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Historical Development Of Islamic Venture Capital: An Appraisal

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ABSTRACT

Venture capital is commonly defined as medium to long-term equity investment provided for unlisted companies to finance their start up, expansion, survival and change of ownership. The origin of which was traced back to mudharabah; which is commonly translated to Islamic limited partnership. The application of venture capital seems to be abandoned in Muslim world for long, while Western communities get steady development of it. Since the inception of Islamic banks for almost two decades, Islamic banks are also turning a blind eye to venture capital. In spite that venture capital is akin to Islamic bank’s principle of profit and loss sharing. The first Islamic bank which was introduced 1963 at Mit Ghamr by Dr. El-Naggar, was primarily built on mudharabah contract which constitutes a tiny portion in day-to-day operations of Islamic banking and financial institutions to date due to risks associated with this area of investment. However, venture capital considered as a formidable tool for economic and technological development in the West. This study aims at studying historical development of mudharabah and musharakah that constitute the root of the modern venture capital. The study covers both classical and modern Islamic venture capital. The study finds that modern Islamic venture capital operates in form of banking and financial institution at the outset. This is could be imagined with the establishment of the first Islamic bank at Mit Ghamr Egypt 1963, Tabung Hajj at 1960s. On the contrary, Mudharabah Companies established in Pakistan in1984 operates in form of fund management company. Nevertheless, the first fund carries the tittle of Islamic venture is Injazah funds established in2004. The first fund and management corporation dedicated for Islamic venture capital is Musharaka Venture Tech. and Management established in Malaysia 2008. The first banking institution dedicated for Islamic venture capital and private equity investment is Venture Capital Bank established in Bahrain 2006. The common *Shari‘ah* applicable principles are *musharakah*, *mudharabah*, and *wakaalah*. Although muzara’ah and *musuqat* are seldom applied in the agricultural sector. In a nutshell, the study provides *Shari‘ah* framework for Islamic venture capital and proposes solutions for pressing issues.

Key words: *Mudharabah, Musharakah,* venture capital, Shari‘ah principles, Shari‘ah framework,

Introduction

Venture capital plays significant role in in three ways; developing human capital, providing financing, and ideation. Therefore, almost all nations concur with the significant importance of venture capital for their economic and social development. However, it is unfortunate that this equity financing method is a missing antique in Islamic world today. Islamic countries being categorized as developing signifies the need for innovation and technology which venture capital is main investment base for venture capital industries. The impact of venture capital industry in socio-economic could be best understood via its historical performance in USA, UK, Japan, and the remaining countries. In view of this, the presence and getting momentum of Islamic finance should be an incentive to set up viable venture capital industries through the use of Shari‘ah principles. Although it has been argued that the origin of venture capital itself could be traced back to *mudharabah* or an Islamic business partnership constituting profit sharing, however, the structure of conventional venture capital still needs some screening processes, whereby some elements that are inconsistent with the principles of Shari‘ah should be extracted including *inter alia* contractual agreements and related constraints, as well as activity of the management and the investee company.

Background and Development of Islamic Venture Capital:

The venture capital activity is an ancient practice, the clear evidence of which could be found in 15th century in the Far and Middle East ((Durrani and Boocock 2006). The merchant practice in the Arabian Peninsula before the advent of Islam embraced both equity and debt financing. The debt financing constitutes two types of *riba (*MabrËq, 2004), namely: *riba al-nasi’ah* (interest loan); and *riba al-fadl* or *riba al-buyuu’*

