

# Intellectual Discourse

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# *Intellectual Discourse*

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## Transliteration Table: Consonants

Arabic	Roman		Arabic	Roman
ب	b		ط	ṭ
ت	t		ظ	ẓ
ث	th		ع	‘
ج	j		غ	gh
ح	ḥ		ف	f
خ	kh		ق	q
د	d		ك	k
ذ	dh		ل	l
ر	r		م	m
ز	z		ن	n
س	s		ه	h
ش	sh		و	w
ص	ṣ		ء	’
ض	ḍ		ي	y

## Transliteration Table: Vowels and Diphthongs

Arabic	Roman		Arabic	Roman
اَ	a		اَ، اِيَّ	an
اُ	u		اُو	un
اِ	i		اِي	in
اَ، اِ، اِيَّ	ā		اَو	aw
اُو	ū		اَي	ay
اِي	ī		اُو	uww, ū (in final position)
			اَي	iyy, ī (in final position)

*Source: ROTAS Transliteration Kit: <http://rotas.iium.edu.my>*





# Developing *Sharī'ah*-Compliant Asset Pricing Model in the Framework of *Maqāṣid al-Sharī'ah* and Islamic Wealth Management

Igo Febrianto\*  
Norhayati Mohamed\*\*  
Imbarine Bujang\*\*\*

**Abstract:** This article offers a conceptual framework for developing the *Sharī'ah*-Compliant Asset Pricing Model (SCAPM) using the *Maqāṣid al-Sharī'ah* and Islamic Wealth Management (IWM). This article also provides a new perspective on finding Islamic financial benchmarks as an alternative to conventional financial benchmarks in the Islamic finance industry. This research was conducted using a qualitative research method with deep reference to published journal articles and books in the fields of *Maqāṣid al-Sharī'ah*, Islamic Wealth Management, and asset pricing model. As a measure of the expected minimum rate of return in an asset pricing model, this article proposes the fulfilment of basic necessities (*darūriyyāt*) and zakāt rate as proxy for investors' required rate of return. This study acknowledges both systematic and non-systematic risk's effects on asset pricing.

**Keywords:** *Maqāṣid al-Sharī'ah*, *Sharī'ah* compliant, asset-pricing model

**Abstrak:** Artikel ini menyediakan rangkai kerja konseptual untuk membangunkan Model Harga Aset Patuh Syariah menggunakan *Maqāṣid al-Sharī'ah*. Kajian ini juga memberikan perspektif baharu dalam mencari penanda aras kewangan

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Islam sebagai alternatif kepada penanda aras kewangan konvensional dalam industri kewangan Islam. Penyelidikan ini dijalankan menggunakan kaedah kajian kualitatif dengan rujukan mendalam kepada artikel jurnal dan buku terbitan dalam bidang *Maqāṣid al-Sharī'ah*, Pengurusan Kekayaan Islam, dan model Penentuan Harga Aset. Sebagai ukuran jangkaan kadar pulangan minimum dalam model penetapan harga aset, artikel ini mencadangkan inflasi sebagai proksi untuk memenuhi keperluan asas pelabur dan Zakāt sebagai proses pembersihan dan pengagihan kekayaan dalam Pengurusan Kekayaan Islam. Kajian ini mengambil kira kedua-dua kesan risiko sistematik dan tidak sistematik terhadap penentuan harga aset.

**Kata kunci:** *Maqāṣid al-Sharī'ah*, patuh syari'ah, model penentuan harga aset

## Introduction

The relationship between the expected return and risk in investment has an important role in a financial decision and lies at the heart of financial management. In Islamic finance, this relationship is governed by the principles of risk and return sharing, wherein investors share both the risks and potential profits of an investment. This stands in contrast to conventional finance, where investors typically expect fixed rates of return. This unique risk-return relationship serves as the theoretical foundation for the development of *Sharī'ah*-Compliant Asset Pricing Model (SCAPM) for investment in the Islamic financial industry (Selim, 2008; Sadaf, 2014; and Hazny et al., 2020).

It is interesting to note that classical Islamic literature has discussed the connection between return and risk in investment. In this context, *Majallāt al-Aḥkām al-‘Adliyyah*, the Ottoman Empire's civil code from the late 19th and early 20th centuries, outlines the principle of *al-ghunm bil ghurm* as one of the *Sharī'ah* legal maxims. This principle, detailed in article 87, states that an investor, as the owner of the underlying asset, activity, or capital, must bear market risk and ownership risk in order to earn a return on his investment (Abdullah, 2022). To manage assets effectively, investors must assess risk factors alongside expected returns. Understanding the relationship between return and risk, guided by principles of *al-ghunm bil ghurm*, enables informed decision-making for achieving expected returns.

However, it must be admitted that in the modern era of empirical literacy, Islamic finance has lagged behind conventional finance due to

a lack of data and research, standardisation, government support and regulation, specialised human resources, and its small global market share. This is evident in the evolution of financial theories and models. In conventional finance, to elaborate the relationship between return and risk in investment, Sharpe (1964), Lintner (1965), and Mossin (1966) have developed a famous asset pricing model known as the Capital Asset Pricing Model (CAPM). This model simplifies the relationship between return and risk, expressing expected return as the sum of the risk-free rate and the market risk premium, offering a quantitative measure of risk-adjusted return.

The CAPM has been widely adopted in both conventional finance and Islamic finance due to its practicality and ease of use. While scholars such as Selim (2008), Hakim et al. (2016), and Jabeen & Kausar (2021) have explored its applicability in Islamic finance, its integration into the industry remains a topic of debate. As a demand-side model seeking to maximise investor utility, the CAPM poses challenges in Islamic finance due to *Sharī'ah* compliance requirements. Given Islamic finance's emphasis on ethical investments and prohibition of interest-based transactions, a thorough examination of CAPM assumptions from a *Sharī'ah* perspective is imperative.

