ORIGINAL ARTICLES

The Principle of Risk Management: Sharia Perspectives

Azlin Alisa Ahmad and Salmy Edawati Yaacob (PhD.)

Department of Syariah, Faculty Islamic Studies, The National University of Malaysia, 43600 UKM Bangi, Selangor, Malaysia.

ABSTRACT

Risk management has started centuries ago. Till today, financial risk management is vital for businesses, industrial and financial institutions to continue to survive. Risk management is very important and is strongly recommended in Islam. However, risk management cannot be dissociated with derivatives instrument because derivatives are basically designed to manage risk. Even though the derivatives instrument is needed to manage risk it is also infamous for speculative purposes. In fact, derivatives also have *sharia* issues such as injustice, non-transparency, *riba* (usury) element, *gharar* and gambling. Hence, the objective of this study is to discuss the necessary basic principles of *muamalat* that should be present in the management of risk in order to fully adhere to the principle of *sharia*.

**Key words:** risk management, Islam, Sharia

Introduction

The key to successful enterprise is dependent on the attainment of efficient risk management. The management of risk is often associated with the use of derivatives for the original design of derivatives is to manage risk. However, most of the Islamic scholars are of the opinions that when the derivatives instrument is used to manage risks, gambling activities will begin and the activities of risk management will end (al-Saati 2003); (al-Suwailem 2006). Nevertheless, Obiyathulla (1999), Kamali (2005), Securities Commission (2006), al-Amine (2008), and Saadiah (2008) permit the use of derivatives as long as it is used only for the purpose of risk management.

Risk should be efficiently managed because if not, it can cause escalation of costs rate, decline in the rate of returns, decline in profit rate and occasionally lead to a loss of profit. Risks such as currency rates fluctuation, prices, interest rates, and inflations could probably be harmful to the parties involved if the necessary precautions are not in effect. The process of risk management in Islamic finance is generally the same as in the conventional finance (Mohamad Akram Laldin and Shabnam 2009). However, Islamic finance introduces an additional process i.e. *sharia* screening. Negative *sharia* screening refers to the forbiddance of *usury*, *gharar* and *maysir*. On the other hand, positive *sharia* screening refers to the attainment of *maqasid al-sharica*. An efficient risk management is a prerequisite in *sharia* because it likens to assets guardianship which is part of *maqasid al-sharica*. Thus, any negligence of measures affecting the efficiency of risk management is against the *sharia*. Therefore, this article will discuss the management of risk according to the Islamic perspective by analysing the *sharia* principles outlined in the risk management.

The Basic Principle of Muamalat in Risk Management:

The Islamic risk management must adhere to the *sharia* principles and in compliance with the guidelines as stated in Islam. Among the principals of *muamalat* as stated in Islam are the principle of justice, transparency, the forbiddance of usury, the forbiddance of *gharar* and the forbiddance of activities which have forbiddance elements.

The Principle of Justice:

Justice is an important value to be appreciated by mankind because it will ensure the well-being of mankind in the world and the hereafter. Islam gives equal opportunity to all Muslims in the field of *muamalat*. They have the right to make use of the economic resources available to best fulfil their needs accordingly. However, there is an economic theory that human needs are unlimited (Chapra, 1985). These unlimited needs make some people greedy and selfish. This act is not fair because the true social welfare is not achieved. Islam also allows for wealth accumulation, though fairness and balance in the world and hereafter is priority. Thus, wealth...
accumulation by the greedy without fairness and balance in this world and hereafter is forbidden. Wealth cannot be controlled by certain groups but must be distributed fairly. Furthermore, the resources that Allah SWT bestowed to mankind are not just anything but a trust from Allah SWT that one must uphold.

All contracting parties must share the risks as far as the aspect of risk management is concerned. The practice of transferring the risks as what is being done in the conventional finance is not fair to the parties involved. Risks transfer indicates that one does not face the risks, thus the proceeds realized without risk-taking is prohibited in Islam. Risks transfer brings negative effects on the economy because it will cause an increase in the amount of risk in the financial institutions and subsequently resulted in the collapse of the interbank market. Consequently, the act of transferring risks leaves the burden of conventional risk management and liability to others.