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(usury trade), and deferred sale of *‘uquud al-mu‘aawaÌaat* (exchange contracts). On the other hand, the equity financing contains *‘uquud al-‘ishtiraak* (participatory contracts). The participatory contracts comprise *mushaarakah (AOIFI, 2008)*, (partnership), *mudhaarabah* (*Majallat Art.1404)* (silent partnership), *musaaqaat* (*Majallah* No.1441), and *muzaara‘ah* (Majallah No. 1431). In general, the participatory contracts are considered as *mushaarakah* and *mudhaarabah* whereby both the contracts are considered separate contract not intertwined. In that regard *mudaarabah* seen as part of *ijarah* while *mushaarakah* is a separate contract. However, some classical scholars mostly hanbalith jurists like Ibn Quddamah (Ibn QuddÉmah, 2004), did consider *mudhaarabah* as type of *mushaarakah.* Thus, they foresee them as intertwined as they go over and under each other. In addition to this, Ibn Taymiyyah and his fellow Ibn Qaayim and others consider *musharakah* as wide concept including *mudharabah*, *muzaara‘ah,* and *musaqat*. In this regard Ibn Qayyim said: The rule of *musaqat* and *muzara‘ah* is the same with the rule of *mudhaarabah* in respect of portion of worker in terms of being common ratio from the total of the fruits…these contracts are kinds of *sharkat* or participatory contracts not exchange contracts; that is *ijarah*(lease) (Ibn QuddÉmah, 2004). He also said: "…also *musaqat* and *muzaara ‘ah*, though some scholars thought that they are kinds of *ijarah* but the right view is that they are under *musharakat* and are in accord with concept of *musharakat.*

It is noteworthy that classical partnership business (*musharakah* and *mudharabah*) took its origin from the equity financing of the pre-Islamic merchant practice. As such, the most widespread merchant practices in the pre-Islamic Arabia were *musharakah* and *mudharabah.* This is prior to the advent of Islam into the peninsula. When Islam comes into Arabia Peninsula, the focus of the Prophet is not to erase commercial practice of the people rather to reform it in a manner that will be in line with *Shari’ah* tenets. As far as Islamic venture capital is concerned, the first question agitating the mind is where does venture capital come from? The simple answer to this could be venture capital is an ancient phenomenon traces back to an earlier time. In fact, it as old as man himself. Interestingly, the way the modern venture capital is structured makes it akin to *mudharabah*. The consideration here will be given to Islamic venture capital with a few discussions on its conventional counterpart.

In view of this, the emergence of Islamic venture capital could be categorized into two evolutions; classical and modern evolution of Islamic venture capital. The first category is classical Islamic venture capital *musharakah* and *mudharabah.* This category dates back to the birth of Islam (Mogens, 1976). This partnership is akin to the pre-Islamic system though with some remarkable reforms. This is because Islamic commercial law comes not to establish the new system which is mean to commercial customs that has become a tradition of populace rather it comes to reform and upgrade the existing contractual customs and laws in fair and fear.

Perhaps, this claim can be supported with some practices in the golden age of Islam including *inter alia* evidence that indicates tacit approval by the Prophet (pbuh) on the pre-Islamic business partnerships (*mudharabah*). The followings are some of the Prophetic tacit approvals relevant to commercial activities:

(a) Abdullah ibn MasÑËd and al-ÑAbbÉs ibn ÑAbdul-MuÏÏalib did engage in *mudharabah* contract (al-ÙabarÉnÊ vol.4, p.161). The Messenger of Allah had been informed about the conditions that ÑAbbÉs ibn ÑAbdul-MuÏÏalib posed on his money given for *mudharabah* investment, and he permitted the practice.
(b) ×adÊth Øuhayb which was narrated by ‘Ibn MÉjah, that the Prophet (pbuh) said: ‘‘There is blessing in three transactions: *al-bayÑ ‘ilÉ ‘ajal* (credit sales), *mËÌÉrabah* (silent partnership), *khalÏu al-Burr bi al-shaÑÊr li al-bayt lÉ li al-bayÑ*, (mixing wheat and barley for home, not for trading).
(c) ImÉm al-KÉsÉnÊ, has stated that the practices of *mudharabah* were carried out by the companions during the Prophetic era without pronouncement of disapproval by the Prophet (pbuh). This tacit approval maintained by the Prophet- may peace and blessing of Allah be upon him-indicates the legitimacy of *mudharabah* contract (Al-KÉsÉnÊ, 2005).