According to Reilly and Brown (2003), the key assumptions of the CAPM can be summarised as follows: investors can borrow or lend at the risk-free rate, investors have homogeneous future return expectations, all investments share the same time horizon, no taxes or transaction costs exist, investors can freely trade portions of holdings, no inflation or interest rate changes, and capital markets are in equilibrium with fairly priced investments. While most assumptions in conventional CAPM align with Islamic finance principles, the first, concerning the risk-free rate, conflicts with interest prohibition. While certain adjustments and refinements may be necessary to address specific Islamic finance principles and market dynamics, the fundamental assumptions underlying CAPM do not contradict the core principles of Islamic finance. Recognising the compatibility of these assumptions with Islamic finance principles enables researchers and practitioners to further develop *Sharī'ah*-Compliant Asset Pricing Model, tailoring it to reflect the unique characteristics and ethical considerations of Islamic financial markets.

Investors utilise a risk-free rate as the baseline for minimum expected return with zero risk over a specific period. Some Muslim scholars perceive this rate, often based on government securities' interest rates, as closely resembling *ribā* (*usury*), which is strictly prohibited in Islamic law. Therefore, a securities model with a risk-free rate component is considered *Sharī'ah* non-compliant (Sadaf & Andleeb, 2014). Some Muslim scholars tolerate using interest rates as a benchmark in Islamic finance, given the industry's relatively small share of the global financial market despite its growth and development. Meera et al. (2010) argue that, because of that small portion and its co-existence with well-developed conventional finance, the Islamic finance industry is obliged to use the benchmark of the formal conventional market in which they operate. Hearn et al. (2011) mentioned that due to the narrow focus on Islamic finance, there is limited literature on the roles and principles of Islamic stock markets.

This article argues that using interest rates as benchmarks in Islamic finance should be avoided if alternative options are available. The prohibition of *ribā* (*usury*) forms the fundamental rationale against such benchmarking (Kantakji & O'haj, 2012). Conventional interest rates, according to Naik (2006), are inappropriate as benchmarks for profit rates in Islamic finance due to differing concepts and philosophical, accounting, and contractual bases. Pricing Islamic finance products based on conventional interest rates is considered unfair given the varying prices of different commodities in daily life. Pricing financial securities remains a prominent topic of discussion (Ahmed et al., 2014), with ongoing debate among Islamic scholars due to differing perspectives (Salman, 2014).

One of the resolutions issued by Fiqh Academy under OIC in its 8th Conference on Currencies Issues, held in Jeddah 18-19 Shawwal, 10-11 April 1993, urges to promptly create a benchmark that is acceptable from the *Sharī'ah* perspective as an alternative to interest-based rates to determine the profit margins. Usmani (2007) urges Islamic financial institutions to discontinue this practice immediately. First, he argues that using interest rates as a benchmark for *ḥalāl* business is undesirable. Secondly, it does not advance the basic philosophy of the Islamic economy, thereby making no impact on the system of distribution. Moving forward, Islamic finance, which is inherently different from the conventional system, needs its own benchmarks, yet progress across

jurisdictions necessitates time and sustained efforts, remaining a future agenda for stakeholders in the industry.

In the context of benchmarking in Islamic finance, the ongoing debate over interest rates highlights the necessity for a comprehensive and *Sharī'ah*-compliant approach in developing asset pricing models. Previous studies of the SCAPM (Ashker, 1987; Shaikh, 2009; Hanif, 2011; Hazny et al., 2020) have focused on replacing the risk-free rate without thoroughly examining Islamic theory and principles as benchmarks. This article proposes integrating *Maqāṣid al-Sharī'ah* into SCAPM, addressing gaps in previous research, thus laying a pivotal foundation for its advancement. Firstly, it emphasises understanding the essence of the risk-free rate before proposing substitutes, ensuring subsequent advancements are well-grounded. Secondly, it critically evaluates previous substitutes, paving the way for more nuanced alternatives aligned with Islamic finance principles. Thirdly, by integrating *Maqāṣid al-Sharī'ah*, it fosters sustainable Islamic finance development, emphasising ethical decision-making. This incorporation into the risk-return trade-off framework forms a robust basis for future advancements in the field.

To strengthen the position of *Maqāṣid al-Sharī'ah* as a grounded theory, a contemporary practical approach to Islamic finance is needed. Within the realm of investments, the most relevant contemporary approach is Islamic Wealth Management (Anggraini, 2020), reflecting a harmonious alignment between financial practices and the broader goals of *Maqāṣid al-Sharī'ah*. Islamic Wealth Management, guided by the principles of *Maqāṣid al-Sharī'ah*, delivers investment decisions that comply with Islamic finance principles and contribute to the well-being and development of individuals and society.

One of the objectives of *Maqāṣid al-Sharī'ah* is the preservation of wealth (*hifz al mal*), emphasising responsible and ethical investment practices. Islamic Wealth Management avoids investments in activities prohibited in Islam and adheres to risk-sharing principles. Additionally, the equitable distribution of wealth (*qasḍ al-nafs*) is promoted through practices such as *zakāt* and charitable giving, contributing to a more just and fair economic system. Economic stability and the well-being of society (*hifz al-'umr*) are prioritised, encouraging investments that positively impact economic development while avoiding speculative

or exploitative practices. Unlawful transactions (*ḥarām*), such as usury and excessive uncertainty, are strictly avoided in *Sharīʿah*-compliant investments. Social justice (*ʿadl*) is a fundamental principle, and Islamic Wealth Management fosters investment decision making that contribute to the betterment of society, emphasising economic development and inclusivity.

Therefore, in this article, we aim to elaborate deeper into the SCAPM by constructing a framework that emphasises the connection between return and risk utilising the theory in Islamic finance known as *Maqāṣid al-Sharīʿah* ground principle and Islamic Wealth Management (IWM) approach. By using this theory and approach, the development of the SCAPM would involve tracing the origins of Islamic principles and concepts as the initial benchmark. This would ensure that the model is based on a thorough understanding of Islamic finance and investment, which would result in a more robust and accurate model. This would also provide a sense of authenticity to the model, which would increase its acceptability among the Muslim community.

