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***MUDARABAH AS AN EFFECTIVE TOOL TO
ALLEVIATE POVERTY THROUGH MICROFINANCE***



**MASTER OF SCIENCE (FINANCE)
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***MUDARABAH AS AN EFFECTIVE TOOL TO ALLEVIATE POVERTY
THROUGH MICROFINANCE***

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UUM
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**Thesis Submitted to
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Pusat Pengajian Ekonomi,
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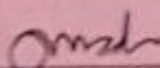
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ABSTRACT

Microfinance has been identified and proven to be an important financial instrument that facilitates the poor group to access to the financial service to move from the poor socio economic group. As the microfinance program highly concentrate to the poor group people it helps to alleviate the poverty and thus achieve Malaysia 11th Plan Goal. Microfinance with *Mudarabah* contractual becomes a good combination to combat the poverty. *Mudarabah* is an Islamic financial tool that aims to aid the poor people and at the same time it is good for the economic and social development. This paper provides the Islamic thoughts and a motive behind these initiatives also discusses the compatible financial mechanisms proposed by Islam to encourage them to move from poor group for a better living. The qualitative method is used to carry out the objective of this research.

Keyword: Microfinance, Islamic Finance, Poor, *Mudarabah*, socio economic



ABSTRAK

Pembiayaan mikro telah dikenal pasti dan terbukti sebagai satu instrumen kewangan yang penting yang memudahkan golongan miskin untuk akses kepada perkhidmatan kewangan keluar dari kumpulan sosio ekonomi golongan miskin. Program pembiayaan mikro ini fokus kepada golongan miskin, justeru ia juga membantu untuk mengurangkan kadar kemiskinan dan dengan itu dapat mencapai Rancangan Malaysia ke-11. Pembiayaan mikro dengan mengaplikasikan kontrak Mudarabah menjadi gabungan yang baik untuk mengurangkan kadar kemiskinan. Mudarabah adalah salah satu kontrak kewangan Islam yang bertujuan untuk membantu golongan miskin dan juga ia membantu untuk pembangunan ekonomi dan sosial. Thesis ini terdedah kepada ajaran islam dan motif serta inisiatif kewangan Islam dan juga membincangkan mekanisme kewangan yang sepadan yang dicadangkan oleh ajaran Islam untuk menggalakkan mereka untuk keluar dari kemiskinan dan ke arah gaya hidup yang lebih baik. Kaedah kualitatif digunakan untuk menjalankan objektif kajian ini.

Katakunci: Pembiayaan Mikro, Kewangan Islam, Miskin, Mudarabah, sosio ekonomi



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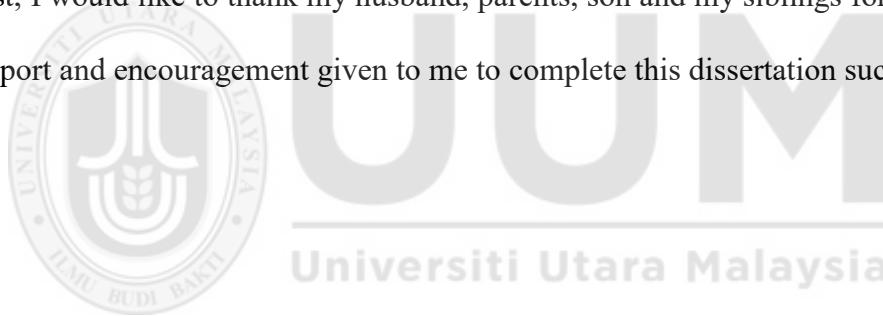


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CHAPTER 1

INTRODUCTION

1.1. Introduction

Poverty is defined as lacking adequate money or means to live comfortably (Concise Oxford Dictionary). Poverty in the country resulted due to poor development and discrimination. Combination of efficient institutions, supportive social value systems, technical and empirical understanding of the poverty, able to create an effective economic policies of a country Elwardi (2015).

Everyone needs a financial access to run a life cycle as the money is the medium of every single transaction. There should be appropriate access to the financial service. The poor people are often left out and find difficulty to enjoy the service to upgrade their financial levels. There are poor people that able to move from the poverty group and move toward better lifestyle and yet some continued with the poverty and remain with the same status. Any government in the world aims to reduce poverty in the country and therefore it requires a steady financial system that does not excludes the poor and have the same access as others to the financial system.

Microfinance (MF) is important as it is an alternative loan for the poor people especially micro entrepreneur to access for funds and expand their businesses. The poor people are given a chance to grow themselves and to come out from the poverty

by generating more income. The loan is given on a trust basis and therefore no collateral or guarantor is needed to secure the loan.

The Muslim entrepreneurs prefer financial service as per the Islamic teachings and norms. They insist financial product that prohibits interest (*Riba*), Avoidance from *Gharar*, and *Halal* business transactions. The alternatives to interest based business in Islam are partnership, trade or lease based that allows the ownership or use of commodities or product required for production by a company.

Dusuki (2008) highlighted that Islamic banks should have high participation to enable financing needs reached the poor group society. He added, Islamic banks should take charge in social and economic development after the persistence growth for three years, besides their focus on maximizing the profit. Therefore, he recommended Special Purpose Vehicle (SPV) as one alternative concept to funds to the poor people. A SPV is also known as bankruptcy- remote entity because of its role to secure the commitments when the parent company bankrupt with an assets and liability formation and legal status planned accordingly. The SPV is normally used to separate financial risk. An entity can use a special purpose vehicle/entity when invest in mega project to avoid the risk effects the entire firm. In the event the parent company made huge losses the subsidiary company will not be affected. This SPV can be funded with Islamic charitable techniques such as *Waqf* endowment, *Qard Al-Hasan*, and Zakat. Dusuki also highlighted features and the procedure of using SPV for Islamic MF as follows:

- i. The Islamic bank creates few sources of funds with detailed MF objectives.
- ii. The Islamic banks design a SPV
- iii. The banks assign a portion of funds and parked the funds at SPV.
- iv. The funds are then channelled to their clients based on the demand

The research on the implementation of MF in Malaysia is not complete and there was a big gap between theoretical and practical aspects. As such this research investigates the perspectives of *Mudarabah* as an effective Islamic finance tool to alleviate poverty through MF.

1.2 Problem Statement

In the country like Malaysia, it is extremely important for the MF to play major role in developing the socio economy of the community. There are several institutions which can be grouped into non-governmental organization (NGO), government agencies and banking institutions that provided MF to Malaysian community. The Amanah Ikhtiar Malaysia (AIM) as a NGO functioned in helping the poor by creating job opportunities to the poor group people. AIM targeted the hardcore poor, poor and low income women to disburse the funds. Besides AIM, there are other MF agencies such as TEKUN Nasional (Tabung Ekonomi Kumpulan Usahawan Niaga) and YUM (Yayasan Usahawan Malaysia) and being a part of the Malaysia government programs to reduce poverty in Malaysia. Each of the institutions has its own loan systems for a different group of people. Even though all these institutions have different management and system but they share some similarities. AIM and YUM offer loans mainly to the hard-core poor, poor and to poor women, whereas

TEKUN gives loans to both poor and not-so-poor men and women borrowers. In addition AIM lends the money by group lending method whereby a group is consist of 5 women, meanwhile TEKUN and YUM are using individual lending scheme.

Bank Negara Malaysia (BNM) also gave mandates to several Malaysian banking institutions to offer microcredit loans in year 2007 in order to develop the MF industry in Malaysia. Microcredit loans given are between RM 1,000 to RM 50,000 by 9 banks in Malaysia with no collateral (Bank Negara Malaysia 2010). The loan tenure is shorter and normally up to 5 years with minimum document required for approval of the loan. The microcredit loans by these banks are guaranteed by the Credit Guarantee Cooperation (CGC) an agency that provides assurance to the financial institutions on the credit given (Bank Negara Malaysia 2010).

Basically, the MF pioneer contributor Grameen model was founded by Professor Muhammad Yunus in Bangladesh on 1983 towards poverty alleviation can be hardly overemphasized. A Nobel Prize was received in year 2006 for the model of MF that is being replicated through one of the largest international network of microcredit organization for the poor people in the world. Malaysia replicate Grameen bank model as the example of the MF. Malaysia MF only focuses on microcredit loans, meanwhile Grameen bank also offer other MF products such as microsavings, microinsurance and pension funds to its borrowers besides microcredit loans. The difference between Malaysia MF and Grameen bank is Malaysia MF is subsidised by the Malaysia government.

Even though, there are many MF institutions that can functioned in eradicating poverty, yet there are many issues arising from the current MF practices. The current MF limitation is due to interest rate that imposed to the borrowers, Islamic MF that will be discussed in this paper will be based on the interest free and outlined with the *Mudarabah* model.

a) Some weaknesses/issues of current MF practices

In general, MF groups is stronger due to the teamwork of the group in screening to ensure good loan repayment, cost effective peer monitoring and overcome enforcement problem compared to collateralized transactions. But, it is failing in some cases whereby the trust is breached and multiple MF borrowing by their clients. Loans have been diverted to the people that are not targeted by the MF programs Baker (2000) and the collateral has been violated by the lenders themselves Bastelaer (2000).

The other issues with the MF are high cost, poor marketing and lack of financial products Segrado (2005). Furthermore, Akhtar (2007) mentioned that geographical constraint is another problem of MF. The rural areas are not properly accessed and the poor group people are being left out. MF will not reach the people in the rural area and also due to the weakness of the marketing channel the rural poor group are often left out. To reduce poverty not only the poor group should find the solution to reach the aid meanwhile the government also have to work out ways to trace the poor people in the rural area and offer them the financial solution to overcome their poverty.

b) Current MF Models are based on Interest

The lending mechanism in conventional MF is different from Islamic MF due to prohibition of the interest. As the Muslims strictly avoid interest and stick to *Syariah* law, therefore the conventional MF is not welcomed among the Muslims as it is not compliant to the *Syariah* law. The differences of the conventional and Islamic MF are tabulated as below;

Table 1.1
Difference between Conventional MF and Islamic MF

Conventional Microfinance	Indicator	Islamic Microfinance
External, client saving	Source of Fund	External, client saving, zakat and waqf
Interest Based	Financing	Islamic mode financing
Ultra Poorest are left out	Financing the Poorest	Ultra poor are targeted
Cash Term	Fund Transfer	In kind
Women Preferred	Target Group	Any Member of Family
Women Empowerment	Targeting Objective	Family Empowerment
Material	Work Incentive	Material and Spiritual
Secular	Social Development Program	Religious

One major concern of the Islamic finance issue is the prohibition of interest (*Riba*) in the business transactions. *Riba* derive from the Arab word means ‘to increase’, ‘to grow’ and ‘to exceed’ including the interest charged by the bank on the loans provided to the customers. *Riba* is prohibited and a Prophet said “Allah has cursed the one who consumes *Riba*, the one who gives it, the one who witnesses over it, and the one who writes down the transaction.”