From this evidences and instances, classical and contemporary jurists conclude on validity of *mudharabah* investment with some elements and conditions detailed in juristic tests. This is a short discussion about the classical venture capital initiatives. In the following paragraphs, modern Islamic venture capital would be demystified including west practice of venture capital as it is the origin of modern venture capital prior inception of Islamic finance, which calls the attention of Muslim economists to research for venture capital from Islamic perspective. Henceforth, attentions are drastically directed toward this active equity financing.

The second category is modern Islamic venture capital:

The rise of modern Islamic venture capital began with evolution of modern Islamic finance, which was emerged with the creation of Islamic banks in the early 1960s. However, venture capital is seen as one of the capital market activity. In this regard, the period of 1990s to 2000s considered as a golden era for emergence of Islamic capital market, which comes into being as a result of inactive of funds generated in Islamic banks and Takaful companies on account of limitation in investment opportunities (Securities Commission Malaysia, 2009). This is because the liquidity in Muslims community has not utilized to spur the innovation and development as it is in western world. Therefore, attempts have been made to create Islamic capital markets throughout Muslim countries. Coming to Islamic venture capital, one must take note that here that the idea of Islamic venture capital comes about in different colours namely, in conceptual form, and institutional form.

In a more conceptual sense, the evolution of modern Islamic venture capital could be traced back to the establishment of the first Islamic bank in 1963 at Mit Ghamr by Dr El-Naggar. In this context, Cizacka revealed that the initiative of Dr El-Naggar was just an expansion of the classical *mudharabah* partnership to be applicable in current and complex financial system. He further extenuates the above statement that "the bank has characteristic of triple or two tiers, in addition to multiple *mudharabah* contract. These are; first, the multitudes of investors; the second, the bank; and third, the multitude of firms or entrepreneurs that signed partnership agreement with the Islamic bank. Islamic bank and venture capital do share some similarities; the followings are most important similarities: The first: Islamic bank obtained the fund from the investment account holder on the basis of *mudharabah* usually on 20:80 ratio. That is 20% of the net profit belongs to the bank, while *mudharabah* account holder get 80%. In the venture capital sector the same system is being applied with ratio 20:80 being utilized Securities Commission Malaysia, 2009).

The second: This relates to the structure of the institutions, Islamic bank has double personality; it functions as *muÌÉrib* (agent), in the first phase, to whom the capital provided by *muÌÉrib* is entrusted, at the same time it assumes the role of major investor when it comes to financing the entrepreneurs. This attitude is also observed in venture capital lifecycle.

The third: profit and loss sharing; this stresses on the financial type, support extended to entrepreneurs, and full participation in profits or loss. Hence, both the systems are based on profit and loss sharing; both shun the fixed interest rate applied in conventional banking system (Securities Commission Malaysia, 2009).

In an institutional form, modern Islamic venture capital could be traced back to the *mudharabah* Companies established in Pakistan 1984 (Khan, 1996). The idea of setting up *mudharabah* Companies came on 1979 when President Zia-ul-Haq established the Council of Islamic Ideology (Herein after CII). The CII was created to come up with a blueprint for Pakistan Islamization of economy from 1980 onwards. Thus creation of Mudharabah Companies is a blueprint. The Mudharabah Companies comprise both management and investors. The management will manage the fund and investors contribute capital. However, the management contributes only 10 per cent of the venture capital (Kadri, (1428/1998). The Companies are governed with Mudharabah Companies and Mudharabah Floatation and Control Ordinance 1980 (Khan, (1996).

Giving that *mudharabah* acts the first institution; the Injazat Capital Limited also gets the honour of being the first fund purportedly set up for Islamic venture capital investment. It mainly stresses on private equity with unique transactions such as MBO, ILBO and multi-stage investments.