From the Muslim investor point of view, the goal of SCAPM application is achieving *al-falāḥ*, which can be translated as well-being, prosperity or welfare in the world and Hereafter. By integrating the concept of *al-maṣāliḥ al-ʿāmmah*, or public interest, in addition to financial considerations, SCAPM can promote an ethical and holistic approach to investing, fairness and justice, resulting in the well-being of both investors and society. The model would have a strong emphasis on social responsibility, which would ensure that a portion of the wealth generated is used for the benefit of society and aligns with the principle of wealth distribution.

This article aims to shed light on the significance of the importance of incorporating the principles of *Maqāṣid al-Sharīʿah* ground principle and the Islamic Wealth Management approach into the development of the SCAPM. In addition to providing theoretical insights, this research will also explore practical applications of the model, with a specific focus on its potential benefits for Muslim stakeholders within the Islamic financial industry. Through this examination, the article aims to contribute to the development of a more comprehensive and inclusive approach to investment management that aligns with Islamic ethical principles.

## Literature Review

### *Maqāšid al-Sharī'ah*

*Maqāšid al-Sharī'ah* refers to the objectives of Islamic law. The term 'maqāšid' (plural: *maqāšid*) denotes a purpose, objective, principle, intent, goal, or end (Ibn Ashur, 2006). Abu Hamid al-Ghazali classified these objectives under 'unrestricted interests' in his work *al-Mustafa fi Ilm al-Uṣul* (d. 505 AH/1111 CE). Al-Qarafi further linked *maṣlaḥah* and *maqāšid* by a fundamental rule stating that a purpose is valid only if it leads to the fulfilment of some good or the avoidance of mischief. 'Sharī'ah' denotes the rules and provisions revealed by Allah through Prophet Muhammad (PBUH), forming the foundation of the Islamic worldview and system of ethics (Elahi & Alam, 2022). *Maqāšid al-Sharī'ah* serves as the pillar of the Islamic financial system, enhancing justice and well-being for stakeholders at both macro and micro levels (Soualhi, 2015). Islamic economics aims to cultivate a real economy, trading in tangible assets and providing returns proportional to risk.

This article uses the *Maqāšid al-Sharī'ah* rationale established by Abu al-Ma'ali al-Juwayni (d. 478 AH/1085 CE), further developed by Abu Hamid al-Ghazali (d. 505 AH/1111 CE) and Abu Ishaq al-Shatibi (d. 790 AH/1388 CE). *Maqāšid al-Sharī'ah* encompasses three categories: (1) necessities (*ḍarūriyyāt*), crucial for religious and worldly affairs, requiring protection to prevent chaos; (2) needs (*ḥājjiyyāt*), neglected interests leading to individual or community hardship; and (3) luxury/complementary (*taḥsīniyyāt*), improving desired aspects of life, whose loss may not disrupt daily life but diminishes comfort.

Under the category of necessities (*ḍarūriyyāt*), as depicted in Figure 1, Al-Ghazali introduced the term 'preservation' and prioritised the necessities suggested by al-Juwayni as follows: (1) preservation of faith/religion, (2) preservation of soul/life, (3) preservation of mind, (4) preservation of offspring/lineage, and (5) preservation of wealth. These five essentials ensure the stability of worldly welfare and security in the Hereafter (Auda, 2011). Understanding *Maqāšid al-Sharī'ah* entails recognising Islam's goal of achieving success in both worldly and the hereafter (*al-falāḥ*) within the framework of Islamic *Sharī'ah* law. *Maqāšid al-Sharī'ah* provides a foundational framework for Islamic finance, guiding the industry's ethical and moral standards (Malik et al.,



2021). It aims to protect social order, promote human well-being, and preserve core community principles (El-Mesawi, 2006).

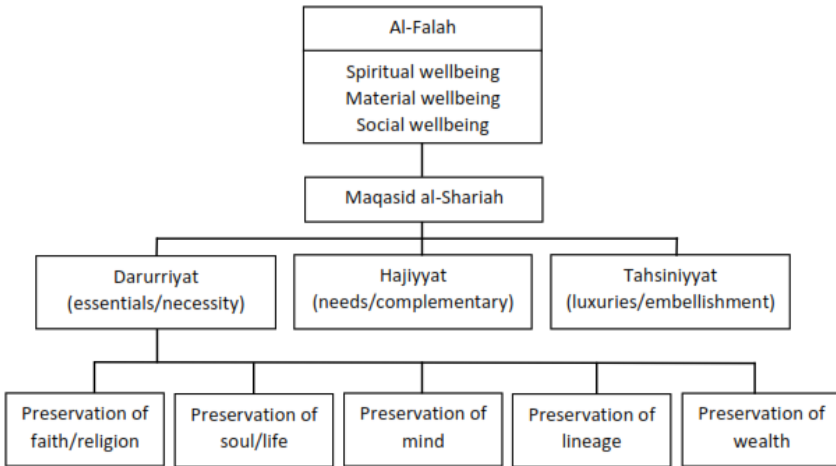


Figure 1: Level of necessities in *Maqāṣid al-Sharī'ah*.  
[Source: Adopted from Auda (2011)]

In the context of Islamic finance, *Maqāṣid al-Sharī'ah* plays a pivotal role in shaping financial products, regulatory guidelines, and ethical standards, providing a framework for understanding its objectives and principles governing transactions (Qoyum, 2018). It guides stakeholders in navigating complexities, promoting values advocated by *Sharī'ah*, and shaping regulatory guidelines and ethical standards for socially responsible financial practices. *Maqāṣid al-Sharī'ah* utilisation in discussing Islamic finance is driven by various factors, including its role in determining benefits and harms, understanding the various levels of *Sharī'ah* objectives, priorities, and categories, facilitating legal reasoning, and serving as a gateway for analogical decisions (Al-Ayubi & Halawatuddu'a, 2021).