Riba is *Haram* in Islamic finance because Allah had declared it. Meanwhile the Islamic scholar gives reasons why *Riba* is *Haram* in Islamic:

- i. *Riba* being a burden to the people to pay the debt and the poverty remain in the country.
- ii. *Riba* is based on greediness, self-interest and hard heartedness.
- iii. *Riba* become major contributes to high prices.
- iv. *Riba* become root for distress and hopelessness to people due to growing debts.
- v. *Riba* is additional income without and riskiness
- vi. *Riba* creates a situation where rich people become richer and poor become poorer.

The Daily Vatican newspaper, L'Osservatore Romano on March 2009 reported that Western banks may follow Islamic finance system as an alternative during the global financial crisis in year 2008 and 2009. The Vatican also stated that: "*The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service*". The article also added that Islamic bonds can be used as a security and as alternative to interest by the western banks. Islamic financial institutions will not suffer if the interest based market fails as the risk is shared by both parties, the lender and borrower.

The current MF practice is charging the interest rate on the loan amount made and also the interest rate is varied based on the loan products. The Muslims prefer *Riba* free loan and therefore seldom opt for conventional MF as it against their Islamic *Syariah* norms. Conventional MF charge the *Riba* on the customers and Muslims are not keen to get financial aid which is on interest based, therefore it is very hard combat poverty in the country.

Generally, Islamic business contract is built up with four major principles and the Muslims keen to follow these principles in performing their business transaction. The four principles are;

- i. The prohibition of interest.
- ii. Risk-sharing between the capital provider and borrower of the business.
- iii. Money calculated based on time-value and *Riba* banned.
- iv. The prohibition of *Gharar* (uncertainty) due to insufficient information.

Islamic MF definitely has to oblige to these. The basic principles of Islamic MF are as below and the model to be construct by taking into account the following principles:

- i. Prohibition of interest rate
- ii. Focuses mainly on the poor people charity
- iii. Assets based financing
- iv. Profit and loss risk sharing
- v. Financing in Halal and *Syariah* compliant activities

c) Need for Islamic MF that are based on *Syariah* principle

MF and Islamic finance share several of common principles and elements. MF principles conform to the broader goals of the Islamic financial and economic systems Dhumale and Sapcanin (1999). Islamic finance and Islamic MF are based on social foundations and aim at financial inclusion and risk sharing Ferro (2005). On the other hand, conventional MF does not accomplish the needs of many Muslim

clients as they consider the option of conventional financial products to be contrary with the *Maqasid Al-Syariah* (foremost objectives of Islamic law), which aim at preserving the wellbeing of people, namely their faith (*din*), their lives (*nafs*), their intellect (*‘aql*), their prosperity (*nasl*) and their wealth (*mal*) Chapra (2000). An interesting study conducted by Abdul Rahman and Dean (2013) examined the challenges faced by Islamic MF institutions (MFIs) and determine some logic consideration in overcoming the issues. Among the solutions suggested are that banks should engage more in MF and diversify their portfolio.

The framework of an Islamic financial system is based on elements of *Syariah* that strictly prohibits *Riba* and *Gharar*. The *Syariah* compliant investments are structured on the trade of assets or services with money acting as the medium of the transaction. The Islamic finance industry has developed a broad range of *Syariah*-compliant financial products to ensure that the contracts are acceptable by both traditional Islamic legal and also conventional financial contracts.

a) *Musharakah*

Principle of *Musharakah* was practiced before the existences of Islam. During the Prophet Muhammad (PBUH) living period, this principle was accepted as valid means of Islamic financing by Sunnah of the prophet. Originally, *Musharakah* is a contract of business and trade where profit and loss shared among the investors. The term *Musharakah* is derived from the Arabic word *Sharikah* meaning partnership. In the modern financing mode, *Musharakah* is about contributing capital to a project, asset transactions and for a company. The profit and the losses is shared among the share partners. In this contract all parties must provide capital.

b) *Murabaha*

Murabaha is the basic Islamic financing and it is known as Mark up or Cost plus financing. The word *Murabaha* means profit. *Murabaha* is a contract of sale in where the goods and supplies are sold on profits. *Murabaha* is a contract of exchange based on sale-and-purchase contracts with a predetermined cost and profit. The seller states the cost he has incurred on the asset that he intended to sell and mark-up cost before sell to the buyer.

c) *Ijarah*

An *Ijarah* contract is a contract of exchange and similar to lease. The ownership of the assets will remain and the fixed asset will be leased. The income from the lease will be returned to the owner at the end of the lease period.

d) *Istisna*

Istisna is a contract of participation. The capital provider agrees to supply goods or asset at a pre-determined time and price. This contract provides flexibility to the customer as payments can be made anytime in instalment, after completion of project or upon delivery of goods.

e) *Mudarabah*

Islamic MF principle with the *Mudarabah* concept will contribute for the less fortunate and reach out to millions poor people in Malaysia, that prefer loan based on the *Syariah* values. The *Mudarabah* is more to profit and loss sharing Islamic finance instruments, the profit will be shared based to the agreed proportionate and the loss

will be bare solely by the capital provider meanwhile the borrower will loss his efforts. As such the borrower will sincerely contribute his knowledge and hard work, meanwhile the capital provider will ensure the amount loaned is utilised effectively to avoid the loss between the both parties.

1.3 Research Questions

The study is to develop an Islamic MF model using *Mudarabah* contract. The following research questions are designed to achieve the research objective:

- i. What are the MF models used in Malaysia and Bangladesh?
- ii. What are problems and issues arising from current MF models?
- iii. What is the most suitable Islamic finance principle used to construct the Islamic MF model?

1.4 Research Objective

The main objective of the study is to investigate the impact of the Islamic MF on poverty and the contributions of *Mudarabah* contract model to alleviate poverty social group in Malaysia. The specific objectives are as follows:

- a) To study the MF models used to alleviate poverty in Malaysia and Bangladesh
- b) To identify issues and problems in MF models from several MF institutions
- c) To propose Islamic MF model based on the *Mudarabah* principle contract.

1.5 Significance of the study

Poverty became the fundamental for social crisis in many countries including Malaysia. There are increases in theft, drugs suppliers, child kidnapping and bribes. Poverty is the major illness that need to treated and much important than the need of political. One of the methods to reduce poverty is through Islamic MF by adapting *Mudarabah* one of the Islamic finance instruments Elwardi (2015). *Mudarabah* concept is very general; the profit and loss will be shared among the committed parties that agreed and signed the transaction contracts.

There are no evidence supports that *Mudarabah* contract can reduce the poverty, it likely will have fruitful result as *Mudarabah* contract is combined with MF. This is because *Mudarabah* concept is a profit and loss sharing whereby the involvement of the capital provider, investors, financial institutions and government agencies will be helpful to the macro entrepreneur and poor people.

These concepts ensure the wealth are distributed to the needy to upgrade ones socio economic either from hardcore poor to poor category or from the poor group to financially stable group.

This study presents *Mudarabah* MF as a tool for poverty reduction, and how it is an effective solution for many social and economic crises. The Malaysian Government policy makers might find this study useful because it highlights on the areas and roles that the government can play in the fighting against poverty. This study also contributes important knowledge to the existing information or literature in the field

of Islamic finance in general. The findings should therefore form a useful material for reference that may be used by academicians, researchers who wish to carry out further studies on a related subject.

1.6 Scope of the study

This study wrap a full meaning of poverty and its significant impact on the economic growth of the country, and the role of *Mudarabah* contract for the Islamic MF as a tool for poverty reduction in Malaysia. The study will be useful for the business, the government, NGO, banks and investment enterprises to invest by engaging in *Mudarabah* contracts.

1.7 Organization of the Paper

This study is organized into five chapters. The first chapter is the introductory of the topic, problem statement, research questions, objective of the study and finally scope and limitation of the study.

The second chapter is the up-to-date information in great detail which is the literature review that is applicable to the study also in this chapter a critical review of some selected previous studies on critical success factors for MF program presented also, which has been used in this study.

The third chapter is about the description of the methodology and procedures used in the research. It gives in detail explanation on the process and of the research. The fourth chapter is discussion and analysis part which is the result of the methodology used, the result and analysis of the research methodology outlined in Chapter 3 were presented and discussed in Chapter 4.

In the fifth chapter and the final is the conclusion and recommendations based on the findings obtained. The paper is finalized and wrapped up with references and appendices.



CHAPTER 2

LITERATURE REVIEW

2.1 Theoretical Literature Review

2.1.1 Microfinance

MF is a financial service that offered to the low income group people according to Otero (1999). An innovator from the Global South introduces small amount of capital for a short term period that can help the poor people to escape from the poverty and improve in their economy and this known as microcredit. Schreiner and Colombet (2001) define MF as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.” Therefore, MF provides services to the people who fail and unable to get access to banking sector such as savings, loans and insurance. Nowadays the term “microfinance” refers to wide range of financial service that designed to fit the needs of poor individuals.

Microcredit and MF are different. Microcredit refers to small loan meanwhile MF is a general term whereby the loan and financial services that are offered such as micro savings and micro insurance by NGO or other MF institutions.

2.1.2 Microcredit

Microcredit is a part of MF that provides micro loan to the poor people according to Sinha (1998). Microcredit is one of the MF products besides micro savings, micro insurance, pensions and scholarships. MF is a process of extending the financial aid and service to the poor people that are neglected by the financial institutions. Besides that microcredit is also a small amount of fund that borrowed to the poor people without collateral, properties or a steady income that is used to create a business opportunity and to generate income and at the same time move from the poverty group.