Injazat Capital was initiated the operation by the Islamic Corporation for the Development of the Private Sector, and Gulf Finance House, in partnership with Dubai Islamic Bank, Saudi Economic Development Company and Iran Foreign Investment Corporation. The firm is registered in Bahrain while the headquartered is in Dubai (the Daily Star, 2004). Injazat Capital is operating in line with the rules of *Shari'ah*, and proves itself to be a successful firm and active participant in investee companies throughout MENA region. It invests portions of capital between $1 million and $5million to hold equity growth potential companies, besides valued added, managerial and marketing skills contributed to enhance the business growth for the interest of all stakeholders make the investee company a success. Above all, Injazat Capital currently manages portfolio of five successful companies, on threshold of stage of expansion; namely: DocMan, Ducoont, Omnix Media Networks, all headquartered in Dubai, and Rubicon and Specialized Technical Services Group (STS), which are based in Amman, Jordan (the Daily Star, 2004).

Moreover, the first banking institution set up to operate venture capital activity in line with *Shari'ah* requirements is Venture Capital Bank (herein after, VCBank). The VC Bank is the first dedicated Islamic venture capital investment bank under the license and regulation of the Bahrain Monetary Agency (BMA), with paid up authorized capital of $500 million and composition of 80 prominent high net worth individuals and institutions from around the GCC region and internationally. The VC Bank launched its $250 million venture capital fund in 2005 focusing on investment in small and medium sized enterprises (SMEs) in the GCC and MENA regions. The fund is jointly established and co-managed by Global Emerging Markets (GEM) the Group of a leading US-based private investment firm with offices in New York, London, and Paris. The fund was launched and marketed by the first quarter of 2006. The VC Bank and GEM Group raised capital together from wealthy individuals and institutions from both the GCC region and internationally.

In Malaysian context, the first Malaysian venture capital company was established in 1984 through setting up Malaysian Venture Investment with approximately 13.8 million fund through the Singapore based South East Asian Venture Investment (SEAVI).This is followed by Southern Bank Venture Capital Corporation, which was set up 1989. It was in the early 1990s that several government-sponsored venture capitals began to exist, namely: Malaysian Technology Development Corporation (MTDC), which was established in March 1992 as a venture capital company, and jointly owned by the government and some private sector entities. At the same year, Perbadanan Usahawan National Bhd (PUNB) was also set up to provide venture financing, managerial, and marketing expertise as well as other valued added services to growing Bumiputera entrepreneurs. Sequence to this development, the Malaysian Venture Capital Association (MVCA) was established in February 1995 to provide a platform for venture capital industry participants to articulate their views and provide input to policy makers on issues relevant to the development of the venture capital industry (Securities commission of Malaysia, 2004).

However, Perbadanan Usahawan Nasiaonal Bhd (PUNB), announced its first Islamic venture capital company on November 9, 2000, owing to rigorous advocating *Shari'ah* complaint financing method. Therefore, PUNB Ventures are of two types *Shari'ah* compliant and conventional investments. Besides the expected initial RM 5million, PUNB still expected to raise funds to be deployed via *mushÉrkah* (partnership) and *musharakah mutanÉqiÎah* (diminishing partnership), *ijÉrah* (lease) *murÉbaÍah-bayÑ muÑajjal* (deferred payment–mark up sales), *istiÎnÉÑ* (deferred delivery sale/ordered), which will be disbursed to investee companies in six stages, namely; seed, start up, first stage, second stage, third stage, and mezzanine. Moreover, the areas of focus of its investment are: automotive sector, consumer goods, electrical and electronic goods, engineering services, transportation, petroleum, and gas, in addition to food, franchising, information technology, steel, rubber, and wood based industries (Amin, 2000).