*Maqāṣid al-Sharī'ah* has received significant attention in the field of Islamic finance, with numerous studies adopting it as a regulatory framework for financial institutions, policy-making, economic development, performance measurement, evaluation of social performance, product design, and product assessment (Arshad et al., 2018; Alziyadat & Ahmed, 2019; Hamidi & Worthington, 2018; Laela



et. al., 2018; Qoyum, 2018; Julia & Kassim, 2020; Ramli et al., 2019; Mohammed et al., 2020; Tarique et al., 2021). These studies highlight the importance of incorporating *Maqāṣid al-Sharī'ah* in various aspects of Islamic finance, from the formulation of policies and products to the evaluation of social and economic performance.

Considering social sustainability poses a growing challenge in Islamic finance (Tarique et al., 2021). In this article, *Maqāṣid al-Sharī'ah* guides SCAPM development to integrate social sustainability into asset pricing models. SCAPM, thus formulated, serves as an educational tool for promoting ethical and socially responsible financial practices (Julia & Kassim, 2020). This incorporation of *Maqāṣid al-Sharī'ah* is crucial for fostering ethical and socially beneficial financial practices in Islamic finance (Malik et al., 2021). It ensures alignment with Islamic law objectives, contributing to societal well-being (Rosly, 2010), and positions SCAPM to significantly impact the future of Islamic finance, promoting compliance with *Sharī'ah* while upholding moral and social responsibility (Hasan et al., 2016).

However, while integrating *Maqāṣid al-Sharī'ah* into the development of SCAPM is crucial, it presents several challenges, highlighting the need for a conceptual framework to guide its application. Such a framework provides insight into how scholars identify objectives, how Islamic financial institutions implement them, and how consumers adhere to them. Balancing the diverse objectives of *Maqāṣid al-Sharī'ah* while creating a practical and effective asset pricing model can be complex (Shahwan, 2014). It is also essential to ensure that SCAPM remains adaptable to changing economic and financial conditions for its long-term success (Qoyum, 2018). Drawing from the normative foundations and essential elements of *Maqāṣid al-Sharī'ah*, this article aims to offer a framework that facilitates the development of SCAPM aligned with its principles as an Islamic ground principle.

### ***Islamic Wealth Management***

To implement *Maqāṣid al-Sharī'ah* in economic activities, Muslim scholars linked it with Islamic Wealth Management (IWM) (Nasr, 2015; Basah & Tahir, 2019; Budiantoro & Larasati, 2020; Mahmud et al., 2021). IWM is a holistic approach to asset management that adheres to *Sharī'ah* law and promotes social responsibility. As can be seen

in Figure 2, it encompasses five stages in the wealth cycle: creation/accumulation, consumption, purification, distribution, and protection (Al-Faizin & Akbar, 2018). IWM ensures that all economic activities and investments comply with Islamic finance principles (Ibrahim et al., 2014; Bedoui & Mansour, 2015), emphasizing the preservation of *Maqāṣid al-Sharī'ah* fundamentals and objectives.

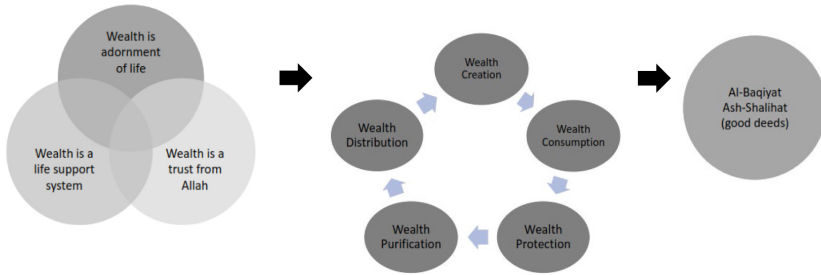


Figure 2: Model of Islamic Wealth Management.  
[Source: Adopted from Al-Faizin & Akbar (2018)]

In Islamic thought, wealth, as defined by the Shafi'iyyah, Malikiyyah, and Hanabilah schools of thought, encompasses all valuable things. Its value is determined by its process and the final product or service it provides. Islamic teachings stress socially responsible wealth use and distribution, promising rewards in both this world and the Hereafter. Muslims believe that everything belongs to Allah, and humans are mere caretakers of the wealth bestowed upon them. Allah is the absolute owner of everything, including wealth, and humans are entrusted with it to please Allah through good deeds. Hence, wealth plays a critical role in human life, necessary for fulfilling human needs.

Islamic Wealth Management (IWM) and SCAPM are closely linked in *Sharī'ah*-compliant investments. IWM demands adherence to *Sharī'ah* principles, necessitating that any asset pricing model in Islamic finance incorporates ethical and legal aspects like the prohibition of *ribā*, *gharār*, *maysir*, *ghabn*, and *ḥarām* activities. SCAPM, in particular, requires a comprehensive understanding of Islamic finance's unique features, including profit and loss-sharing and the role of risk-sharing. Additionally, the model must consider the social and environmental impact of investments, along with wealth distribution and protection

throughout the IWM cycle, such as investing in socially responsible activities and ensuring equitable returns.

***Sharī'ah-Compliant Asset Pricing Model (SCAPM)***

The Capital Asset Pricing Model (CAPM) determines the required rate of return on an investment, asserting that the expected return equals the risk-free rate plus a risk-based premium. Developed from the Modern Portfolio Theory (MPT) in the 1960s, refined by scholars like Sharpe, Treynor, Lintner, and Mossin, it emphasises systematic risk as the primary consideration for investors. While widely used in conventional and Islamic finance, CAPM encounters challenges in Islamic finance due to its reliance on the risk-free rate, associated with *ribā (usury)*. Additionally, its focus on maximising returns without ensuring fairness and equity contradicts the principles central to Islamic finance. Thus, using CAPM in Islamic finance may be problematic as it may not fully align with Islamic financial practices' principles of fairness and equity.

Muslim scholars have attempted to adapt the conventional CAPM model by substituting the interest-based risk-free rate with *Sharī'ah*-compliant variables. Subekti and Rosadi (2020) introduced and summarised these adjustments, as presented in Table 1 below.