2.1.3 Microsaving

Microsaving is another part of MF. Microsaving is whereby fund will be deposited into a saving account that is offered to the low income group people for the future use. Microsaving accounts function is similar to conventional savings account but the differences are the amount of funds, microsaving fund deposited is smaller amount. Minimum balance amount is not required and this allow depositors to save little amount of money and also there is no service charges imposed to the individual.

2.1.4 Microinsurance

Microinsurance is designed to low-income people to guard them against specific risk with low premiums. Microinsurance products aim to protect people from the risks that most commonly faced by poor people. Poor people are also given chance to

purchase insurance for their future to overcome any unfavourable circumstances as their lifestyle is risky. Premiums insured are low yet the coverage is balanced to the probability of cases and able to cover for the risk involved.

2.1.5 Microfinance Models

The MF has few models that have been developed before the Grameen bank models.

Those models are as below:

- i. **Grameen Model:** Pioneered by Grameen Bank in Bangladesh in the late 1970s, now extends world-wide through Grameen replicators.
- ii. **Village Banking:** Developed by John Hatch in Latin America in the mid-80s, focus is on forming independent village banks.
- iii. **Self-Help Groups (SHGs):** Savings-led approach pioneered by Myrada and Pradan in India in the mid-80s. Similar to Village Banking, focus is on developing community-run Self-Help Groups.
- iv. **ASCAs, ROSCAs, small Credit Unions, etc.:** Similar groups have been operating formally and informally around the world for hundreds of years.

2.1.6 Islamic Microfinance

Riwajanti (2013) stated that “Islamic MF should be measured as one of the method that alleviates poverty, it need to be developed due to its exclusive characteristics that is rich with good values and human oriented”. Besides that, Abdul Rahman and Dean (2013) focused on the Islamic MF challenges and suggested solutions to

overcome the issues. Abdul Rahman and Dean (2013) identified the effectiveness and achievement of MF is determined with the external and internal practices. They stated that challenges faced by MF are high operation cost, sustainability and poor market access. Therefore, they recommended resolution to increase participation of the banks to expand the portfolio, Islamic based partnership contract to be developed, and provides knowledge for the staff.

The severe contribution to the Islamic Banks development programs are including MF schemes that found in the studies done by Dusuki (2008); Abdul Rahman and Dean (2013). For an example, Dusuki (2008) highlighted the importance for the participation of Islamic Banks in MF to reduce poverty. Nevertheless, Grameen group-lending model proposal overcome a low rate of non-payment Hailey (2009). Moreover, Abdul Rahman and Dean (2013) further explain that this group-based lending method substitute physical security with social security, that aims to reduce the risk of the organization. They also added that Grameen Bank model, has been achieving a successful result in collecting the loan amount by shaping up a group and payment of the loan weekly by the borrower.

Abdul Rahman (2007) emphasized to develop an alternative potential microfinance with interest based especially for Muslim clients by using the Islamic finance contract such as *Musharakah*, *Ijarah*, *Mudarabah*, and *Murabaha*. In line with that, he proposes Islamic Banks should adopt the potential alternative structure of the *Wakalah* contract that practiced by Takaful in their operation to provide more service to their customers. Moreover, due to the increase demand for Islamic banks, Hassan et al. (2013) proposed a model to incorporate MF into Islamic banks in Malaysia and

many institutions are unwilling to adopt the model because of the risks. Theoretically, banks avoid MF because of the cost and risk, undesirable selection, information irregularity, and moral hazard according to Hassan et al. (2013). On the other hand, the biggest concern of the default risk by all financial institutions, for both Islamic and conventional, are manageable as of to date. Mokhtar et al. (2012) stated that Amanah Ikhtiar Malaysia (AIM) has recorded a good performance of 98.9% loan repayment annually. This has proven that credit risk of default can be overcome and encourages Islamic banks to engage in MF.

The MF model discussed earlier focus mainly on the sharing of the profit and risk, therefore *Mudarabah* concept will be best to link with the MF objective. *Mudarabah* model is based on the partnership as the profit and loss will be shared among the borrower and capital provider.

2.1.7 The Islamic Scholars Perspective on *Mudarabah*

Mudarabah has been used by the Arabs for trade activities initially. *Mudarabah* is also known as *Muqaradah* and *Qirad*. *Muqaradah*. *Mudarabah* was used earlier by muslims in their trade activities and there is no foundation in the Quran or the Sunnah. The term “*Mudarabah*” is derived from *al-darb al-ard* which means “travelling through the land” as mentioned in the following verse of the *al-Quran*: “...others travelling the land seeking of Allah’s bounty” (*Al-Muzzammil*: 20).

It was also approved by Prophet Muhammad (S.A.W) as reported by Suhayb r.a.:

“Three matters that have the blessing (of Allah (S.W.T)) i.e. a deferred sale, Muqaradah (Mudarabah), mixing the wheat and barley for domestic use and not for sale” (Ibn Majah).

According to Al-Zuhaily (2007) *Mudarabah* is also known as “silent partnership” because the fund provider (*rabbul mal*) becomes sleeping partner meanwhile the entrepreneur (*mudarib*) manages the business.

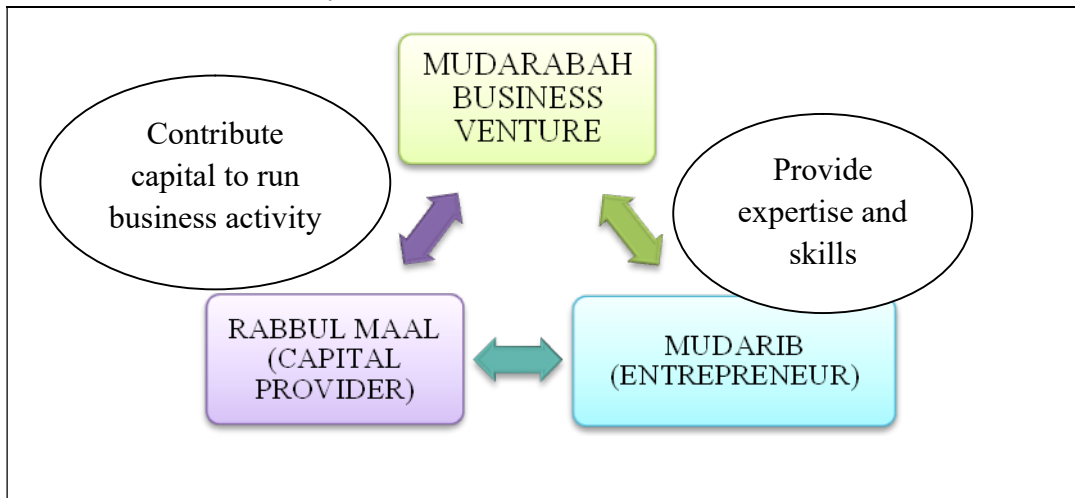
2.1.8 Mudarabah as Mode of Financing

There are two types of *Mudarabah*, namely; al *Mudarabah al Muqayyadah* (restricted *Mudarabah*) and al *Mudarabah al Mutalaq* (unrestricted *Mudarabah*). In the former one, the *rabbul mal* restricts the *mudarib* to invest the capital only in specified fields; meanwhile another allows the *mudarib* to invest in any business that tie with Islamic *Syariah* norms. The *mudarib* is the person who is responsible to invest, utilise and manage the capital provided by *rabbul mal* to generate profit in parallel to the *Syariah* law. The *mudarib* will only invest and venture the business based on his knowledge and skills and he cannot claim wages to run the business.

The profit earned through the business venture will be shared between the *mudarib* and *rabbul mal* as per the agreed ratio based on the *Mudarabah* contract. In the event of loss incurred in the business it will be borne by the *rabbul mal*, meanwhile the *mudarib* losses his efforts.

Figures 2.2

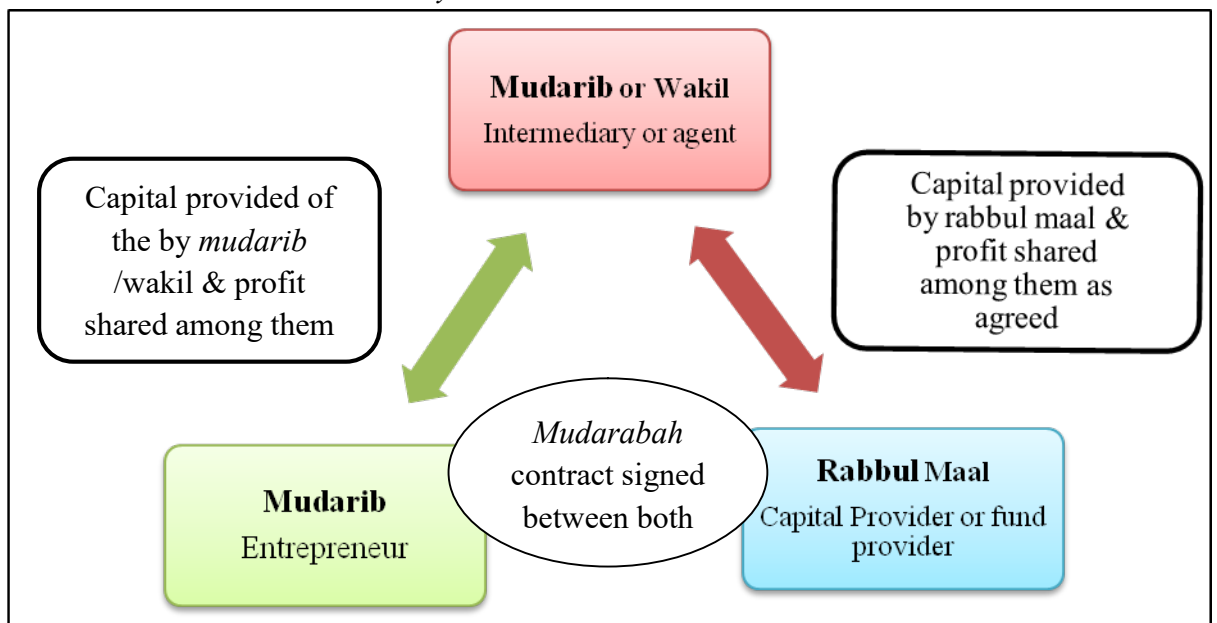
Mudarabah business activity contract model



Another type of *Mudarabah* is called two tiers *Mudarabah*. Whereby the capital provider will be *rabbul mal* and the *mudarib* will be the bank or any intermediary who will sign the first agreement between them. The second agreement will be signed by the bank or any intermediary with another *mudarib* (the person who will conduct the business).