It was 17 July 2008 that Malaysian Venture Capital Management Bhd (Mavcap), the venture capital arm of the Ministry of Finance launched the first Islamic venture capital fund, managed by Musharaka Venture Management Sdn Bhd. The fund size of RM35 million; RM30 million from Mavcap and RM 5million raised by other investors. The management has been started working towards increasing the size of the fund by approaching several local and foreign investors (Business Times, 2008).

In terms of sectorial focus of the investment, the management discloses that the fund is assessing proposals from among technology; orthopaedic traumas treatment, radio frequency and software companies. Meawhile, the assessment normally takes two months up to a year on each proposal. So, setting up Musharaka Fund by Mavcap is considered as part of its Second Outsource Partners Programme (OSP2) (News Straits Times-Business Times, 2008).

Another a well-known venture capital industry, in Malaysia is CIMB Private Equity and Venture Capital; a subsidiary of CIMB Group that aims at bringing CIMB Group's financial expertise, experience and network into the sphere of private equity investment. It has over RM 1.3 billion in third party funds under the management. It invests in a wide range of industries, such as healthcare, communications, agriculture, information technology and manufacturing. It offers sector specific funding for technology and agriculture companies in various stages of development. For agriculture, the focus is on "integrated Agro" in fisheries, farming, agro and aqua biotechnology and food technology. The investment maybe provided for restructuring, acquisitions or expansions. The investment is range between medium to long term within Southeast Asia. It has as at present over 40 companies in investment portfolio (CIMB).

Also, Navis Capital is a private equity firm established in 1998, with focus in investment on area of growth-oriented buyouts in South and Southeast Asia. The firm manages several private equities funds with limited from well-known US, European, Middle Eastern, and Asian commercial and investment banks, pension funds, insurance companies, corporations, and high net worth individuals and family office. It has six offices across the region including Malaysia. The size of funds under the management of the firm is approximately $3 billion. It has invested in 41 companies, of which 36 are without using acquisition finance. The firm provides investment in *Shari'ah* complaint portfolio in parallel with conventional private equity fund.

Another good example of Islamic venture capital is also KFH; the first bank established in Kuwait 1977 operating in line with the *Shari'ah* tenets. It has emerged as one of the leading Islamic bank across the globe. KFH is the first foreign Islamic bank granted the licence in Malaysia under Islamic Banking Act 1983. This is a response to heels of Bank Negara Malaysia's decision to open the ground for foreign players as stated under its Financial Sector Master Plan to explore investment opportunities and compete with the local institutions. More importantly, KFH offers a wide range of *Shari'ah* based financial products and services. It also established KFH Asset Managment Sdn Bhd(KFH Reports 2009), which is the first foreign Islamic fund manager (special scheme) approved in Malaysia on 14 July 2008 and licensed 25 November 2008. The sector provides asset and fund management activities which encompasses private equity, alternative investments and unit trusts. The asset of this sector amounts to RM215.54 million as at August 2010. Of the funds managed is the Global *Shari'ah* Shipping Fund L.P. and Al-Faiz Fund 1 Limited (a private equity fund).

Performance of Islamic Venture Capital:

Fund Raising:

As at the end of 2007, there were 98 venture capital corporations (VCC) and venture capital management corporations (VCMC) registered under Securities Commissions with funds worth of 3.3 billion. However, most of these funds are conventional funds, while some are *Shari'ah* compliant investment such as Musharakah Venture funds. Of that are CIMB private equity and venture capital, Navis capital which is also a combination of *Shari'ah* compliant with conventional private equity funds, which are over 3 billion, but its investment goes beyond Malaysia. Also, KFH Asset Management Sdn Bhd, which invests in private equity with a fund amounts to 215 million. This shows bright future for Islamic private equity and venture capital in Malaysia.

In addition to the above, the private equity recently in MENA reported to be worth about $2 trillion, out of which the Islamic private equity is worthy about 3 billion. Private equity funds, real estate, and leasing fund have been combined together in Market reports. *Shari'ah* complaint PE funds initiated from the MENA account for 39% of the market (GIFR, 2010).