**Table 1:** The Development of *Sharī'ah*-Compliant Asset Pricing Model

Models	Variables	Authors
SCAPM-1	Market Risk Premium (MRP)	Cyril & Karim (1987)
SCAPM-2	Zakāt and MRP	Ashker (1987)
SCAPM-3	NGDP and MRP	Shaikh (2009)
SCAPM-4	Inflation Rate and MRP	Hanif (2011)
SCAPM-5	Sukuk rate and MRP	Hakim et al. (2016)
SCAPM-6	Sukuk rate and MRP with zakāt purification	Hazny et al. (2020)

Source: Adopted from Subekti and Rosadi (2020)

The table above illustrates five SCAPM development models spanning from 1987 to 2020. SCAPM-1, introduced by Cyril and Karim in 1987, employs the CAPM without the interest rate. Subsequently, scholars sought to replace the risk-free rate with *Sharī'ah*-compliant

factors. For instance, Ashker's SCAPM-2 (1987) uses the *zakāt* rate, while Shaikh's SCAPM-3 incorporates the national gross domestic product (NGDP). Hanif introduced SCAPM-4, integrating the inflation rate, while Hazny et al. (2020) developed SCAPM-5, substituting the risk-free rate with the sukuk rate and incorporating *zakāt*. These models have advanced SCAPM's suitability for Islamic finance. However, most of these developments replaced the risk-free rate without considering the origin of Islamic principles and concepts as the primary source.

Ashker (1987) proposed substituting the *zakāt* rate as a substitute for the risk-free rate in SCAPM. However, *zakāt* may not be suitable as it does not represent the minimum expected rate of return in investment decisions, unlike the risk-free rate, which reflects individual investment goals and preferences. *Zakāt* primarily serves wealth purification and distribution objectives, not aligning directly with investors' financial goals and risk tolerance. Sheikh (2009) suggested substituting Nominal Gross Domestic Product (NGDP) for the risk-free rate in asset pricing models. While NGDP reflects overall economic health, it fails to represent the minimum expected rate of return in individual investment decisions and lacks consideration of Islamic ground principles essential in Islamic finance

Hanif (2011) proposed substituting the inflation rate for the risk-free rate, highlighting its similarity to technical asset valuation models in the conventional framework. However, this model lacks reference to Islamic ground principles, making it less comprehensive by neglecting social obligations and responsibilities inherent in Islamic investment. Using inflation alone does not fully consider the ethical and religious dimensions emphasised in Islamic teachings, such as the obligation to purify wealth and the social responsibility of wealth distribution. Substituting sukuk rates for the risk-free rate in the SCAPM framework (Hazny et al., 2020) has limitations. Although sukuk rates closely resemble the risk-free rate, they offer a narrow scope, primarily focusing on Islamic bonds and excluding other *Shari'ah*-compliant asset classes. Moreover, relying solely on sukuk rates may create expectations of specific returns, which may not align with the unpredictable nature of financial markets and may lead to expectations of predetermined returns.

Based on the discussion of previous studies on SCAPM above, this article aims to develop SCAPM from an Islamic perspective, addressing

a gap in previous research by focusing on Islamic ground principles that can serve as the basis for further development in determining the measurement and proxy, rather than simply seeking a replacement for the risk-free rate. Challenges in SCAPM implementation in the capital market include difficulties in agreeing on expected rates of return, crucial for establishing benchmarks. The delayed development of SCAPM compared to conventional CAPM requires acceleration for practical application. Empirical proof of SCAPM application, for example, in the development of behavioural finance or time-varying markets, is lacking. Using *Maqāṣid al-Sharī'ah* offers alternative solutions and opens discussions for benchmarking, fostering further development. This article proposes using *Maqāṣid al-Sharī'ah* and the Islamic Wealth Management (IWM) approach to formulate the SCAPM framework comprehensively.

### ***Methodology of Conceptual Framework***

This study adheres to Jabareen's (2009) approach in constructing the conceptual framework, which is referred to as a grounded theory technique. The procedure for conceptual framework analysis entails several phases: (1) Mapping selected data sources involves mapping the spectrum of multidisciplinary literature on the phenomenon, identifying text types, and other data sources, ensuring comprehensive data collection for validity, (2) Extensive reading and categorising of selected data aim to categorise data by discipline and importance within each discipline. Recognising the imperative nature of incorporating *Maqāṣid al-Sharī'ah* into SCAPM, the IWM approach was identified as a crucial bridge to offer a comprehensive understanding of Islamic finance and investing. This phase necessitated the identification of specific *Sharī'ah*-compliant components in alignment with the principles of *Maqāṣid al-Sharī'ah* and the IWM approach, encompassing wealth creation, consumption, purification, distribution, and protection; (3) Identifying and naming concepts involves reading and rereading data to "discover" concepts, allowing them to emerge from the literature, (4) Deconstructing and categorising concepts includes identifying main attributes, characteristics, assumptions, and roles, organising concepts based on features and ontological, epistemological, and methodological roles; (5) Integrating concepts aims to group similar concepts into a new one, reducing their number; (6) Synthesis, resynthesis, and making sense involve iterative processes until a coherent theoretical framework

emerges, involved presenting the constituents of the proposed framework in both narrative and graphic forms, drawing inspiration from the methodology outlined by Miles & Huberman (1994). This dual presentation method offers a multi-dimensional understanding of the framework's components, elucidating the intricate connections and dependencies within the model. It goes beyond a mere description, providing a visual representation that enhances clarity and accessibility. (7) Rethinking the conceptual framework acknowledges its dynamic nature, subject to revision based on new insights, comments, and literature, ensuring it makes sense across disciplines and enhances their theoretical perspective on the phenomenon.

### ***Proposed Sharī'ah-Compliant Asset Pricing Model in the Framework of Maqāṣid al-Sharī'ah***

Proponents of *Maqāṣid al-Sharī'ah*, including Auda (2007), Chapra et al. (2008), and Lamido (2016), assert that *Maqāṣid al-Sharī'ah* could serve as a framework for economic development theorisation. *Maqāṣid al-Sharī'ah* can potentially guide the activities of human beings since it offers a legal framework that guides the boundaries of economic activity performed in a society (Asutay, 2007).

