An Islamic Perspective on: Risk

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The whole discipline of finance revolves around the study of risk. Insurance exemplifies another field where the study of risk is the core of the whole industry.

However, if we survey how risk was handled theoretically we find that there are three aspects to the study of risk.

a) Risk in the decision making process:

In every decision we take, we seek an outcome that will, hopefully, take place shortly or longly after that, decision has been taken. However, we know that there are always "forces" that may not allow the outcome to materialize the way we intended for it to be. Some of these forces are well known to us, others are mysterious and may remain beyond comprehension. But we know they are these. This aspect of risk is not new, rather humans have always been aware of it. For this reason, they could distinguish between events that are purely random and those that are the result of "cause and effect", and they tried to study these causes and how they influence the outcome. When they discover these causes, they will then have more control over the outcome, hence they maximize the area where they have such control. This is what gave rise to the importance of information about the decision we are to take. All this is well known to everyone to the degree that it can be considered part of the human nature.

b) <u>Measurement of risk:</u>

If these forces that cause the outcome of our decision to be contrary to our desire do exist, then surely these forces must be sometimes strong and sometimes weak. It is not difficult to see that. However, developing a method that enable us to attach numerical values to risk, didn’t take place until may be the 17^{th} century, particularly on the hands of Pascal who pioneered probability theory.

Though probability theory originated as an attempt to excel in the games of chance, it soon became the platform for the study of risk. Out of it came the ability to attach a numerical value to these forces that cause the outcome to deviate from the desired path. Hence, we can compare the risk involved in smoking two packets of cigarettes a day, and that in travelling by train!…etc.

c) <u>Risk as object to exchange contracts:</u>

Now that we know the value of this "risk", it became possible to sell and buy such risk.

We know that goodwill is a valuable thing. However, it became possible to "sell" such goodwill only when it became possible to measure the commercial value of trademarks and company names via volume of sales and rate of profit. Though goodwill is intangible, but it is, still a thing with unmistakable value and substance. Risk is different. It is difficult to comprehend how risk can be an object of an exchange contract, for what is desirous is not "risk", but compensation when ever strikes. However, in a contract where consideration goes up or down dependent only on the "size" of risk (or probability of a happening to take place), one cannot escape the conclusion that what is being exchanged for price is "risk".

d) Risk and Gharar:

There is a fundamental difference between the concept of risk and that of gharar. Gharar is the contractual uncertainty in exchange transactions. While a contract impeded with gharar is void from Shari'ah point of view, the same cannot be said about risk. Risk is a natural thing, which exists in every situation. It can't be avoided. While gharar is a special risk created by the structure of the contractual arrangement between two parties. For example, lending money to a non-credit worthy individual (or selling him on Murabaha basis) is risky, but it is not gharar. On the other hand, selling an object for two prices one for cash and the other from differed price leaving the matter to be decided by the buyer after sales has been effected is void because it is gharar. But it may not be very risky.