Besides, the 2007 financial crisis, also known as the subprincipal crisis was caused by high lending rates charged to the lower class borrowers. The imposing of higher interest rates is one way the financial institutions used to avoid the risk of loss when that debt is not settled. Loans given to people who do not qualify and cannot afford to repay reflect the occurrence of oppression and injustice because this group will be charged a higher rate due to their high risk profile. According to Tag El-Din (2009), interest bearing loans and borrowings is the most popular borrowing strategy for a return of capital without the risk of loss. But, it is a strategy that is unfair because all risk is transferred to the borrower only.

In Islam the process to achieve a goal is as important as the goal itself (Mohamad Akram Laldin & Mokhtar, 2009). Whereas the risk management which is permissible in Islam must uphold the principle of justice in order to ensure everyone’s right is protected as mentioned in a hadith, in translation: The Prophet s.a.w. (peace be upon him) said: Allah said: I am the third from two people who are in trading as long as one does not sell out or betray the other.

The principles of risk management in investment and business are closely connected with justice, which is by creating a balance between the contracting parties according to the fiqh method. Thus, to achieve an optimal risk management, the approach to manage these risks must not violate the principles of justice. In fact, Islam insists on justice in the distribution of wealth among the society without any oppression and persecution.

**The Principle of Transparency:**

The second principle to be observed in the muamalat activity is the transparency principle. This principle encourages mankind to carry out their deeds with honesty and in a transparent manner. Hence, they will always be honest and will not cheat for their own gain. Thus, any act of cheating contrary to the principle of transparency is despised by Islam. Allah SWT said in the Al-Qur’an: ...and Allah will never guide the snare of the false ones (Al-Qur’an, Yusuf 12:52).

*The Prophet s.a.w. (pbuh) said:* 

Once, when passing by a grain merchant, the Prophet s.a.w. (pbuh) thrust his hand into the heap of grain and found it wet.”What is this, O merchant?” he asked. “It is because of the rain,” the man replied. The Prophet s.a.w. (pbuh) then said to him, “Why did you not put it on top so that people could see it? He who deceives us is not of us.”

The hadith above shows that Islam forbids the acts of cheating and concealing the defects of any products to gain hefty profits, instead the seller must explain the defects to the buyer. The act of cheating is a reference to a known defect but not made known to the buyer. This detestable act of non transparency is despised in Islam and cursed by Allah SWT. The punishment is appropriate to any dishonest person because it violates the principle of transparency that hinders contracting parties (buyers) of the benefit owed to him. Therefore, any non transparency or concealing the true and actual information is prohibited in Islam and is against the ethics of the Islamic muamalat.

For the purpose of risk management, the application of CDS (Credit Default Swap) which has the same function as an insurance, which is intended to shelter from credit risks, have also raised several issues of non transparency for there is no regulation in place to monitor the activities such as the requirement of true asset ownership to buy CDS. This has opened up opportunities for speculator to reap profits by selling CDS to anyone interested to have it. Owing to the securitization of asset which is not based on real assets, but instead debt based, the failure to pay debts will cause the issuing financial institution to also fail to provide the promised returns. The absence of strict laws as a clear contract also resulted in no one knows the actual amount of use of CDS, and the real identity of the buyers and sellers. According to International Swap and Derivatives Association (ISDA), the total notional outstanding of CDS fell by 12 percent in the first six months of 2008, which is from US$62.2 trillion to US$54.6 trillion. This means that non transparency exists because the whereabouts of US$50 trillion of CDS in the market is unknown (Asyraf Wajdi & Smolo, 2009).
This proves that the use of CDS is not only incapable to manage the risk of bad repayment, but also resulted in other risks such as liquidity risk and emerging market risk that would eventually create a systemic risk in the financial markets (Hassan 2009). This scenario also shows that without the principle of transparency in managing credit risk, other problems will ensue.

By adhering to the principle of transparency in the management of risk, then all activities undertaken are transparent and clear without any fraud or exploitation by certain groups. This ensures that no individual can take advantage in taking more than what is right and not in derogation of the rights of others (al-Qaradawi, 1998). Hence, this principle can guarantee the maximum contentment of mankind for the principles of transparency gives benefit to all parties.