Figures 2.2

Two tier Mudarabah business activity contract model

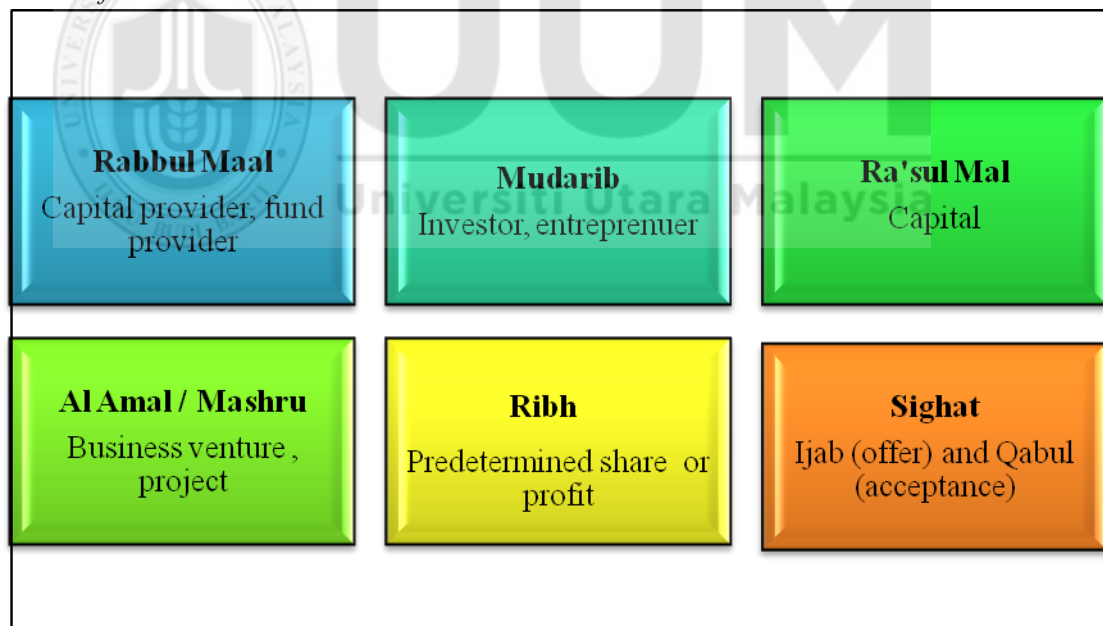


2.1.9 The Pillars of *Mudarabah*

The main three pillars as below are important for a valid *Mudarabah* contract:

- a) There should be two or more parties involve; *mudarib* (investor/ entrepreneur) and *rabbul mal* (capital provider/fund provider).
- b) There should be a Halal business to venture (*al-amal / mashru*), capital (*ra'sul mal*) and profit distribution (*ribh*).
- c) There also should be a *Sighat* on the *Ijab* (offer) and *Qabul* (acceptance).

Figures 2.3
Pillars of Mudarabah contract



The first pillar is involvement of two or more parties in the Halal business venture. The involving parties should be a competent, mature and a physically and mentally normal person that able to make a business transaction. The person that involves in

the business transaction should be able to make a rational decision for a successful and significant transaction.

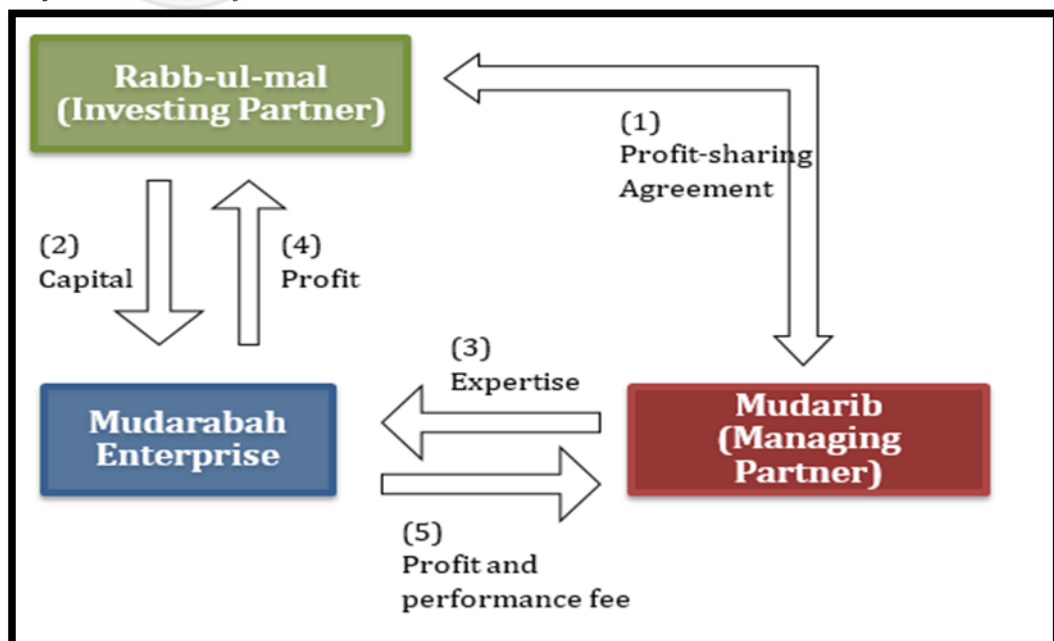
Secondly the operation of the business, the capital provided should be either money or goods that are valuable to run a business. The capital that is offered by the *rabbul mal* should be discussed earlier and agreed by the both *mudarib* and *rabbul mal*. The capital can be either cash or tangible asset that has been determined earlier by the involving parties and *mudarib* utilize the invested capital in the business transactions. The business activities conducted by the *mudarib* should be Halal and according to Islamic *Syariah* law. The business activities can be restricted or unrestricted business transaction but should be strictly permissible by Islamic values. The profit earned through the business will be shared between *mudarib* and *rabbul mal* according to the pre-determined ratio that has been agreed mutually earlier. In the event the loss is incurred by the *mudarib* due to his negligence or violation the loss will be bear by the *mudarib*, otherwise the loss will be bear by capital provider if the business loss is incurred.

Finally, one of the important pillars is the *Sighat* (verbal agreement). The verbal agreement should be between *mudarib* and *rabbul mal* on the *Ijab* and *Qabul*. Once the both parties agree with the business arrangement, the agreement that consist of vital elements will be signed before commencement of the business transactions. In the event any unnecessary issue raised by one of the contracting parties, the written and signed agreement will be the fundamental for the judgemental.

2.1.10 *Mudarabah* Profit Distribution

Profit earned in the business activities will be shared as per the agreement mutually agreed and signed by both involving parties. The *mudarib* is allowed to fix any amount as salary for the job done. He also may claim valid business expenditure subject to the conditions agreed. If the event *mudarib* had diversify the business activities and unfortunately incur loss in some transactions and at the same time gain profit in other business, the profit earned will be used to compensate the loss firstly before distribution of the remainder profit according to the agreed ratio. If the business is overall in loss the *rabbul mal* will unable to claim the investment and the *mudarib* will lose his hardwork. Loss that incurred in the business will be solely borne by the *rabbul mal*, with the exception of misconduct, negligence or breach of contract by the *mudarib*.

Figures 2.4
Profit distribution of Mudarabah contract



2.1.11 Termination of *Mudarabah* Contract

Termination of the *Mudarabah* contract can be done at any time by the both parties or either one party. The termination will take effect upon receiving the written notice by the parties. The contract termination terms and conditions will be also agreed during the signing of the agreement to avoid unfavourable effect to both parties.

2.1.12 A *Mudarabah* Contract Model for Microfinance by Bank

The bank will provide capital to the micro enterprise to drive their business operation successfully. Capital needed by a micro enterprise will be made available by the banks and the micro entrepreneur will offer labour and expertise to run the business activities. The profits incurred by such financing will be shared as agreed between the bank and the entrepreneur at a fixed ratio.

The *mudarib* liability is limited to the time and effort spent, meanwhile the financial losses borne by the MF program. The contract arrangement between the MF program offered by the banks and the *mudarib* is known as restricted *Mudarabah*. This is because the MF program agrees to finance the *mudarib* for the specific Halal business activities. The relative profits will be shared proportioned according to the agreed percentage.

2.1.13 Assumptions of the *Mudarabah* Model

The devote Muslims are the main participant in the Islamic MF program. They strictly ties to the Islamic teachings and will not go against the norm and Islamic law. As such, the Muslims will not ever take part or join the fraud, and other malicious activities. They will definitely say “NO” to the *Riba*. This is because *Riba* will mess up their Halal earnings. They always bear in their mind the sayings of the Holy Prophet that “*Whoever bears arms against us is not one of us, and whoever cheats us is not one of us.*” (Saheeh Muslim).

Another assumption is the fixed profit earned monthly on the loan duration. The business activity financed by *Mudarabah* will ensure fixed profit earned monthly. This is because of the mutually agreed arrangement earlier on the financing amount, ratio of profits proportioned and duration of the repayment. As the details of the business activity such as the type of business to conduct, the person who will conduct the business transaction, profit sharing ratio, and duration of the repayment is transparent, it will ease the capital provider to finance the *mudarib* without any doubt. The *Mudarabah* contract secures the both *rabbul mal* and *mudarib*.