In spite of current economic meltdown, the Middle East, North Africa, South Asia known as (MENASA) region have been able to record 80 percent growth in private equity investment in 2007 which exceeds $17 billion, however, venture capital funds raised in 2005, 2006, and the last appeal in 2007. Its viability in the MENA is still questionable in terms of presence of quality deal flow and successful exits (Private Equity and Venture Capital in the Middle East Annual Report 2007). If fact, the same also goes for Malaysian context, other than the Malaysian government supports for venture capital including Islamic venture capital has been drastically increased.

Sizes:

In terms of fund size, private equity and real estate funds are the third largest in the Islamic fund universe, after Equity and Fixed income (Private Equity and Venture Capital in the Middle East Annual Report 2007). In addition to that, in Malaysian, the first official Islamic venture capital fund is RM 30 million with RM 5 million by other investors, as well as RM 5 million raised by PUNB and forthcoming fund that has been expected to rise in near future (Amin, 2000). This is in addition to 215 million for KFH Asset Management and CIMB 1.36 billion on *Shari'ah* compliant venture capital and private equity investment.

In fact, the MENA region has currently the largest concentration of high valued funds. A 2007 CORECAP (an alternative investment firm with operations in Dubai and Qatar focusing on the Middle East and Asia) report predicted the Islamic private equity in the Gulf to grow to $ 4 billion by 2011 (GIFR, 2010).

Geographical Focus of Funds:

Malaysia is also a focus for all *Shari'ah* compliant funds, accordingly it is uncovered that the interest of investors from Switzerland and Middle East (Business Times, NST , 2008) in Islamic venture capital fund in Malaysia is steadily increased. As it was clearly stated by many of these firms such as CIMB, Navis Capital, and KFH Asset Management, the geographical focus of the funds is Southeast Asia as well as South Asia. However, in the case of MENA, Egypt is the most preferred sector for private equity (PE) investment for 2006 and 2007, with total capital of $ 1.6 billion in 2007, because the largest two transactions Abraaj Capital's investment in EFG Hermes Holding Company, 2006 and Abraaj Capital's investment in Egyptian Fertilizers Company (Egypt) in 2007) is present there, which indicates the potential of Egypt being an investment destination.

Sector Focus of Islamic venture capital investment:

Basically, most of funds generated in Islamic venture capital and private equity are focusing on technology, however, this is not end up here, as the attention is being directed toward many promising areas such as healthcare, agricultures and consumer sector. A good example for this is statement of the managing director of Musharaka Venture Managment Sdn Bhd. Mr. Nor Idzam Yaakub in a report when saying that the fund is assessing proposals from among technology; orthopaedic traumas treatment, radio frequency and software companies (Mavcap (2008)..

Similarly, Gulf States stresses on diversification of their economies via technology transfer and entrepreneurship in a host of industries including real estate, healthcare, aviation, energy, and telecommunication. Private equity players like RHT Partners are targeting IPO centric sectors and were involved in AED 750 million ($204 million), Dubai Madaares education deal. The other players like Venture Capital Bank has also launched a $100 million real estate fund, besides $3million *Shari'ah* compliant fund that Abraaj raised in 2006 (GIFR, 2010).

Shari'ah Framework Applicable to Islamic Venture Capital:

Since Islamic venture capital bears Islamic coloration, the compliance with Islamic tenets will be a must. In general, there are the three *Shari'ah* principles applicable to Islamic venture capital investments namely, *musharakah*, *mudharabah*, and *wakÉlah*. However, there some underlying contracts without which the basic contracts would come in existence. The contracts includes *amÉnah*, *kafÉlah,ijÉrah*, *muzÉraÑah*, and *musÉqÉt*.