No Element of Usury:

Usury means an additional of no equal in value term (al-Misri, 1987). The act of taking and receiving usury is despised in Islam because of the ill-effect to the community and nation, more so when usury is the cause of economic inflation. Usury also results in the wealth accumulation confining to only certain groups, widening the gap between the rich and poor. The weak and poor will always remain in hardship and oppression. They have trouble paying due to the excessive high rates imposed for late debt repayment. This is a burden to those who can’t afford and is a mistreatment to their lives. This situation illustrates that usury causes the loss of the practice and spirit of helping each other that the concept of qard al-hassan promoted in Islam has failed to function. On top of that, usury also causes the kinship and brotherhood gap to widen, degrading and wrecking the fabric of social community due to the traits of greed, selfishness and money flirtation. This in return will create hate, revenge, cruelty, animosity, exploitation and destruction in the society (Chapra, 1984). Indeed, the practice of usury will also tend to make people lazy in striving for the better because they are confident of getting regular fixed gains without having to work hard. As a result, the production activity is stalled because manpower, which is one of the productivity factors, is unutilized and wasted. Thus, to achieve optimal level of the economic, the act of usury which is pivotal of all problems must be entirely eliminated.

No element of Gharar:

As discussed earlier, the element of gharar cannot exist in the mu'amalat transactions such as risk management because it can cause harm to the parties involved. Risk management using derivatives instrument is only allowed if the element of gharar is non existence. The permissible use of derivates for risk management however is strongly opposed by the fiqaha due to the existence of gharar when the product delivery and prices are deferred.

According to Siddiqi (2009), there are two methods of risk management; risk sharing and risk transfer. Risk sharing method can lead to more equitable income distribution. Instead, risk transfer can result in injustice, persecution and animosity. In general, the most popular method of risk management in conventional finance is the use of derivatives. Derivatives are a form of complex securities, transferring one form of risk to others, but in reality creates another form of risk (Hassan, 2009). This method is also known as risk shifting (Gassner, 2009). Risk transfer actually had adverse effects on the economy because it will cause an increase in the total risks of the financial institutions and inadvertently resulted in the collapse of the interbank market.

Besides that, the often occurrences of financial crisis in the world economies are due to the existence of gharar element. For risk management purposes, information regarding a subject must be truthful, clear and transparent. Instead, the opposite happened when the majority of the Wall Street fund managers dabbled with the wrong and false information and manipulated that information. This led to mismanagement of risk and inadvertently caused other risks to also emerge in the financial system.

Hence, the principle of prohibition of gharar is to ensure the fullest acceptance and satisfaction of the parties involved in risk management. This acceptance will only be achieved through certainty, full knowledge, full disclosure and transparency of information about the object of the contract. With the compliance of the principle of prohibition of gharar, the injustice and exploitation among the contracting parties can then be avoided.

No Containment of Prohibited Elements:

The Islamic muamalat principle states that every undertaken transaction must be free of prohibited elements. Among the prohibited elements are gambling activities, speculations and manipulations. Other than that, the muamalat principle also stipulates that every transaction entered cannot be in corroborative with illegal activities such as drug, gambling, pornography, the production of dangerous products and the likes.

The word gambling refers to a wager of asset in anticipation of huge profits through excessive risks taking. Gambling is also a game or wager that depends on pure luck without the involvement of real economic activity (Ayyash 2005). The practice of gambling has been forbidden by Allah SWT as mentioned in the Al-Qur'an,
with translation: O ye who believe! Intoxicants and gambling, dedication of stones, and divination by arrows are an abomination of Satan’s handwork. Eschew such abomination, that ye may prosper. Satan’s plan is to excite enmity and hatred between you, with intoxicants and gambling and hinder you from the remembrance of God, and from prayer. Will ye not then abstain? (Al-Qur’an, Al-Maidah 5: verses 90-91).

The above verses prove how abomination is the practice of gambling. Allah SWT has warned His subjects to eschew the practice of gambling and likens the act as dirty and despicable spoor and satan’s handwork. This shows that when one conducts the activity of gambling, Satan would dominate oneself and hinder the remembrance of Allah SWT.

Islam forbids gambling activities that yield unworthy returns which resulted in only one party to win and gain huge profits while the other lost and victimized (al-Saati, 2002). In fact, the unearned income is actually derived not from their efforts (unearned income) and is a liability to others. The prohibition of gambling shows that the third parties are not allowed to “buy” at risk. This is because gambling is a risk taking activity that are sold or transferred from other parties as was the case in many speculative financial products such as CDS (Siddiqi, 2009). The effects of speculative activity are similar to the adverse effects of gambling because both are dependent on sheer luck alone (al-Saati, 2002).