2.1.14 Types of Poverty

There are various definition and perspective given for the poverty throughout the world. There are two types of poverty hardcore and poor group of poverty. The poverty group is recognised and measured with the amount of money earned to meet their basic life necessities. Hardcore poverty is defined for the people without a meal a day and also a shelter Kamalanathan (2008). Hardcore poverty is also people with lack of healthcare, education and a without a fixed income. Hardcore poverty refers to the deficiency of basic human needs, which generally includes food, water, sanitation, clothing, shelter, health care, and education (UN declaration 1995). Relative poverty is defined by Dogarawa (2009) as discrimination of the economic based to location or lifestyle of the people. Dogarawa, further explains that, in reality the existence of relative poverty is due to discrimination in gaining the income monthly and wealth distribution. Hence, relative poverty is still manageable compared to the hardcore poverty.

2.1.15 Poverty from the Islamic Perception

Islam does not assume poverty as a desirable quality, besides it is considered as a severe issue that consist of negative effects that must be alleviated and overcome the issues. Poverty meaning in Islam is a person with material difficulties that cannot execute certain task and needs of the others, as “*fakr, fakir* and (plural form) *fukara*” is mentioned in the Qur’an twelve times. Muslims are also highly encouraged to do the best maximum to win for the material wealth in this world. Muslims should put their efforts, make decisions and conduct their activities in the way that the public

interest should come first before the individual interest. But the conventional economy's view makes importance for the individual interest rather than the public interest. Islam is a practical religion and therefore it requires their faith is shown in their daily actions. Equality is one of the most important elements in Islam practice. As such, the rich people often make use of the poor people. Besides that, there should be a focus on the in the wealth distribution channel such as *Zakah*, *Sadaqah* and *Waqf* in order to safeguard the equality in Islam, it can be the source and access to the productive and income to the poor people. All Muslims are responsibility to ensure their brotherhood is in a good condition. Muslim should take care the well being of each other. The Holy book says that one should not abandon the poor. If they neglect the poor, it also means neglecting the religion. "Have you observed him who denies religion? That is he who repels the orphan, urges not the feeding of the needy." Next, Leaman (2006) mentioned that "fighting for the poor is considered as fighting for Allah's cause and is equivalent to the act of praying and fasting". This statement shows that it is very important to eliminate the poverty. Even though Islam religion highly encourages Muslims to help the needy ones, Islam religion is also emphasises of hard work to gain the income. This is proven by the Quranic verses as below:

"Man will get nothing but what he strives for" (Quran 53:39.)

Allah has created sufficient resources for his creatures (Quran, 41:10).

Allah says: It is Allah who created the heavens and the earth, and sent down from heaven water wherewith He brought forth fruits to be your sustenance. And He subjected to you the sea at His commandment; and He subjected to you the rivers and He subjected to you the sun and the moon constant upon their courses, and He subjected to you the night and the day, and gave you all that you asked Him.

According to Choudhury (2002) stated that Islam religion brotherhood always ensure economic and social should be equally for all the human being and Muslims in particular. In view of the above, it is Muslims duties to ensure their religion teaching,

Allah word is to be taken as granted. Therefore, to alleviate poverty it important to distribute the wealth gained to the needy ones and encourages them for their hard work. This wealth distribution will be conceptualised through the MF using the *Mudarabah* concept.

2.2 Empirical Literature Review

About 72 percent people that are living the Muslim countries do not utilise financial institutions services Honohon (2007). The Muslims in view that, the conventional banking products are contrary with Islamic teachings and *Syariah* law. CGPA in year 2007 revealed through their research that Islamic MF global outreach is only to 380,000 people, the information was collected on over 125 institutions that contacted 19 Muslim countries experts. MF institutions has move forward to provide their services to the poor Muslims that demand financial assistances that comply to Islamic financial principles and lead to the development of Islamic MF as a new market niche. Afghanistan, Bangladesh and Indonesia are the countries that focus Islamic MF with 80 percent of the global outreach. Meanwhile in country such as Syria, Jordan and Algeria revealed that 20 to 40 percent of respondent do not prefer to conventional microloans due to the religious reason.

The study by Bhuiyan and Hassan (2013) revealed that the sustainable livelihood of the poor borrower is influenced by the microcredit. The empirical comparison study between Islamic finance and conventional microcredit found that 59.49% of the Islamic bank respondent improved in the personal confidences. Islamic bank microcredit loan borrowers used the loan for income generating business transactions

and at the same time improve the living standard. Furthermore, the Islamic bank respondent increase in the personal responsibility of the family with 62.56%. Through the study it is known that the capability of resolving the problem is more to the respondent of the Islamic banking. In the nutshell, it can be said that the Islamic banking borrower is doing better.

Besides that the microcredit program encourages the borrower to operate their businesses to generate income to improve their live. This study also shows that the respondent is motivated by the microcredit to improve their children's education by sending them to school. The microcredit in whole influences the borrower's faith to improve their livelihood and borrowers' decision making.

Through the analysis made by Aslam (2014), using the qualitative data it can be seen that Islamic MF play role to improve the lifestyle of the poor people. These directly impact the poverty alleviation in Pakistan. The borrowers are interested due to prohibition of the *Riba* in Islam and contain religious approaches.

Riwajanti and Asutay (2015) studied data collected from 21 BMT (Baitul Maal wa Tamweel) and BPRS (*Syariah* People Credit Bank) branches in 12 towns in East Java. The aim of the study was to find the borrowers impact and view after receiving financing from the particular financial institutions. The findings suggest that the loan helps to reduce the percentage of poor BPRS respondents as per the national poverty line with the result of 35.5% before the loan financing to 23.1% after the loan financing. As such the paper suggested that BMT and BPRS to expand services to their client to ensure they are away from the poverty by innovating more Islamic

financial products, educate their client on the Islamic financial products to achieve a positive result.

Ana (2012) conducted a research that targeted respondent from the low income household that is known as credit unworthy by major formal institutions that refuse to provide credit and services. This study also includes the geographic locations of MF which resulted variables on social performances in the selected region are except for Eastern Europe and Central Asia.

Mckernan (2002) used primary data from household borrowers in Grameen Bank, non borrower, and two similar microcredit programs to evaluate the consequence of credit on the total production. Productive capital and program participation were treated as main variables in the analysis. The study shows great positive outcomes of participation and the non-credit aspects of participation on self-employment profits.

Another empirical study was used to examine the effect of group-based credit for the poor in Bangladesh on the seasonal outline of household expenditure. Quasi experiment methods were used to analyze the 1991 to 1992 survey data, and the same methods were repeated in 1998. The study shows microcredit programs is useful and gives positive output to the borrowers with the income flow and time demand that never support the existing agricultural activities. The results recommended that an inspiration for participation in a credit program is required for a flawless consumption pattern Pitt (2003).

Chan and Ghani (2011) discussed in their paper if the MF programs reached the potential remote villagers, and if the borrowers could live a better lifestyle with the help of MF. 72 remote villagers were selected as a respondent from three villages whereby their poverty line is below. The study shows that 93% of the borrowers able to move to a better living by increasing their income, assets and able to spend on their family members. Therefore, micro loan able to promote to the growth of rural women.

2.3 Chapter Summary

Mudarabah contract basically an Islamic finance partnership contract. This contract exists as a basic in whole, the muslims help each other to develop and reduce poverty. The Islamic teaching also says that, there should be a hardwork and gain income. They should be away from the poor condition by living a good lifestyle, as such other muslims are welcomed to help to contribute funds to the poor people for them to work hard and gain income from their hard earnings, besides receiving donations. *Mudarabah* concept is a partnership that involves a well to do person to contribute fund or modal to the potential entrepreneur to create or build a business. The cash inflow and nett profit will be shared among the both involving parties as agreed earlier. Added to the above *Mudarabah* contract also has its own way of handling losses in the business. Any financial losses incurred in the business will be borne by the capital provider and the entrepreneur will loss all his efforts contributed towards the business. There are also terms and conditions set with the contract based to the Islamic practice.

Microfinance idea overall to alleviate poverty as per the Islamic teaching that discourage poor people. Through the microfinance most of the poor people tend to get golden opportunity to change the lifestyle as desired with the utmost hardwork pumped into the business. Microfinance is a general term basically with wide range of products that help to overcome poverty such as micro savings account, micro loans, pension plans and micro insurance. All the mentioned products are not easily accessible to the poor people, hence with the existence of MF the poor people also may enjoy and besides that it helps them to upgrade their lifestyle to a better one and also to their preferred way of living.



CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

The purpose of research is to update the current available method and requirement. Research must be in high feature in order to construct understanding that is applicable outside of the research setting with suggestion. Research methodology is an organized way to attain solution for the research questions.

3.2 Research Design

Decision of the research what, where, when, how much, by what means relating to an inquiry or a research study comprise a research design. “A research design is the preparation of conditions for collection and investigation of data is an approach that aims to merge significance to the research rationale. This research employs the qualitative research to generate answers to the objective of the research. The qualitative research method used commonly is interview and focus group. Qualitative research is done through the interviews with the respondent who is related and able to answer the objective of the research. This method was applied because this requires knowledge, understandings, opinion, interpretations, motivation and communications from the experienced people. The interview is the relevant tool to the designed research question.

The purpose of the research interview is to explore the views, experiences, beliefs and motivations of individuals on specific. Qualitative methods, such as interviews, are believed to provide a 'deeper' understanding of social phenomena than would be obtained from purely quantitative methods. It requires ideas and multifaceted information that able to be answered by the experts in that particular field. There are three elemental research interviews structured, semi-structured and unstructured.

3.3 Data Collection Method

Structured interviews are set and determined earlier by the interviewer according to Cohen (2006). Each of the respondents is asked similar questions. There is a slight difference in response and therefore is open ended question included in the interview. The question is standardized and remains consistent from interview to interview. The interviewer play role as casual and friendly during the interview session.

Unstructured interview is a formal interview between the interviewer and respondent. The both parties set time for the interview and discuss with each other. The interviewer has the clear picture and plan in mind regarding the goal and focus of the interview. There is no question set prior to the interview, but the interviewer builds relationship or rapport with the respondent and gets their open opinion on the research. The question is open ended and slight control is ensure to the anticipate response. Unstructured interviewing is suggested when there is enough understanding of topic studied and has a clear agenda for the discussion with the respondent, and still requires understanding of certain part of the study.

