principles: freedom from riba (interest), whereby returns are generated through profit-and-loss sharing mechanisms such as mudharabah and musyarakah rather than predetermined interest rates; freedom from maysir (speculation and gambling), which prohibits transactions based on chance or unsubstantiated speculation; freedom from gharar (excessive uncertainty), requiring full transparency and clarity in contracts and investment objects to prevent harm to either party; investment restricted to halal (thayyib) sectors, excluding businesses associated with alcohol, gambling, pornography, and other prohibited goods or services; and social justice and ethics, wherein profit and risk are shared equitably and investment is directed toward broader societal and environmental benefit (maslahah). The study finds that these principles have been operationalized in modern financial instruments including Shariah-compliant stocks, sukuk (Islamic bonds), Islamic mutual funds, and gold-based investment through mechanisms such as profit-sharing contracts and standardized screening criteria. However, the study also finds that technical Shariah compliance alone is insufficient; recent literature increasingly emphasizes that Islamic investment must fulfill the substantive ethical objectives of Maqasid Shariah particularly justice, sustainability, and social welfare rather than formal compliance alone. This study contributes to the growing discourse on Islamic economics by clarifying the conceptual foundations that link religious ethics with practical investment mechanisms in contemporary finance, and by highlighting the distinction between formal compliance and substantive ethical fulfillment.

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INTRODUCTION

The global investment landscape has undergone significant transformation over the past few decades, driven not only by financial innovation but also by growing demand for ethical and values-based financial systems. Among these, Islamic investment has emerged as a distinct paradigm, rooted in the principles of Shariah (Islamic law) and offering an alternative to conventional, interest-based financial practices.

At the core of Islamic investment lie several interrelated principles: freedom from *riba* (interest), *maysir* (speculation and gambling), and *gharar* (excessive uncertainty), which together form the foundational prohibitions governing Islamic financial transactions (Uddin, 2015). Islamic financial institutions operate strictly under these prohibitions, generating returns instead through profit-sharing contracts such as *mudharabah*, in which capital and entrepreneurial effort are combined and profit distributed according to a pre-agreed ratio(Fauzi & Rafik, 2024).

Beyond these prohibitions, Islamic investment is further governed by sector-based screening. Contemporary Shariah-compliant equity markets rely on standardized screening criteria such as those issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which combine a qualitative business activity filter with quantitative financial-ratio thresholds to determine a firm's Shariah compliance status (Habib & Ahmad, 2017). These mechanisms institutionalize the principle of *halal* (*thayyib*) sector restriction within modern capital markets.

At the same time, a growing body of recent literature cautions that formal, technical Shariah compliance is not sufficient on its own. Scholars increasingly argue for ethical investment frameworks grounded explicitly in *Maqasid Shariah* (the higher objectives of Islamic law), integrating theological principles with real-world stakeholder concerns for justice, sustainability, and social impact, rather than mere rule-based compliance (Sheikh, 2025). This literature also identifies governance limitations such as potential conflicts of interest within Shariah supervisory boards as a concern that formal compliance mechanisms alone cannot resolve (Sheikh, 2025).

Despite the expanding literature on Islamic finance, conceptual studies that systematically synthesize the five core principles *riba*, *maysir*, *gharar*, *halal* sector restriction, and social justice while also situating them within this broader *Maqasid*-based ethical discourse, remain limited, particularly within international economic discourse. This study seeks to address this gap by providing a conceptual, literature-based synthesis of Islamic investment principles and examining how these principles are

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reflected both technically and substantively in contemporary Shariah-compliant financial instruments.

Accordingly, this study aims to: (1) elaborate the core principles of Islamic investment as derived from Shariah; and (2) examine how these principles are institutionalized in modern Shariah-compliant financial instruments, while distinguishing formal compliance from the substantive ethical objectives of *Maqasid Shariah*.(Affandi et al., 2022)

METHODOLOGY

This study employs a qualitative research approach based on a literature study (*studi literatur*), combining descriptive and normative philosophical analysis. This approach is directed at examining the conformity of contemporary financial instruments with core Shariah investment principles, particularly the prohibition of *riba* (interest), *gharar* (uncertainty), and *maysir* (gambling).

Research Design

A descriptive, normative-philosophical literature study design is adopted. This design is appropriate given the study's objective: to conceptually elaborate and synthesize normative principles derived from Islamic jurisprudence (*fiqh muamalah*) and to examine how these principles are reflected in the structure of contemporary Shariah-compliant financial instruments.

Data Sources

Data were obtained from secondary sources, comprising:

1. Peer-reviewed journal articles on Islamic economics and finance, prioritizing publications from the last ten years to ensure contemporary relevance;
2. Foundational texts and scholarly works on Islamic jurisprudence related to financial transactions (*fiqh muamalah*);
3. Regulatory and standard-setting documents, such as those issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and national Shariah supervisory boards;
4. Institutional and industry reports relevant to Shariah-compliant financial instruments (e.g., sukuk, Islamic mutual funds, Shariah-compliant equities).

Data Analysis Technique

Data were analyzed using qualitative content analysis, involving three stages: (1) data reduction, in which relevant concepts related to the five core principles *riba*, *maysir*, *gharar*, *halal* sector restriction, and social justice were identified and extracted from the

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collected sources; (2) data categorization, in which extracted concepts were organized thematically according to each principle and its corresponding application in modern financial instruments; and (3) conclusion drawing and verification, in which patterns and relationships across sources were synthesized into a coherent conceptual framework linking Islamic jurisprudential principles to contemporary investment practices.