Speculative activity is normally associated with the derivatives market due to the existence of high leverage element in that market. With the convenience of leverage, it is easier for speculators to speculate because of the speculation power that they have are much stronger than the underlying assets. This is because the similar utilization of huge capital can mobilize much larger amounts in the underlying assets of derivatives compared to the normal assets.

On top of that, the acts of gambling and speculation also allow investors/speculators to place their bets based on the prediction of one entity’s credit quality. Therefore, if a company is predicted to be in default they would buy the CDS and sell if it is not (Hassan, 2009). This illustrates that the use of CDS is no longer specific to credit risk protection but instead being manipulated by the speculators to gain profits through betting.

Meanwhile, in the wake of a tendency to carry out speculation and gambling activities to multiply gains; the earlier objective of risk management is not achieved. This is evidenced by Stout (2009) who says that according to BIS, the notional CDS market is US$67 trillion, while the total market value of the underlying bonds issued by the US companies are only US$15 trillion. When the notional value of derivatives market is four times more than the underlying market, this shows that most derivatives trading is aimed at speculation, not hedging (Stout 2009). Therefore, to ensure that the activities of risk management to do well, the elements that contravene with the sharia must be avoided.

The Significance of Risk Management According to Islamic Perspective:

There are many inherent arguments to show the significance of risk management in everyday’s life. In this context, the significance of risk management according to Al-Qur’an, hadith and consensus will be discussed. The significance of risk management in maqasid al-shari’a will also be highlighted.

The Importance of Risk Management According to Al-Qur’an:

Every human being who is the caliph (vicegerent) of Allah SWT must accept all His divine stipulations and succumb to His qada’ and qadar (actions and reactions). Nevertheless, this does not mean that we just have to sit back and be submissive without thinking about how to evade unwanted incidents from happening. On the contrary we should be ready to face any test that comes our way.

There are many verses in the Al-Qur’an which attributes to the significance of risk management so that mishaps can be avoided. Among them are:

“O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties: let not the scribe refuse to write: as God Has taught him, so let him write. Let him who incurs the liability dictate, but let him fear His Lord God, and not diminish aught of what he owes. If the party liable is mentally deficient, or weak, or unable Himself to dictate, Let his guardian dictate faithfully, and get two witnesses, out of your own men, and if there are not two men, then a man and two women, such as ye choose, for witnesses, so that if one of them errs, the other can remind her. The witnesses should not refuse when they are called on (For evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: it is juster in the sight of God, More suitable as evidence, and more convenient to prevent doubts among yourselves but if it be a transaction which ye carry out on the spot among yourselves, there is no blame on you if ye reduce it not to writing. But take witness whenever ye make a commercial contract; and let neither scribe nor witness suffer harm. If you do (such harm), it would be wickedness in you. So fear God. For it is God that teaches you. And God is well acquainted with all things. If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully)
discharge his trust, and let him Fear his Lord conceal not evidence; for whoever conceals it,—his heart is tainted with sin. And God knoweth all that ye do. (Al-Qur’an, al-Baqarah 2: 282-283).

The above verses clearly explain about the importance of debt contract documentations. Ibn Kathir (1998) reveals that these verses are related to debt transaction that has been applied by the community. In virtue of this transaction involving future obligation payments, Allah SWT suggested for both parties (the borrower and the lender) to record all relevant matters and transactions. Even though the word “faktubuh” in these verses is not obligatory command nevertheless it is an order to be very wary of anything that is risky. The risk here is the probability the borrower disavows the debt claims against him (Ibn Hajar 1993). In these verses, Allah SWT ordered His servants that when they practiced muamalat, which was any transactions involving future payment obligations, the debts were to be recorded in writing, clearly stating the rates, time and with the presence of witnesses for this would ease the burden of doubts. Allah SWT in these verses also ordered His servants to be wary of all risky matters. The documentations of debt must be recorded clearly so that the right of the lender will be guaranteed from the risk of denial or disavow from the borrower’s obligation to settle their debts.

The verses also suggested that the debtors to provide for collateral to the creditors to safeguard the right of the creditors. With the collateral provided, the creditor will no longer face the risk of possible non-payment of debt. However, the word amanatalhu in those verses refers to the reliable and trustworthy debtors for they are not required to provide for collateral (al-Khin et al., 2005).