Finally the semi structured interview is formal interview between interviewer and the respondent. The interviewer creates questions and use as an interview guide. There will be a list of questions and topics that need to be enclosed during the discussion, generally in a particular sequence. According to Bernard (1988) semi-structured interviewing, is great to be used when interviewer will not able to get more than one chance to interview someone. The semi-structured interview guide grant a comprehensible instructions for the interviewer and able to provide consistent and equivalent qualitative data.

Focus groups are a data collection method that is collected through a semi-structured group interview process. Focus groups are restrained by a group leader and are generally used to collect data on a specific topic. The methods emerged in the 1940s with the work of Merton and Fiske that used focus groups to conduct audience studies. Focus groups method can be used to explore new research areas, to explore a topic that is tricky to observe, to explore a topic that do not allow to observational techniques but requires attitude and decision making skill, to investigate perceptive topics, and when required experience sharing of experts.

3.4 Data Collection Design

This research used primary and secondary data by using review, study sites, discussion by the field expert in pervious study conducted and the analysis done previously. This research needs several wide knowledge texts and documents as to identify and understand the basic concept of the theory and practice. Primary and

secondary data also play role to build up the research paper and to meet the objectives of the research. The primary data is gathered by interviewing the relevant person with the knowledge of MF, Islamic finance and finance itself. Furthermore the secondary data was collected from the journals, company websites, government websites, and relevant literature.

The model that will be developed is based on the current situation and based on the study done on the existing financing method and the model is constructed using the Microsoft excel. Besides that, it is important to note that this study did not intend to focus solely on Islamic Banks that already have MF products, but sought to include *Mudarabah* concept with wealth circulation.

3.5 Selection of Data Collection Method

The data for this study was collected through the phone by using structured interview method. The structured interview was conducted with the individual whose skill, knowledge, experiences and views seem pertinent with the objective of the research. The experts' helps to provide their relevant answer to the objective of this research that consider as the main and vital method for the data collection for this study. The interview was done with the permission of the relevant personnel through phone. The interview was done with the guideline and tips provided by Wheeler (2016), on how to conduct the interview with proper manner and tips on how to question the individuals.

3.6 Design of Research Instruments

The interview questions for the research was developed based on the research objective and other related secondary data. Only the field experts were chosen for the interview to meet the aim of this study. Based on the feedback provided by the expert the MF model with the *Mudarabah* contract was developed and the main model main concern was on the collection of the funds and recycle of the collected funds.

3.7 Interview Modus Operandi

The interview question set is validated by Dr Ahmad Khilmy, Senior Lecturer of Islamic Business School University Utara Malaysia. Before the interview process the respondent was identified. The respondent was contacted through e-mail and stated the purpose of the interview, introduction of the study, and set a tentative date and time for the interview to be conducted. Once get feedback or response from the respondent, interviewer make a call on the proposed date to conduct the interview via phone. The conversation between the interviewer and respondent was recorded as a proof and data collection method process. The respondent was asked question that has been set earlier and validated by the lecturer. The interview was a structured interview and as such potential respondent selected to meet the requirement of the study and ensure the question set is able to be responded by the informant.

3.8 Sampling

The conduct the interview, five qualified person was approached and only four of them agree to be interviewed. The lists of the qualified individual that agree to be interviewed are as follow:

1. Respondent A, Head of *Syariah* Department TEKUN
2. Respondent B, Deputy Head of Financing Management Department TEKUN
3. Respondent C, Lecturer Islamic Business School UUM
4. Respondent D Lecturer School of Economics, Finance and Banking UUM

3.9 Interview Questions

Research Objective	Main questions	Additional Questions
To study the MF models used to alleviate poverty in Malaysia and Bangladesh	a. What MF model is used in your organization or the country is practicing?	a. How does the model function from the aspect of <ul style="list-style-type: none"> • evaluation process, • financing, • collection of the loan • control measure.
To identify issues and problems in MF models from several MF institutions	a. What are the advantages of this model? b. What are the weaknesses of the model? c. What are the issues and challenges faced by the microfinancing?	a. Advantages from the aspect of evaluation process, financing, collection of the loan and control measure. b. How effective is this model in increasing the countries socio economic. b. What are the weaknesses in aspect of evaluation process, financing, collection of the loan and control measure. c. How to overcome the weaknesses of this model d. In your opinion do you think the micro saving and micro insurance should be included in the model? e. Do you think interest can be paid to the micro saving account? f. What are the challenges faced in

		<p>choosing the eligible borrower and also the issue faced in collecting the loan from the borrower.</p> <p>g. What are the Syariah and operational issues in this model?</p>
To propose Islamic MF model based on the <i>Mudarabah</i> principle contract	<p>a. In your opinion are there any micro financing model that is suitable besides charging of the interest rates?</p> <p>b. Do you think the micro financing based to the <i>Syariah</i> law will be effective</p>	<p>1.4 What contract will be suitable for the micro financing?</p> <p>2.4 Do you think micro insurance and micro saving should be included in this model?</p> <p>3.4 Can the <i>Syariah</i> based model function well in this model?</p>

3.10 Data Analysis

The data collected through the structured interview is analysed and construed. The feedback provided by the experts is analysed and concluded to answer the objective of the research. The model therefore was constructed based on the feedback provided by the individual on the current situation to meet the requirement of MF and to cover the loop holes of the current MF system in the country.

3.11 Chapter Summary

Methodology method selected in this paper is to get the feedback from the expert that has knowledge and expertise in this field. Their correspondence helps the study and to identify the strength and weakness, opportunities and threats of the MF program. The question was set earlier based on the objective of the study, the respondent was furnish with the questionnaire earlier to ensure that they are ready to provide the accurate feedback. The respondent was asked structured questions, whereby the questions are similar with minor dissimilarity due to the experiences and background of the respondent are different.

Besides the feedback from the respondent, other secondary sources was used as a method of analysis. The sources are used as a references and basic of the study. The analysis made was on the *Mudarabah* contract and the recycle of the funds throughout the microfinance program therefore the secondary material was referred.

CHAPTER 4

RESULTS AND DISCUSSIONS

4.1 To Study the MF Models Used to Alleviate Poverty in Malaysia and Bangladesh

In year 1987 Malaysian NGO adapted the Grameen bank model and known as Amanah Ikhtiar Malaysia (AIM). Respondent C said that the both MF in Malaysia and Bangladesh are same as they focuses to the lower and middle income group people. AIM's vision is to be renowned, revered dynamic world class MF institution that eradicates poverty and increase the well being of Ummah. As at June 2015 the total of 366,631 borrowers were benefited from AIM and the number increased to 382,178 in year April 2016 where 70% of the borrowers are aged between 20 to 50 years old. In addition, RM 13 billion loans were disbursed on June 2015 and in April 2016 the total loan increased to RM 15 billion. AIM is also successful as the total repayment of loan is 98.9% in 2015 based on the Amanah Ikhtiar Malaysia Operational reports (2016). In Malaysia stated that average household income increase 4 times after joining AIM. MF is an effective way to reduce poverty and increase in household income and protect them against the economic and social shock according to respondent A, C and B. Poverty in Malaysia defined with several factors such as the minimum monthly wages to fulfil their basic necessities such as food, clothes, healthcare and shelter. There are two types of group which is considered hardcore poor and poor. In Malaysia the category is set as below by Economic Transformation Programme (ETP) as stated by Datuk Sri Idris Jala, 2015 :

i) **Extreme/Hardcore poverty**, is the households that fail to earn enough income monthly to fulfil basic survival needs such as food, clothing and shelter. Households that fall into this category earn average monthly incomes of less than RM460 in Peninsular Malaysia, less than RM630 in Sabah and less than RM590 in Sarawak.

ii) Meanwhile, **poor** category is people fall short of certain standards of consumption which are deemed necessary to maintain ‘decency’ in society, for example, those who cannot afford healthcare and education. Households with average monthly incomes of less than RM760 in Peninsular Malaysia, less than RM1,050 in Sabah and less than RM910 in Sarawak are defined as poor.

Malaysia MF institutions offer only the microcredit loans and other MF products such as microsavings and microinsurance is not offered in Malaysia. This limited financial service is due to restrictions based on the Financial Services Act 2013 that states *“No person shall carry on banking services, including receiving deposits on current account, deposit account, saving account or no other similar account, without a licence as a bank or financial institutions”*.

Effective implementation of the right Islamic financial tool will enable Malaysia to achieve 11th Malaysia Plan goal and eliminate poverty. Islamic MF is one of the best compared to conventional MF, it is because one of the Islamic finance principles is interest free (*Riba*) as such there will be no burden to the poor people during the

repayment of the loan. Poor people will be supported with financial, materials and developments. The Banker's Top Islamic Financial Institutions report (November 2014), pointed the health of *Syariah*-compliant finance in the Malaysia. It clearly can be seen that Islamic Finance is doing good in Malaysia. The evidence is based on the five-year review period that achieved by Malaysia's Islamic banks on the aggregate return on average assets of 1.8% increase from 1.73% from the report year 2013 and has exceeded the global average of 1.68%. More astoundingly, this hike in ROAA occurred as the country's lenders continued to grow their assets with growth of 10% or higher.

Malaysia MF institutions do not offer microsavings because Financial Services Act 2013 states that only bank and financial institutions allowed taking deposits from the borrowers. In this case MF institutions such as AIM, TEKUN and YUM are not one of the financial institutions in Malaysia. Grameen bank offer microinsurance to its borrowers due to higher climatic risk in Bangladesh faced by the agriculture activities. In the event any unwanted disaster happens in Bangladesh that affects the agriculture, burden of the borrower able to be reduced and besides that the financial accounts of the uncollectible funds from the borrower by the Grameen bank can be saved by the microinsurance. Another MF product of Grameen bank is pension funds savings allocated by the borrower for the old age usage.

The Grameen bank lending contracts terms are more flexible than the Malaysia MF institutions especially AIM and YUM. The Grameen bank contract is very friendly to its borrower, the loan repayment mode, grace period, duration, repayment amount and interest rate is charged based on the borrower's business nature and affordability.

As such the contract is differ for all the borrowers. Meanwhile in Malaysia the contract bind between the AIM and the borrower is more tight whereby there is fixed grace period for the loan repayment, the loan instalment to be made monthly, the borrower are only women and based to the group lending.