Before further discussion on the principles, it would be appropriate to highlight some Islamic legal maxims regulating partnership agreement. Below are some of the maxims:

a) The basic rule of *musharakah* is permissibility, unless proved otherwise; *al-'aslu fi al-musharakah al-ibÉÍah*);
b) No pains no gains-(*al-ghurm bÊ al-ghurm*);
c) Shares for partners are in proportion to their contributions (*al-ShurakÉu yatarÉja'Ëna baynahum ÑalÉ qadr ÍiÎaÎihim*);
d) Profits should be in form of common ratio from the total profits accrued not the capital; thus any condition stipulates a fixed ratio or poses ambiguity should be null and void;
e) Profit's eligibility depends on capital, skill, and assumption of liability;
f) Profits accrued to *mudharabah* is a capital protective;
g) Basically, *musharakah* agreement is intrinsically built on *wakÉalah* and *amÉnah*;
h) Freedom to disposal of given to partner and entrepreneur depends on permission of the parties or customary practice, or /and partnership interest;
i) Anything forbidden to take or sell should not be a subject matter of partnership business;
j) Any transaction which is individually forbidden is forbidden jointly;
k) A partnership deal left without profit ratio necessitates equal profit ratio;
l) If a valid partnership contract is terminated due to damages causes to one of the parties or third party with a direct connection to the contract, such termination would be made contingent to replacement of damage with guarantee or others (AÏiyyah and AdlÉn, 2007).

The above legal maxims regulate the formation and structure of Islamic partnership contracts, and thus they must be applied in contractual agreement, formation, and structure in the case of Islamic venture capital to be compatible with Shari'ah requirements.

Apart from the above, in Islamic finance, the compliance of products and activities of the respected industry is paramount importance. In that regard, scholars have been working relentlessly to provided certain investment criteria for Shari'ah compliance. Below are summary of the criteria:

a) Business activities of the company must be acceptable from Shari'ah point of view;
b) Debt ratio including interest-bearing debt of the company should not exceed 30 or 33 percent of the net worth of the company;
c) With regard to free trading of shares, it is a condition that some portion of the assets of the company must be illiquid because if all the assets are liquid, circulation of such shares would be trading money at other than per value, which is strictly prohibited. Moreover, contemporary scholars disagree on the proportion of illiquid assets legitimate for free trading of shares. Thus, some say 51 percent, other say 50 percent, some also say 33 percent, while the other views that a considerable portion is permissible.
d) Assessment of interest bearing funds borrowed or receivables of the company, or deposits of its surplus funds in interest bearing account. More importantly, if the original revenue of the company is legitimate such revenue is lawful. But in case of borrowing or deposits in interest bearing account, some scholars do prohibit investment in such company as well. They say its revenue might have been tainted with interest, and purchasing shares of such company shows partnership and interest in all activities of the company. On the other hand, the majority of the contemporary scholars have declared the legitimacy of the revenues of such company. The reasons for the legitimacy are as follows:

i) If someone purchases shares of such company with the aim that any interest accrued will be used for his personal interest, the purchase in that manner would be unlawful.
ii) Some scholars say according to "Islamic legal maxims": the ruling of the part does not encompass the ruling of the whole". Therefore, in front of overwhelming of the company's revenues, the negligible interest should not impact the whole. Some jurists also give benchmark for the unlawful part which is 5 per cent. They say as far as interest income remained 5 per cent of its net worth income; the judgment can be made on remaining whole part.
iii) If a shareholder opposes an interest based transactions, his objection is overruled by huge numbers of shareholders. It is unfair to conclude that he has given consent (Khan *et al, 2008)*.

Shari'ah Principles Applied in Islamic Venture Capital:

Musharakah is literally meat sharing and mixing shares, but technically it means an agreement between two or more parties to combine their assets, labour or liabilities for the purpose of making profit" (AAOIFI Standard No. 12) The legitimacy of *musharakah* is established and confirmed in the Quran and *Sunnah*, followed by *ijmaÑ* (succession of companion). The *sharkah al-Ñaqd* –partnership by contract and its kinds can be applied in venture capital investment including *mudharabah* for those scholars that foresee it as part of *musharakah*. This also includes *muzÉraÑah* and *musÉqÉt* as all fall within the broad scope of *musharakah* based the most preferable view of scholars.