### ***Al-Falāḥ***

The aspiration of every individual is to achieve success. In the Quran, success is referred to as *al-falāḥ*. According to the book *al-Mu'jam al-Mufahras li-alfāz al-Qur'ān al-Karīm* (Al-Baqi, 1984), the word *al-falāḥ* and its derivatives are mentioned in 40 verses in 25 surahs. *Al-falāḥ* encompasses success in both worldly and Hereafter, serving as a central aspiration for Muslims. On an individual level, it entails meeting basic needs and having the freedom for personal growth. At a societal level, *al-falāḥ* aims for equality and prosperity, fostering growth in socio-economic, political, and religious spheres. Islam advocates ethical economic prosperity alongside moral, cultural, and socio-political advancement. Asutay & Harningtyas (2015) suggest that *Maqāṣid al-Sharī'ah* serves as a foundational framework for promoting *al-falāḥ* by guiding economic activities in line with Islamic principles. It prioritises necessities (*darūriyyāt*) to safeguard fundamental aspects of human life, and serves as a precondition for the attainment of *al-falāḥ* and the realisation of a harmonious and fulfilling life.

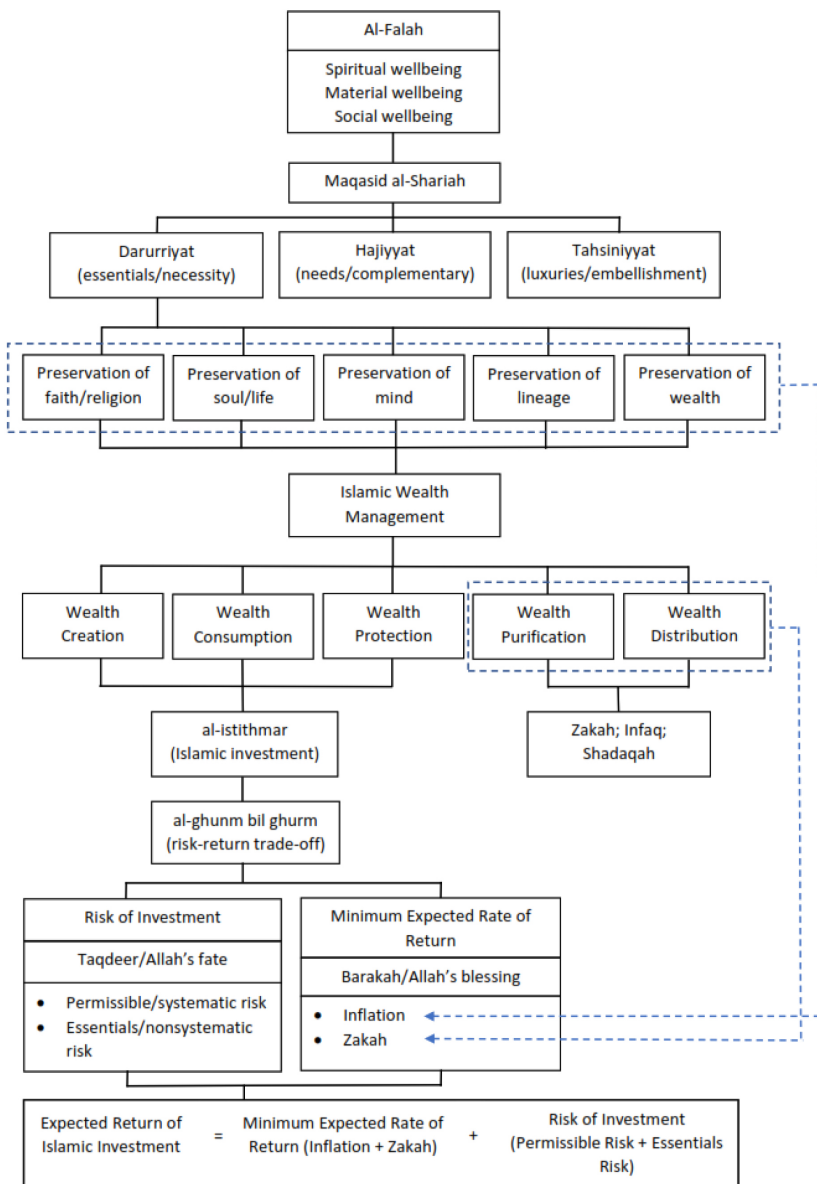


Figure 3: The framework of SCAPM, based on *Maqāsid al-Sharī'ah* and IWM



### *Maqāṣid al-Sharī'ah in Asset Pricing*

Developing a robust asset-pricing model is crucial in Islamic finance. Conventional models like CAPM face challenges due to their reliance on interest rates conflicting with Islamic principles. To address this, the *Sharī'ah*-Compliant Asset Pricing Model (SCAPM) has emerged. This article aims to develop SCAPM, emphasising *Maqāṣid al-Sharī'ah* as a guiding principle. It seeks to establish a strong theoretical foundation rooted in Islamic principles while accommodating investors' unique needs through adaptability to specific contexts. Incorporating Islamic ground principles into SCAPM is crucial. These principles, derived from both *naqlī* knowledge found in the Quran and Sunnah and *'aqlī* knowledge from other sources, guide the framework to align with broader Islamic objectives (Saad et al., 2022). Without them, ethical, legal, and reputational issues may arise, eroding trust in Islamic finance (Ibrahim & Mirakhor, 2015). Emphasising <why> questions alongside <what> ensures adherence to Islamic fundamental principles (Sanuri, 2023), enhancing investment concepts in Islamic finance.

