INTERNATIONAL BONNARD LAW FIRM SON

Sharia compliant private equity and venture capital

Private equity and venture capital are sources of investment capital from high net worth individuals and institutions for the purpose of investing and acquiring equity ownership in companies or providing the required capital to entrepreneurs to set up their business.From Sharia point of view, money is not a commodity and cannot be traded for profits. In other words, the profit must be earned by the investors having active involvement in the business and sharing the risks of the investment. Therefore, investing in private equity and venture capital naturally fits the spectrum of Sharia compliant finance, where the money is invested in real economic activities creating value to the community with the purpose of making profits.**1. Introduction**

a. **What is Private Equity ("PE")?** PE is capital that is not traded on a public exchange. Private equity is composed of funds and / or investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity. Institutional and retail investors provide the capital for private equity, and the capital can be utilized to fund new technology, make acquisitions, expand working capital, and to bolster and solidify the balance sheet.
b. **What is Venture Capital ("VC")?** VC is the financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. For startups without access to capital markets, venture capital is an essential source of money. Risk is typically high for investors, but the downside for the startup is that these venture capitalists usually get a say in company decisions.
c. **Is there a difference between PE and VC?** PE is sometimes confused with VC because they both refer to investment in companies and exit through selling their investments. However, the main difference is that VC providers mostly invest in start-ups with high growth potential, whereas PE investors mostly buy mature companies that are already established.

Image not found or type unknown Diagram **2. What are the investment methods?** The investor can make direct investment in a company. However, many investors would prefer to contribute to a sharia compliant fund that is professionally managed with a portfolio of selected investee companies.To diversify the risk, the investor would typically opt to invest in a fund of pooled funds, under which the fund manager allocates the capital amongst a number of private equity funds. Image not found or type unknown **Diagram a** **3. What are the formulas to structure Sharia compliant PE and VC?**

a. **Mudarabah / Joint Venture** Mudarabah is a type of joint venture structure with profit/loss sharing, under which the investor provides the capital to an entrepreneur for investing in economic activities. Commonly the entrepreneur will be involved in the business, but both parties will share in the profits and risks. The financier will achieve a return in the form of a portion of the actual profits earned, according to a predetermined ratio. However, unlike a traditional creditor, the financier will also share in any losses. Image not found or type unknown Flowchart
b. **Musharakah / Partnership** Musharakah is partnership structure with profit/loss sharing, under which each party will be involved in the business and share in the profits and risks, instead of charging interest as a creditor. The financier will achieve a return in the form of a portion of the actual profits earned, according to a predetermined ratio. However, unlike a traditional creditor, the investors will also share in any losses. Image not found or type unknown Flowchart
c. **Wakala / Proxy** Wakala is a contract of agency or delegated authority, pursuant to which the investor appoints an agent to carry out a specific task or invest on behalf of the investor in permissible activities for a fixed fee or a percentage of the profit.

Image not found or type unknown Diagram 6 **4. What are the practical step of the investment?**Once the investor decides the method and formula of investment, which could be more than one, the following practical steps are recommended:

a. Carry out the due diligence of the company or the fund;
b. Set up a Special Purpose Vehicle ("SPV") (which could be an offshore, free zone or an onshore SPV) and put the right agreements in place, such as the articles of the SPV, the shareholders agreement, the nominee shareholder agreement, memorandum of association etc.;
c. **Carefully review the required agreements of the chosen formula (such as joint venture arrangements, a partnership or investment proxy).**

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