According to Hasan Basri, the word tahlukah gives the meaning of stingy, misery or mingy. According to Zaid bin Aslam, the verses above refer to a delegation sent by the Prophet s.a.w. (pbuh) with inadequate provision, and that they feared of hunger and famine. So Allah SWT ordained them to spend on His missions to eliminate losses as a result of stinginess (Ibn Hajar, 1993). From the explanation of these verses, it can be concluded that Allah SWT ordains us to make a good planning in our expenses in order to avoid the path of destruction (al-Tabari 2005).

Apart from that, other evidence for risk management in Islam is the economic planning of Prophet Yusuf (Joseph) alaihissalam (a.s) as mentioned in the Al-Qur’an when Prophet Yusuf a.s. became the first Economic Minister of Egypt. The verses of the Al-Qur’an below illustrate how the Prophet Yusuf a.s. made planning so that his people do not suffer from hunger and famine after the King of Egypt dreamed of an oncoming draught. The prophet has made a good and careful planning to ensure that the country has enough supply and provisions during the recession. Al-Qur’an says:

“Going to Yusuf, he said, “Yusuf, O man of righteousness! tell me the meaning of the dream of seven fat cows whom seven lean cows are devouring, and of seven green ears of corn and seven withered ones. Maybe I go back to those people and they might understand it.”Yusuf answered, “You will cultivate land for seven consecutive years as usual. During this period thrash out of the harvest you reap only that much grain that might suffice for your food and leave the rest in the ears. Then, after this, there shall come upon you seven hard years. Then you will eat up all that corn you might have kept for that period except that you will have reserved in the store. After that will come another year in which there will be abundant rainfall in answer to the prayer of the people and they will press (juice and oil). (Yusuf 12: verses 46-49)

The Prophet Yusuf a.s. interpreted the King’s dream where the soil would be fertile for seven years due to the abundant of water. At that time, the people of Egypt would gain bountiful provisions from harvests if they worked hard to cultivate the land. However, Prophet Yusuf a.s. advised his people to harvest only what was needed and waste not. They were advised to save some so that it could be used during the lean years, after seven bountiful years. The advice of Prophet Yusuf proves how important is planning for the future in order to avoid hardship.

In the same chapter, there are evidences regarding the importance of careful planning to ensure smooth running of a journey so as not to be overly exposed to big risk. Allah SWT said: “Then Yaacub said "O my children, do not enter the capital of Egypt by one gate but go into it by different gates. However know it well that I cannot ward off from you Allah's will for none other than He has any authority whatsoever. In Him I have put my trust and all who want to rely upon anyone should put their trust in Him alone”. (al-Qur’an: Yusuf, 12: 67).

The above verse focuses on the advice of Prophet Yaakub a.s. (Jacob), Prophet Yusuf’s father. Prophet Yaacub a.s. had advised his children to be careful when entering the City of Egypt by using different gates. This is because Egypt is a big city that likely there would be many trials and dangers unknown to them. The strategy aimed to avoid suspicion and envy of the public. So they should be careful so as not to let danger to harm them. Only when the strategy to use different gates was taken, the Prophet Yaakub then ordered his sons to leave their fates to Allah SWT. The advice from this verse reflects the significance of risk management that is, always be safe from any bad things and Allah SWT will always protect and safeguard it.
The Management of Risk According to Hadith:

There are a lot of hadiths describing the importance of risk management in Islam. Among them is: “I’qilha wa tawakkal”. The hadith tells the story of an Arab asking the Prophet Muhammad s.a.w. (pbuh) about his camel, whether he should leave it to Allah SWT or tie his camel and then just leave its fate to Allah SWT. The Prophet Muhammad s.a.w. (pbuh) instructed him to tie his camel first before leaving its fate to Allah SWT. This shows that while everything is already predetermined by Allah SWT, it is more paramount to first strive and think for the best options available. Despite all that happens is the qada’ and qadar and already determined by Allah SWT, but just to rely solely without giving it an effort is not allowed. Thus, in this case, the risk that the camel would run away or stolen could be minimized by having it tied up. This hadith also shows how the Prophet Muhammad s.a.w. (pbuh) takes great concern about endeavours and efforts and trying before leaving it fully in the hand of Allah SWT.

The Islamic concept of risk control is closely related to the concept of vigilance or al-ihitiyath of doing things. It has been recommended by the Prophet Muhammad s.a.w. (pbuh) in many ways. Among them is the washing of both hands before performing ablation soon after waking up from sleep as stated in the hadith narrated by Abu Hurairah, the Prophet s.a.w. (pbuh) said, in translation:
... and when one of you wakes up from sleep, one should wash both hands before performing ablution because you wouldn’t know where you position both hands during sleeping.

