

Fairness is what successful business is all about ©

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I have recently had reason to become familiar with the commercial aspects of Islamic law or Sharia (Shari'ah) and as a result have had to consider on the subject of fairness and its implications and applications.

Being fair is really the basis for all valid and lasting codes of conduct, regulation and law. In business being fair is and has always been good business as being fair and providing customer value assures repeat business and ultimately allows for higher and sustaining profit. Being fair is a matter of balancing the use of power. The unfair use of power ultimately results in situations which prompt commercial and political rebellion. Social and economic instability are bad for society and bad for business. The application of fairness is good for business and that which is good for businesses is generally good for the local community and larger society.

The principles of Sharia are similar to much of Judeo/Christian ethics in that there is a reasonableness required in the provision of capital and the relationship between capital providers and capital users. Interest (riba) is prohibited as a means of paying for capital whereas participation or sharing of risk and reward is encouraged. In other words, it is the renting of money which is (haraam) not acceptable under Sharia, whereas the sharing of the use of money is Sharia compliant (halal).

The question of what is fair still remains and the answer must relate to both risk and currently available alternative uses for the capital, offering similar reward and risk. It is the assessment of risk which is the most difficult. "All loans appear sound at the time of grant." Is a sign I have seen in lending institutions. Is the risk likely to be total, as is the case in financing many technology based ventures, or partial, as in providing capital to established businesses? Is the business one of competition caused shrinking profit margin or one protected by intellectual property or other barriers to entry? Is the management of the business experienced or unproven? The fact is there is a natural relationship between capital provider perceived risk and anticipated reward.

Another way of looking at reward is to seek a return of a multiple of the return offered by a riskless investment such as a Certificate of Deposit (CD) issues by a major financial institution. One could also simply strive to achieve an annual return of 3 or more times the London Interbank Offered Rate (LIBOR). Of course, liquidity, the ability to readily sell an investment, is a significant factor in determining risk. In most private company transactions the recapturing of equity capital is only likely in the case of corporate success.

There is also the reality that in many cases the greatest risk is taken by the capital provider in the early stages of the relationship, as the company using the funds develops. If the company succeeds the risk to the original capital is lessened and it could be argued the return should also be adjusted to reflect the positive change in circumstance.

Finally, there is the proposition that once a capital provider has received a full return of the capital and there is therefore no further risk of loss that the level of return should reflect the situation.

All of the above considerations are a part of a determination of fairness and the parties to the transaction have to agree. In the case of a transaction involving Sharia compliant parties an independent Islamic law scholar must also agree as to the fairness of the terms of the transaction. This is not unlike the result of applying European or American legal standards to transactions.

As an investment banker and corporate consultant I know that all of the above stated considerations can be assessed, addressed and woven into the fabric of an agreement. I also know that ultimately fairness in business is mandated, either by judges or the marketplace.