Mudharabah literally means to make a journey. This journey as in the past constitutes traveling to do a business. Technically it means a partnership in profit whereby one party provides capital and the other contributes labour or skills.

WakÉlah literally means preservation and delegation of job to another, performing a task on behalf of another. Technically it means the act of one part delegating the other to act on its behalf in what can be a subject matter of delegation.

This is just to highlight the common *Shari'ah* principles applicable to Islamic venture capital and detailing legal rulings on each principle is out of the scope of the article.

Constraints of Islamic Venture Capital:

The fact that the idea of venture capital investment is alien to Muslim world is a pressing issues to prevent. According to above discussion it appears that there many challenges facing Islamic venture capital. The challenges may also be classified into two namely special and general challenges. For general challenges which can be track down both conventional and Islamic venture capital include *inter alia*: sustainability of deploying funds in quality deals; development of feasible and effective exist strategy in order to realize returns; structuring and improving effective legal and regulatory framework in the region (Mansor, 2008).

With regard to special constraints which are exclusively related to Islamic venture capital as part of *Shari'ah* compliance process include among others; the need for common opinion of *Shari'ah* scholars; *Shari'ah* concerns on both limited and general partnership level, as well as the concept of limited liability in partnership contracts; high usage of leverage in a typical private equity transaction; refinancing the underlying companies of their existing conventional debts into Islamic alternative; common tax issues include the following: duplication of transaction taxes (e.g. Stamp duty); differences in taxation treatment of interest (convention), and profit distribution in Islamic finance; application of withholding tax, GST/VAT implication and entitlement over capital allowances (GIFR, 2010). In addition, the issue preference shares in particular non-cumulative whether it could be universally made applicable to Islamic venture capital investment. Even though, it is acceptable in some Muslim countries like Malaysia, but many other Muslim countries still are reluctant to apply it.

Conclusion:

Venture capital is an active equity investment aimed to help out ventures companies to be a success in return for virtual gains. Venture capital activity is an ancient phenomenon as it relates to history of mankind in all its periods. Nevertheless, the close relation between modern venture capital originated from the Western world and *mudharabah,* and some connecting factors drives some Muslim scholars and western scholar to concur that the origin of venture capital can be traced back to *mudharabah.* The first initiative of modern Islamic venture capital traces back to the first Islamic bank in Mit Ghamr in 1963 and Tabung Hajj. The next step is Mudarabah Companies set up in Pakistan in 1984. This is also followed by the first fund exclusively set up for Islamic venture capital investment by Injazat Fund in 2004. In 2006, Venture Capital Bank of Bahrain was also come into being carrying out Islamic venture capital investment under the roof of banking institutions. In 2008, Malaysia Venture Capital Management (MAVCAP) set up fund for Musharakah Tech Venture, the first Islamic venture capital in Malaysia. Besides the fund, there is Musharakah fund management to manage investment of the fund. The common contracts used in Islamic venture capital investment are *musharakah, mudharabah*, and *wakÉlah*. While *muzÉraÑah* and *musÉqÉt* are seldom used in agricultural sector. The constraints of Islamic venture capital can be of two classes namely, general and special constraints. The general constraints extend to conventional and Islamic venture capital. On the contrary, special constraints are exclusively related to Islamic venture capital such as standardization of *Shari'ah* point of view on certain issues like preference shares, screening, limited liability partnership, and others. It should be advisable to create healthy climate and environment conducive, coupled with effective legal and regulatory framework to support venture capital activities in Muslim world. To have an effective venture capital industry, the spirit of work culture should be inbuilt in *ummah* and open market within Muslim countries should be encouraged followed by the global market at large.

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