Malaysia MF institutions are subsidised by the Malaysia government, the MF product is limited to one that is microcredit and the lending contract is harmonised among the rest of MF institutions. However, the Grameen bank offers variety of MF products with a flexible contract term bind between the bank and the borrower.

Table 4.1
Characteristic of AIM, TEKUN and YUM

Characteristic	AIM	TEKUN	YUM
Target borrower	Female Only	Both Female and male	Female only
Coverage of service	All over Malaysia	All over Malaysia	Sabah only
Loan Eligibility	At or below poverty line	At or below poverty line and not so poor	at or below poverty line
Lending Size	Group Lending	Individual lending	Individual lending
Loan size	Min: RM1,000	Min: RM 500	Min: RM 100
	Max: RM20,000	Max: RM 50,000	Max: RM 20,000
Loan Installment	Weekly	Weekly, Monthly and Seasonally	Weekly
Grace periods	1 week	Flexible	1 or 2 week
Management Charge	10%	4%	10% - General Loan Scheme
			18% - Short term loan Scheme
Compulsory Savings	RM 1-RM 15 weekly	5% from annual repayment	2% from the loan

4.1.1 To Identify the MF Models Used in Malaysia and Bangladesh

4.1.1.1 AIM Model

In this case the study focuses on AIM the successful MF evidence in Malaysia. The model developed by AIM is adapted from Grameen bank of Bangladesh. AIM business model is a below:

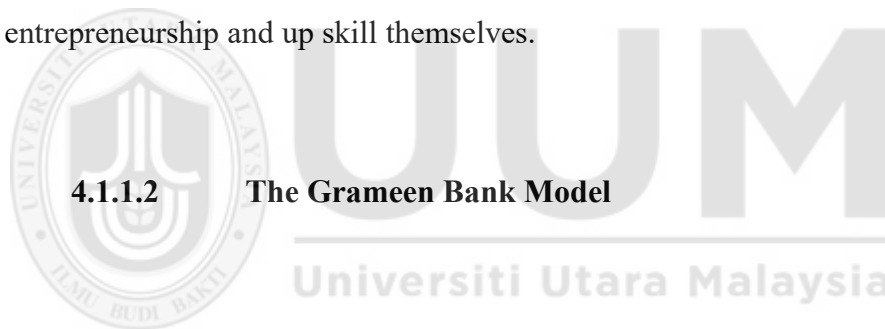
- i. AIM officers identify the hardcore poor, poor and low income group people and register their details.
- ii. The officer disseminates information to the selected households regarding opportunities provided by AIM to increase and how it improves their livelihoods.
- iii. The borrower to form a group consists of 5 members in a particular centre.
- iv. Then the loan officer disburses the loan amount to the borrower.
- v. The officer monitors the borrower activities on the usage of the funds.
- vi. Repayment, compulsory group savings, welfare and wellbeing funds and administration charges collections happen at weekly meetings.

The loan borrowed disbursed based on the amount borrowed and the repayment is made weekly by the borrower. There is 10% administrative fee charged annually to the borrower. Interest cannot be charged to the Islamic Finance as it is prohibited; yet administrative fee can be imposed to the borrower respondent C said

Table 4.2
Disbursement Method

DISBURSEMENT METHOD				
RM 5,000	→	Over 50 weeks	+	1% halal + insurance = RM 110 Weekly
RM 10,000	→	Over 50 weeks	+	1% halal + insurance = RM 220 Weekly
RM 20,000	→	Over 50 weeks	+	1% halal + insurance = RM 440 Weekly
10% ADMINISTRATION CHARGE (ANNUALLY)				

The administrative fee charged by AIM is for the purpose of human resources, crises funds, operational risk and borrowers training. The borrowers are given training on the entrepreneurship and up skill themselves.



4.1.1.2 The Grameen Bank Model

Grameen bank also has their own way of processing for the MF loan approval to the needy ones. Grameen bank officers identify the poor people and follow the process flow below before approve the loan.

- i. Solidarity Group of potential clients consist of five (5) members in a group.
- ii. Given training for a few days to the borrowers.
- iii. Joint responsibility of the group: in case a member defaults the payment all other members have to pay for her or else the entire group excluded from future loans.
- iv. Borrower to attend centre meeting weekly and encourage “loan discipline” among the group members. Elects Centre Leader by the borrowers.

- v. Regular savings by all members.
- vi. Loan disbursed directly to individuals. All loans to be repaid in fifty (50) equal instalments amount by the borrowers.
- vii. Members of the group should adhere to follow “sixteen decision” that set by the Grameen bank such as keeping family small, plant vegetables all round year eat more and sell the surplus, repair houses and constructing new houses, educate children and many more.

The Grameen bank staff will evaluate the borrowers poverty level. The evaluation is to ensure the borrower has improved their lifestyle and move out from the poverty level. Ten (10) indicators as below are used to determine their status:

- i. The family of the borrower lives in a house worth at least Tk. 25,000 (twenty five thousand) or a house with a tin roof, and each member of the family is able to sleep on bed instead of on the floor.
- ii. Family members drink pure water of tube-wells, boiled water or water purified by using alum, arsenic-free, purifying tablets or pitcher filters.
- iii. All children in the family over six years of age are all going to school or finished primary school.
- iv. Minimum weekly loan instalment repayment of the borrower is Tk. 200 or more
- v. Family uses sanitary latrine.
- vi. Family members have adequate clothing for daily use, warm clothing for winter, such as shawls, sweaters, blankets, etc, and mosquito-nets to protect themselves from mosquitoes.

- vii. Family has sources of additional income, such as vegetable garden, fruit-bearing trees, so that they are able to fall back on these sources of income when they need additional money.
- viii. The borrower able to maintains an average annual balance of Tk. 5,000 in her savings accounts.
- ix. Family experiences no difficulty in having three square meals a day throughout the year, and no member of the family goes hungry any time of the year.
- x. Family can take care of the health. If any member of the family falls ill, family can afford to take all necessary steps to seek adequate healthcare.

Table 4.3
The difference of Malaysia MF and Grameen Bank

Malaysian MF Institutions (AIM, TEKUN, YUM)	Type of institution	Grameen Bank
Subsidised		Unsubsidised
(i) Management fees (ii) Government grants and soft loans	Source of operation	(i) Interest rates (ii) Savings
AIM : Group lending TEKUN: Individual lending YUM : Individual lending	Lending design	Group lending
Microcredit	Product offered	Microcredit
		Microsaving
		Microinsurance
		Pension fund
Lending contracts		
Fixed to all kind of loan schemes.	Interest rate	Different on each loan schemes
AIM and YUM: Weekly to all kind of business and borrowers.	Repayment mode	Flexible according to borrower's business revenue

Malaysian MF Institutions (AIM, TEKUN, YUM)	Type of institution	Grameen Bank
Subsidised		Unsubsidised
TEKUN: Weekly mostly to small business activity and monthly/seasonally to agricultural businesses	Repayment mode	cycle.
AIM : 1 week YUM : 2 weeks TEKUN : According to harvesting cycle.	Grace periods	According to harvesting cycle

4.2 To identify issues and problems in MF models from several MF institutions

MF is a very good program that helps to alleviate poverty. It enhances the socio economics of the poor people according to respondent A, C and D. There is a positive movement in the lifestyle of the targeted group people, they are living a better life compare to the earlier stage in their life. Their children able to get education, healthcare, grow in income and wealth.

4.2.1 Loan Repayment Default

As the positive side of MF is overwhelmed, there are also problem in microfinancing. The most common problem is loan repayment. The borrower fails to pay back the loan amount borrowed and the payment become default. Respondent A stated that the default is caused by the attitude of the borrower and the default rate high for the individual borrower. The group borrower faces less issue with the

default loan repayment problem. The group loan is successful because of the peer pressure to make the payment, in some cases the group member helps to pay the loan at the first hand and collect the fund later from their group members according to respondent B and this statement is agreed by respondent A as well. As such the current MF institutions encourage more group based MF loans as its outcomes are positive.

4.2.2 Borrowers Attitude

The failure to repay the loan may be due to attitude of the borrower according to respondent A and respondent B. The funds often used for other purposes other than for which the loan is sanctioned. The loans may be used for non productive purposes and the high chances of default increases. The borrower will have high arrears as the fund is not utilised for the productive purposes.

4.2.3 Natural Disaster

Respondent B mentioned during the interview that there are also borrowers that unable to pay the loan back because of unwanted events for an example natural disaster. The entrepreneur business will be closed because of the natural disaster such as flood, damaged by the fire, earthquake that causes great damages to the business. In that event the borrower unable to repay the loan as all the earning and hardwork is failed. In such cases the MF institutions TEKUN helps to aid the entrepreneur by providing loan for another time and waive the loan given earlier to the borrower.

4.2.4 Lack of Business Knowledge, Skill and Experience

In most cases the male borrower fails to repay the loans in time this is also another cause the loan default increases, the respondent informed that it is due to the attitude of the individual. The female borrower repayment is much better compared to the male group. Besides that some borrower fails because of less knowledge, skill and experience in doing a business. Added they might not have deep knowledge of the product and fails to run the business and result to close the business and the loan cannot be repaid. Respondent C mentioned that the entrepreneur should know to sustain the business. With the limited experience and knowledge they fail on the self-understanding about the vitality of continuous business development.

4.2.5 Low Return Investment

Borrowers in some cases fail to determine the high return business opportunity. It causes the business run by the entrepreneur is not successful as the return gain from the business is not overwhelmed. Definitely for such issue the loan cannot be repaid by the borrower, therefore the new entrepreneur should be exposed with knowledge and business money making skills.

4.3 To Construct *Mudarabah* Microfinance Model

The current MF model is designed for individuals or for a group consist of five (5) of non related members because according to respondent A group lending works better

and with positive results. The funds are provided subsidies by the government, the participant are imposed interest fee on their repayment amount, Islamic finance prohibit *Riba* Respondent D said. The *Mudarabah MFs* are repaid by the participant weekly, monthly or by seasonally. The existing MF exercise is not based to Islamic finance and therefore no Islamic concept is in practice.