In another hadith narrated by Abu Hurairah regarding the preparation to sleep, the Prophet Muhammad s.a.w. (pbuh) said, in translation:
When one of you is going to his sleeping place, one should whether (flap) his bed with the end of his cloth because one would not know what befoul his bed, then one should say: In the name of Allah, I lay my body, and with your name I wake up, if you take stop of my breath, then bless my soul, and if you release it back to me, then preserve it as you preserve your pious servant.

Based on the hadith above, al-Qurtabi concludes that one should flap his sleeping place before sleeping because of the possibility of something hidden in the form of liquid or the likes. Ibn al-Arabi states that this hadith shows that we should conscientious and look at reasoning in order to avoid from bad qadar (stipulations). This hadith also relates to the hadith mentioned earlier, that is i’qilha wa tawakkal (Ibn Hajar 1993) from the aspect of vigilant in doing something. In addition, being cautious and careful in making decision is also emphasized so that any decision made will do no harm or incur no loss. After having satisfied of all the decisions made, only then can we leave ourselves to the disposal of Allah SWT.

Besides that, there are many hadiths that emphasize on the importance of making efforts in every activity and then pray and leave its fate in the hand of Allah SWT. An example of risk management in business during the period of the Prophet Muhammad s.a.w. (pbuh) was a hadith narrated by Ibn ‘Abbas r.a:

Based on the hadith above, the Prophet s.a.w. (pbuh) permits the setting of terms and conditions in the mudarabah investment with the intention to minimize the risk of goods being damaged. It is also the same with the following hadith which attests to the good management of risk as a need in a muamalat transaction. So, the act of taking risk cannot be avoided by a person who expects a profit as stated in hadith: “al-kharaj bi al-daman” means “Profit is the return for loss”.

Based on the hadith above, al-Sancani (1997) is of the view that in the buy and sell transactions, if the goods purchased were faulty, then the item must be returned to the seller and the seller must be responsible for the damage. Without taking the risk and responsible over the damages, defects and missing products, a trader has no right over the profits made. Al-Zuhayli (2006) states that if anyone who bears the cost and risk of loss, only then they are entitled to benefit or gain, if there is any. In other words, the earnings from the sales of products without products warranty against damage are not permitted in Islam.

The Management of Risk According To the Method of Fiqh (Islamic Jurisprudence):

Various methods of fiqh below show the importance of risk management in Islam (al-Suyuti 1990; Ibn Nujaym 1999): “La dharar wa la dhirar”

This method is the most important rule in the Islamic sharia. Its implementation is extensive enough to include various fields of fiqh. It proves that the ultimate objective in Islam is to realize the welfare and interests and prevent injury and damage. Therefore, any harm to soul, property or honor is not permitted at all. Islam also pronounces that any harm cannot be reciprocated by doing the same to others. This means that injuries must be avoided at all costs.

The above method clarifies that any harm and destruction must be overcome. Likewise, the effects from the injury inflicted shall be rectified and treated in the best possible ways. Meanwhile the prevention of any harm should be avoided for allowing harm to occur is a cruelty and injustice and is forbidden in Islam.
This method means that any harm and destruction must be avoided before it does occur and inflict mankind, thus the level best efforts must be prescribed to prevent it from happening. As the proverb says “prevention is better than cure”, more so in Islamic sharia when it allows al-hijr (refraining from spending) with the intention of avoiding harm and distraction that may occur as a result of the action of safih (foolishness) and the debtor (al-Bugha and Mistu, 1994). In other words, the above method states that of the high risk that must be removed in conjunction with the sharia ultimate objective of protecting the benefits of the people.

The following fiqh method shows that to rebuff destruction is more important than the efforts to earn profits. This means, to minimize risk is more important than earning profits because risk is seen as destruction (Tag el-Din 2009).

If there is a collision between harm and benefits, then harm must be avoided. This is because the observation of syarak regarding things which are not permissible is more important than the observation of things that have been ordained (muurath). In general, this method is implemented on the injury that has occurred and that at the same time could be avoided. This shows that the lesser injury takes precedence over the greater and worse injury. The method above is always deliberated specifically when two uneventful harm were about to collide, Islam gives the choice to commit the lesser harm in order to prevent the greater harm (Haydar, 1991).