This article proposes an alternative to the risk-free rate in asset pricing models using *Maqāṣid al-Sharī'ah* and Islamic Wealth Management. It recognises the essence of the risk-free rate in the CAPM within an Islamic framework. The risk-free rate represents the minimum expected return from a theoretically riskless investment. In conventional finance, investors use it as a benchmark to evaluate riskier assets, expecting higher returns. Otherwise, they might prefer risk-free assets like government bonds. In Islamic finance, the minimum expected rate of return reflects *Sharī'ah* compliance and wealth preservation, ensuring that an investor's wealth not only maintains its real value but also grows over time, accounting for economic conditions and the fulfilment of financial obligations of wealth distribution and purification, guided by *Maqāṣid al-Sharī'ah* and Islamic Wealth Management. It ensures adherence to *ḥalāl* criteria, facilitates wealth growth, and fulfils financial obligations, thereby promoting financial stability and social welfare beyond the minimum rate set by conventional finance for asset valuation.

Figure 3 outlines the foundational principles guiding Muslim investors *towards al-falāḥ*, rooted in *Maqāṣid al-Sharī'ah*, the ultimate goal of well-being in spiritual, moral, and socio-economic aspects. It



categorises well-being into *darūriyyāt* (necessities), *hājiyyāt* (needs), and *taḥsīniyyāt* (embellishments), it justifies fulfilling the five basic needs—(1) Preserving Faith/Religion for financial sustainability while upholding religious teachings; (2) Preserving Soul/Life as a financial safety net for health and well-being; (3) Preserving the Mind linking ethical investments with mental well-being and the Islamic pursuit of knowledge; (4) Preserving Offspring/Lineage supporting family well-being and inheritance through long-term financial planning; (5) Preserving Wealth ensuring individual and societal financial stability by safeguarding wealth value over time and meeting financial obligations like *zakāt*—at the necessity level as essential for attaining the primary objective of human life, *al-falāḥ*.

These necessity needs can shape the SCAPM framework for defining the minimum expected rate of return, while considering the specific preservation requirements and principles of *Maqāṣid al-Sharī'ah*. Employing *Maqāṣid al-Sharī'ah* as an Islamic foundational principle can partially answer the question of “Why do you expect a certain level of profit from your investments?” A Muslim investor can respond, “At a minimum, to safeguard my basic needs.” Instead of expecting a specific interest rate, such as the risk-free rate, Muslim investors anticipate returns that preserve their necessities.

To operationalise the fulfilment of necessity levels in *Maqāṣid al-Sharī'ah* within SCAPM, identifying financial indicators representing these preservation needs is crucial. One potential proxy for measuring the minimum expected rate of return is the inflation rate, a key economic indicator reflecting the percentage increase in the general price level of goods and services over a specified period. As inflation rates rise, the purchasing power of currency erodes, meaning the same amount of money can buy fewer goods and services. Inflation can result from factors like increased demand, changes in supply, or fluctuations in currency values.

The foundation regarding the inflation rate as a benchmark in Islamic finance has been discussed by a group of Islamic scholars. Mansoori (1998), in his discussion on the indexation of loans, mentions that Islamic scholars, including Ziauddin Ahmad (1980), Rafiq al-Misri (1981), A. Mannan (1981), Umar Zubair (1982), Sultan Abu Ali (1982), Gui Muhammad (1992), Mawlana Muhammad Ta Sin (1996), and

several others, advocate for indexation and find it to be in accordance with the principles of justice and fairness as laid down in the *Quran* and the *Sunnah*. They suggest that indexing the principal amount, within specified constraints and commensurate with inflation or deflation, seems to be a logical proposition. From a *Sharī'ah* perspective, proponents argue that linking loans to an agreed-upon price index, as is done with index-linked loans, ensures equity in debtor-creditor relationships. In times of inflation, lenders might gain more in monetary terms, and during deflation, less, aligning with the principles of 'equity.'

Incorporating the inflation rate into SCAPM's minimum expected rate of return is crucial to mitigate the erosion of money's real value over time. This ethical approach, free from interest-based calculations, safeguards economic well-being for individuals and society, reflecting economic realities accurately. It offers a robust and *Sharī'ah*-compliant method for investors to preserve and potentially increase their wealth amidst market fluctuations. This adaptation demonstrates the relevance of Islamic finance principles, providing a practical solution for investors facing inflationary pressures, aligning with the goal of protecting purchasing power to meet necessity needs.

The next component of the minimum rate of return under the *Sharī'ah* perspective is *zakāt*. As a Muslim wealth owner, integrating the *zakāt* rate into the minimum expected rate of return enhances the ethical foundation of Islamic finance in SCAPM. *Zakāt*, a Pillar of Islam, promotes wealth purification through a 2.5% contribution, fostering social justice and economic equilibrium. This approach actively stimulates prosperity, ensures fair wealth distribution, and contributes significantly to social welfare and poverty alleviation. *Zakāt* possesses unique dual characteristics as a form of worship integral to the religion and a financial levy with economic implications for both payer and receiver. It reduces wealth inequality and discourages idle wealth. *Zakāt* is not viewed as charity; rather, it is seen as the right of the poor to the wealth of the rich. The Quran emphasises this, stating, "Of their wealth, there is a right for the poor and the beggar" (Q.S 51:19). Regarding the *zakatability* of stocks, scholars offer two main opinions, providing simplicity and ease of calculation in aligning *zakāt* obligations with investment returns. The first approach considers tradable shares as *zakatable* business merchandise, while the second calculates *zakāt* on

stocks based on market value plus dividends, applying a standard zakāt rate of 2.5% for a lunar or 365-day year (Al-Qaradawi, 1999).

### ***Islamic Wealth Management in Asset Pricing***

Islamic Wealth Management (IWM) stands at the forefront of financial practice, integrating Islamic principles to prioritise individual and societal well-being. *Maqāṣid al-Sharī'ah* guides this integration, necessitating a re-evaluation of traditional asset pricing models to ensure alignment with Islamic finance principles. The five stages of the wealth cycle in IWM—wealth creation/accumulation, consumption, protection, purification, and distribution—reflect the importance of preserving wealth in accordance with *Maqāṣid al-Sharī'ah*, which encompasses the satisfaction of human necessities.