RESULTS and DISCUSSION

Shariah Compliance of Islamic Investment Instruments

The literature analysis reveals that contemporary Shariah-compliant financial instruments have been structurally designed to satisfy the five core principles of Islamic investment identified in this study.

Freedom from Riba, Maysir, and Gharar. Consistent with (Uddin, 2015), the analysis confirms that Islamic financial instruments are structured to avoid predetermined interest (*riba*), speculative transactions lacking legitimate business analysis (*maysir*), and contractual ambiguity (*gharar*). Recent literature reinforces this point, noting that Islamic banks operate strictly under the prohibitions of *riba*, *gharar*, and *maysir* found in their conventional counterparts, with returns instead generated through profit-sharing contracts such as *mudharabah*, in which capital and entrepreneurial effort are combined and profit is distributed according to a pre-agreed ratio (Zameri et al., 2024).

Freedom from Gharar. Transparency requirements embedded in Shariah-compliant contracts help minimize ambiguity regarding the object of investment and the rights of each party, consistent with the classical jurisprudential requirement that a contract must not involve ignorance about its subject matter or outcome (Uddin, 2015).

Halal Sector Restriction. The screening of Shariah-compliant equities relies on a two-stage process combining a business-activity filter and a financial-ratio filter, as codified in AAOIFI's standards (Habib & Ahmad, 2017). This mechanism systematically excludes firms engaged in prohibited sectors, ensuring that investment activity remains confined to *halal* (*thayyib*) economic activities.

Social Justice and Ethics. The equitable distribution of profit and risk between investors and fund managers, as institutionalized in *mudharabah* and *musyarakah*based instruments, reflects the broader Islamic economic objective of *maslahah* (Zameri et al., 2024). This is echoed in recent literature calling for ethical investment frameworks grounded explicitly in *Maqasid Shariah* integrating theological principles with real-world stakeholder concerns for justice, sustainability, and social impact, rather than formal Shariah compliance alone(Sheikh, 2025). Sheikh (2025) further highlights governance limitations, such as potential conflicts of interest within Shariah supervisory boards, and calls for independent, Maqasid-based ethical ratings to strengthen the credibility of Islamic investment products.

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Integration of Findings Across the Five Principles

Taken together, the findings suggest that the five core principles of Islamic investment freedom from *riba*, *maysir*, and *gharar*, *halal* sector restriction, and social justice are not isolated doctrinal requirements but form an interconnected ethical architecture. Structural compliance mechanisms (e.g., profit-sharing contracts, AAOIFI screening standards) address the technical dimension of Shariah compliance, while the broader *Maqasid Shariah* framework addresses the substantive, values-based dimension ensuring that Islamic investment serves justice and social welfare (*maslahah*), not merely formal rule adherence (Sheikh, 2025). This distinction is increasingly emphasized in recent literature, which cautions against a narrowly legalistic interpretation of Shariah compliance that neglects its underlying ethical objectives (Sheikh, 2025).

IMPLICATIONS

These findings carry both theoretical and practical implications. Theoretically, this study reinforces the conceptual linkage between Islamic jurisprudential principles and their institutional application in modern finance, while highlighting the growing scholarly emphasis on *Maqasid*-based ethical substance over formal compliance alone (Sheikh, 2025). Practically, the findings suggest that industry stakeholders and regulators should consider strengthening independent oversight mechanisms such as third-party Maqasid-based ethical ratings to ensure that Shariah-compliant instruments genuinely deliver on their ethical and social justice objectives, rather than satisfying only technical screening criteria.

CONCLUSION

This study set out to elaborate the core principles of Islamic investment and examine how these principles are structurally and ethically embedded within contemporary Shariah-compliant financial instruments. Through a descriptive, normative philosophical literature study, the findings confirm that Islamic investment is governed by five interrelated principles freedom from *riba*, freedom from *maysir*, freedom from *gharar*, restriction to *halal* (*thayyib*) sectors, and social justice and ethics which are institutionalized in modern instruments such as Shariah-compliant stocks, sukuk, Islamic mutual funds, and gold-based investment.

The findings further suggest that formal, technical Shariah compliance achieved through profit-sharing contracts and standardized screening mechanisms such as those issued by AAOIFI is necessary but not sufficient. A growing body of literature emphasizes that Islamic investment must also fulfill the substantive ethical objectives of *Maqasid Shariah*, particularly justice, sustainability, and social welfare (*maslahah*), rather than satisfying formal compliance criteria alone.

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These findings reinforce the conceptual understanding that Islamic investment is not merely a product-based alternative to conventional finance, but a values-driven system in which ethical principles, transparency, and governance integrity jointly determine its practical and moral legitimacy. Theoretically, this study contributes to the discourse on Islamic economics by synthesizing normative Shariah principles with the substantive ethical objectives underlying them. Practically, the findings highlight the importance of strengthening independent Shariah governance mechanisms such as third-party, Maqasid-based ethical ratings to ensure that Shariah-compliant instruments deliver genuine social and ethical value, not only technical compliance.(Mustakim et al., 2023)

This study is not without limitations. As a literature-based conceptual study, its findings rely on the interpretation and synthesis of existing secondary sources rather than original empirical data, which may limit the generalizability of its conclusions to specific market contexts or investor populations. Future research is encouraged to complement this conceptual synthesis with empirical investigation for instance, examining how Shariah governance practices are implemented across different Islamic financial institutions, or how investors themselves perceive the ethical substance of Shariah compliant products.(Mohd-Zameri et al., 2025)

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