All the above fiqh methods give the views that Islam emphasizes the matters of effort and ingenuity to reduce and control the presence of risks. With this, risk management is highly recommended in Islam in order to avoid unwanted harm and destruction. Following this, all fuqaha (Islamic scholars) unanimously have agreed on the necessity of risk management because of its big role in human life. The failure to manage risk is the cause of significant financial losses and eventually the world financial crisis recently. The table below illustrates the losses suffered by the various worlds’ leading companies due to weakness in managing risks.

The Relationship of Maqasid al-Shari'ah and Risk Management:

Every transaction conducted in the economy, business and finance should be based on sharia. The concept of sharia is very broad, encompassing all regulations including regulations regarding muamalat. These regulations are vital in ensuring that all parties involved in muamalat activities enjoy the benefits from the transaction and attained maqasid al-shar'i a.

According to Ibn 'Ashur (2001) maqasid al-shar'i a refers to the preservation of good and rejection of evil, upholding justice and nurturing stability. In this relation, the main sharia objective is to preserve good and forbid evil (jalb al-masalih wa dar' al-mafasid). This objective is vital to safeguard the public interest, i.e. the well being of mankind in this world and hereafter.

Maqasid al-shar'i a can be categorized into three, i.e. daruriyyat, hajjyyat dan tahsinyyat. The daruriyyat of Maqasid al-shar'i ah is the guardianship of religion, body, mind, lineage and assets. The guardianship of these five basic human rights is also known as al-daruriyyat al-khamsah. This means that the need to safeguard one’s asset is very important because is a part of daruriyyat category.

The guardianship of asset is a trust and responsibility given by Allah SWT to His servants. Asset is a necessity to live a life. However, in pursuit of asset guardianship, one has to face the risk because it is part of life. Hence, every individual must strive to safeguard his asset and take the necessary steps to reduce the risk so as not to cause hardship.

In economy and business, a too high risk could negatively affect the business activities and the financial performance of a company such as losses in revenues and costs overrun. Because risks could badly affect the industries and businesses, the problems must be overcome by applying a systematic risk management. A systematic and orderly risk management can prevent the exposure of asset from danger and can safeguard the benefits of all parties concerned. The attainment of well being or benefits also means the attainment of maqasid al-shar'i a. This means, the objective of all communities’ well being and avoiding harm to the asset as a result of too many risks will be achieved. So it is compulsory for every individual to strive hard in avoiding loss of property which may threaten the lives and economic status.

Since risk is ill-favoured, it is regarded as destruction and harmful which must be reduced and minimized. This is in accordance with the rules of fiqh of al-darar yuzal which means that the risk must be eliminated earnestly. Since the existence of risk is a fact of life in the economy and business world, it is the prerogatives of all parties concerned to take the necessary steps to minimize those damages. They are vital because it is the prerequisite to the successful continuity of a business activity. With the right strategies to reduce risk, huge losses can be overcome. In one swoop the well being of the community can be guaranteed, and when the objective of sharia is attained, then the real success (falih) will also be attained.

As mentioned before this, the guardianship of asset is one the five basic human needs that must be preserved. Thus, the cooperation in reducing the effect of harm and distraction is recommended based on maqasid al-shar'i a which emphasises the safeguarding of assets. The failure in safeguarding the assets against risks and losses is deemed as neglecting one’s responsibility towards his religion and is very much despised by
Allah SWT. Neither the act of passiveness nor of not taking any step to safeguarding the assets from risks is acceptable, as though it is neglecting the maqasid al-sharī’a.

Conclusion:

The management of risk is a very important factor and is highly recommended in Islam. Islam recommends risk management considering that it could preserve the values of an asset. Even to avoid harm is more important than reaping the returns, and financial risk is deemed harm that needs to be avoided. It is a fact of life that all activities which promise a return contain elements of risk. If that is the case, then a smart management of risk is needed for a business with interests in maximizing profit and minimizing loss.

Therefore in this relation, it is a prerequisite for all parties concerned in financial transactions, specifically the investors and businessmen to find a balance between the needs to taking risk and the needs to reducing risk systematically. Moreover, the objective of assets guardianship is in line with the objective of Islam as enshrined in maqasid al- sharī’a. Even though the objective of values guardianship is allowed in Islam, the method towards the attainment of risk protection however must comply with the prescribed principles – the principle of justice, transparency, no element of usury, no element of gharar, and no elements prohibited in Islam.

References