In the context of developing the *Sharī'ah*-Compliant Asset Pricing Model (SCAPM), the IWM perspective proves essential in operationalising *Maqāṣid al-Sharī'ah*. IWM infusing ethical and *Sharī'ah*-compliant considerations into financial practices. Grounded in these principles, IWM ensures that SCAPM not only adheres to *Sharī'ah* compliance but also advances broader socio-economic objectives such as risk mitigation, wealth distribution, and sustainable investing. By integrating IWM concepts, SCAPM becomes a holistic model that reflects Islamic finance values, bolstering investor confidence and contributing to *Maqāṣid al-Sharī'ah*'s objectives within asset pricing.

Moreover, IWM elucidates the relationship between return and risk across investment stages, fostering ethical and responsible investing decisions. In the stages of wealth creation/accumulation, consumption, and protection, the IWM approach plays a role in determining investment decision-making processes based on *Sharī'ah* principles. These principles are essential to the development of SCAPM, as they ensure that investors and entrepreneurs share in the risks and rewards of an investment in a fair and equitable manner. In wealth purification and distribution, IWM underscores the importance of *zakāt* as an additional component in determining the expected minimum rate of return. It is important for a Muslim to note that every wealth held comes with obligations that are directly attached to it. By fulfilling *zakāt* obligations, Muslims not only uphold their faith but also contribute to wealth purification and distribution, advancing both personal and societal well-being. Thus, IWM plays a dual role in SCAPM, elucidating investment

principles aligned with *Sharī'ah* and incorporating zakāt into the minimum expected rate of return calculation.

### Research Contribution

The conceptual framework of SCAPM based on *Maqāṣid al-Sharī'ah* and IWM presented is expected to contribute to stakeholders involved in the Islamic finance industry. Figure 4 summarises the contribution of the framework for practitioners, regulators, and academics.

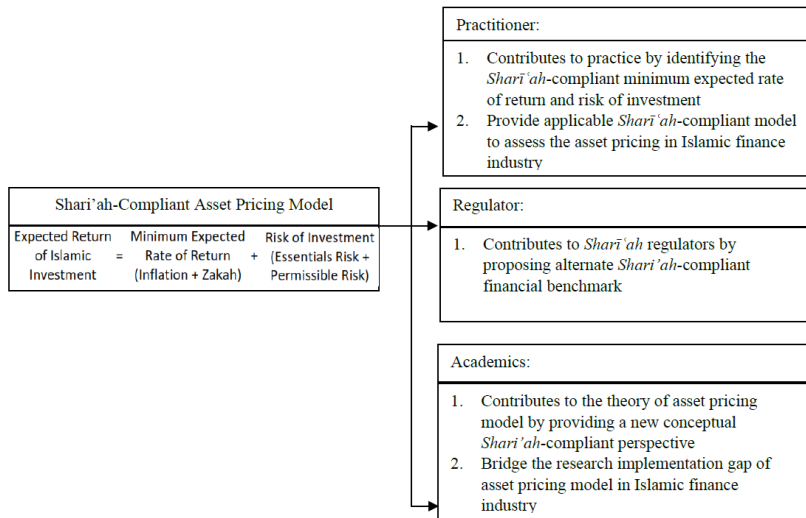


Figure 4: Contribution of the SCAPM framework based on *Maqāṣid al-Sharī'ah* and Islamic Wealth Management (IWM)

### Conclusion

*Maqāṣid al-Sharī'ah* ground principle and Islamic Wealth Management approach has provided an important foundation for developing an economic and financial framework. The *Sharī'ah*-compliant assessment of investment asset values, which relates to the expected return and the risk that must be borne, is a promising endeavour. However, its development and application must always comply with *Maqāṣid al-Sharī'ah*. Therefore, research and study must be conducted continuously and simultaneously on the essential components of *Maqāṣid al-Sharī'ah* in the Islamic finance industry. Not only at the theory and conceptual framework level but also in its interpretation and application in Islamic finance transactions.

This article provides a comprehensive framework based on the *Maqāşid al-Sharī'ah* theory as the basic foundation and the concept of Islamic Wealth Management for establishing a *Sharī'ah*-Compliant Asset Pricing Model (SCAPM) that is simple, easy to apply, and most importantly, constructed from a *Sharī'ah* perspective. SCAPM will allow Muslim investors to assess their asset's value in the context of the relationship between expected return and risk on investment by incorporating the inflation rate and obligation to pay zakāt into the minimum expected rate of return. This framework will assist the Islamic finance industry in implementing *Maqāşid al-Sharī'ah* when assessing the value of its assets. Furthermore, the insights gained from this article will enhance awareness among scholars, academics, and *Sharī'ah* practitioners regarding the opportunities and potential for implementing the *Maqāşid al-Sharī'ah* approach in economics practice, especially in the development of practical financial models. Therefore, this is an initial attempt to address the research gap.

### **Research Limitation**

The proposed framework is conceptually developed based on the views of prominent classical Islamic scholars and jurists without focusing on a particular business or product of the Islamic financial industry. The framework does not apply specific parameters to justify the proxies used to create the SCAPM. However, this paper will initiate future research expansion by addressing the current challenges to adopting *Maqāşid al-Sharī'ah* in the Islamic finance industry. The objective of the future study will be to develop a practical framework based on quantitative and qualitative research, establish *Maqāşid al-Sharī'ah* parameters, and develop an applicable asset pricing model compliant with *Sharī'ah*.

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## **Journal Article**

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(i) direct quotation, write as 30:36

(ii) indirect quotation, write as Qur'ān, 30:36

Reference:

*The glorious Qur'ān*. Translation and commentary by A. Yusuf Ali (1977). US: American Trust Publications.

## **Ḥadīth**

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(i) Al-Bukhārī, 88:204 (where 88 is the book number, 204 is the ḥadīth number)

(ii) Ibn Hanbal, vol. 1, p. 1

Reference:

(i) Al-Bukhārī, M. (1981). *Ṣaḥīḥ al-Bukhārī*. Beirut: Dār al-Fikr.

(ii) Ibn Ḥanbal, A. (1982). *Musnad Aḥmad Ibn Ḥanbal*. Istanbul: Cagri Yayinlari.

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*The new Oxford annotated Bible*. (2007). Oxford: Oxford University Press.

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