In this paper, *Mudarabah MF* model will be proposed by taking into account few criteria such as source of the operation, target group, product offered, repayment mode and interest rate.

Figures 4.1
Criteria for Selection of Potential Participant

Source of Operation	<ul style="list-style-type: none"> • Government
Target Group	<ul style="list-style-type: none"> • Family members
Product	<ul style="list-style-type: none"> • Microcredit • Microsavings
Interest Rate	<ul style="list-style-type: none"> • Zero
Repayment Mode	<ul style="list-style-type: none"> • Monthly

This model is created based on the MF criteria and limited to *Mudarabah* concept. *Mudarabah* concept is very straight forward; firstly it is a partnership business contract, profit and loss sharing, to conduct Halal business and finally no *Riba*. As such this research outcome will benefit both Muslim and non Muslim Malaysia poor citizenship and aid Malaysia to achieve Malaysia 11th Plan Goal to eliminate poverty. Therefore Malaysia government should play major role to achieve the goal.

The proposed model practice will be similar to the normal *Mudarabah MF* process, but the criteria set is differ from the existing models. The criteria set is segregated on the eligibility or requirement to enable fund to be *Mudarabah MF*, financing the potential entrepreneur, *Mudarabah MF* repayment method that will ensure the less default payment and microsavings for the participant. This *Mudarabah MF* is given to a family to run a so called family business besides than giving to individuals or group members that are non related as practice by current MF organizations.

4.3.1 Mudarabah MF Eligibility

The Mudarabah MF giveaway is filtered to the applicant with the below stated eligibility:

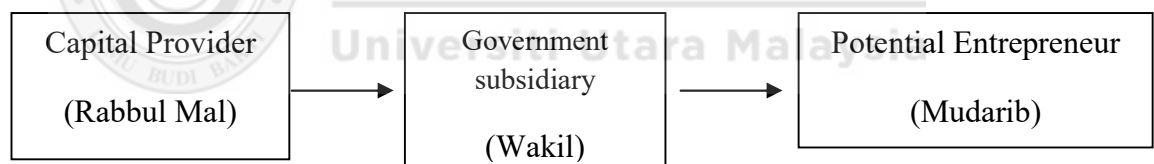
- i. The applicant age must be 25 years and above
- ii. The applicant should be family member with kids
- iii. Have a good business proposal and only *halal* products
- iv. No any account or transactions with the banks.

The family members are selected as the target group, because there will be more cooperation among the family members compared to group of non related peers. The understanding between the family members will be strong and each other willing to help to ensure they move from the poverty group by motivating among them. Family members will encourage each other to create a quality output and more creative idea can be generated. There should be a background check on the participant before proceed further. As such the main requirement that will be traced is the poverty status of the participant. The participant should be either from hardcore poor or poor

category, married person with kids will be prioritize, have business plan and no any single transaction with the banks.

4.3.2 Financing the Potential Entrepreneur

Once the potential entrepreneur is identified through the filtration process, they will be financed to start their business as proposed during the *Mudarabah MF* application process. The financial amount will be as approved earlier. An account will be created to the participant to monitor the *Mudarabah MF* repayment. The diagram below shows the fund movement from the capital provider to the potential *mudarib*. Between the *rabbul mal* and *mudarib* there will be a *wakil* who is a middle man that actively engage in the dealing to arrange and negotiate the *Mudarabah MF* transaction.



As such there will two contracts that are required to be agreed and signed. The first agreement will be the *Mudarabah* contract between *Rabbul mal* and *mudarib* and the second agreement will be among the *wakil* and *mudarib* called *Wakalah* contract. Upon signing of the abovementioned agreement the *Mudarabah MF* will be provided to the participant to start their business. The participant with their creativity and idea will start the business and gain income. The entrepreneur must ensure that the business transaction is in line with the Islamic finance and *Mudarabah* contract.

Upon verification of the business and successful interview, the potential *mudarib Mudarabah MF* will be sanctioned and enters into a legally arranged agreement as mutually agreed. The main terms and conditions that will be included in the agreement is as the below scenario.

- i. Type of the business activities in accordance to *Syariah* law and permissible as per the Islamic value.
- ii. Amount of the capital contributed by the *rabbul mal* and the labour contribution by the *mudarib*.
- iii. The ratio of the profit sharing between *rabbul mal* and *mudarib*.
- iv. Tenure of the *Mudarabah* contract and the *Mudarabah MF* repayment tenure.
- v. *Mudarib* buy back the share contributed by *rabbul mal* before *Mudarabah* contract ends.

4.3.3 Mudarabah Microfinance Repayment

The *Mudarabah MF* repayment is one of the issues faced by the current institutions that provide MF *Mudarabah MF*. The repayment method should be designed to benefit both capital provider and entrepreneur. Therefore in this paper micro saving is included in the *Mudarabah MF* repayment. The participant will need to pay the *Mudarabah MF* amount, saving and management fee annually. The participant is proposed to pay *Mudarabah MF* amount monthly as agreed earlier in the *Mudarabah* contract, 7% management fee to be paid annually and savings. The savings made during *Mudarabah MF* repayment made difference in this paper. The current MF institutions have fixed amount of savings or by percentage. Amanah Ikhtiar Malaysia

savings plan is from RM1 to RM15 and made compulsory. The amount of the savings is based to the amount *Mudarabah* MF by the participant.

Microsavings proposed in this paper are based to the willingness of the participant to commit saving amount to be paid monthly. The maximum amount of the saving is RM500 per month. Once the participant committed the saving amount he /she have to park their money in savings until the *Mudarabah* MF repayment mature. The participant may use the saving for any purposes including for personal use. The funds can be utilised to run their existing business, expand the existing business, healthy investment, and for personal use. A condition is to be set that the funds can be utilised only after the *Mudarabah* MF is successfully repaid by the participant.

4.3.4 Mudarabah MF Repayment and Wealth Circulation

The scenario below is illustrated to develop the *Mudarabah* contract model for MF program. The parties involved will be capital provider (*rabbul mal*), participant (*mudarib*) and government subsidiary (*wakil*). The involving contract will be *Mudarabah* contract and *Wakalah* contract, therefore an agreement will be bind between *Rabbul mal*, *Mudarib* and *Wakil*.

- i. Contribution of the capital for Islamic MF program (*rabbul mal*) will be RM10,000 and the *Mudarib* will contribute his labour expertise in producing the traditional chips. *Wakalah* contract will act as intermediary for both parties. *Wakil* will be in charge as the *Mudarabah* MF officer and play role till end of the agreement period and *Mudarabah* MF repayment amount settled.

- ii. Profit sharing ratio between the *rabbul mal* and *mudarib* is 10:90. In this case the 10% share will be given to the capital provider and balance of 90% to the *mudarib*.
- iii. Tenure of *Mudarabah* contract will be one year or 12 months.
- iv. The *mudarib* will buy the shares lot contributed by *rabbul mal* monthly by repaying the *Mudarabah* MF amount together with agreed profit sharing.
- v. *Mudarib* will pay 7% of the profit annually to wakil as management fee.
- vi. *Mudarib* will have microsavings account with the government subsidiary agencies on the committed amount to be paid monthly until the *Mudarabah* MF is fully repaid.

To simplify the understanding on the model, assumption to be made that the profit is fixed at RM 2,000 per month on the amount disbursed by the capital provider and also the *Mudarabah* MF repayment is paid equally for 12 months before the maturity of the agreement tenure. *Mudarib* will buy one lot of share on monthly basis and the profits will also be shared on Monthly basis. In this scenario *Mudarib* will buy a share worth RM 833.33 on Monthly basis or 8.33% of total capital provided by *rabbul mal* that is RM10,000. As one of the objectives mentioned in this paper is circulation of the wealth to the poor people, therefore in this model micro saving to the account will assumed as RM100 per month and finally management fee of 7% will be charged per annum toward the *Mudarabah* MF amount.

Table 4.4

Proposed Mudarabah Financing and Repayment Model

Month	Rabbul Maal					Mudarib				
	Rabul Maal Capital ownership share (%)	Fixed profit monthly	Profit sharing (10%)	Price of share paid monthly	Total payment = share price + profit sharing amount	Mudarib capital ownership share (%)	Profit sharing (90%)	Microsaving account	Management fee (7% per annum)	Net profit
1	100	2,000.00	200.00	833.33	1,033.33	0	1,800.00	100.00	58.30	608.37
2	91.7	2,000.00	183.34	833.33	1,016.67	8.4	1,816.66	100.00	58.30	641.69
3	83.3	2,000.00	166.60	833.33	999.93	16.7	1,833.40	100.00	58.30	675.17
4	75.0	2,000.00	150.00	833.33	983.33	25.0	1,850.00	100.00	58.30	708.37
5	66.7	2,000.00	133.40	833.33	966.73	33.4	1,866.60	100.00	58.30	741.57
6	58.4	2,000.00	116.80	833.33	950.13	41.7	1,883.20	100.00	58.30	774.77
7	50.0	2,000.00	100.00	833.33	933.33	50.0	1,900.00	100.00	58.30	808.37
8	41.7	2,000.00	83.40	833.33	916.73	58.4	1,916.60	100.00	58.30	841.57
9	33.4	2,000.00	66.80	833.33	900.13	66.7	1,933.20	100.00	58.30	874.77
10	25.0	2,000.00	50.00	833.33	883.33	75.0	1,950.00	100.00	58.30	908.37
11	16.7	2,000.00	33.40	833.33	866.73	83.3	1,966.60	100.00	58.30	941.57
12	8.4	2,000.00	16.80	833.37	850.17	91.7	1,983.20	100.00	58.70	974.33
13			1,300.54	10,000.00	11,300.54		22,699.46	1,200.00	700.00	9,498.92

From the assumption mentioned above and model of the MF illustrated on the capital provided to *mudarib* for his chips business, it shows that during the first month of the MF program 100% capital is provided by *rabbul maal*, so *rabbul maal* will receive RM200 as profit share and as an assumption made earlier that *mudarib* will buy a lot share from the capital worth RM 833.33 for 12 months continuously then the total payment by the *Mudarib* to the MF program will be as below:

<p>Profit Share of the program + Price of one Share from capital = Total Monthly Payment</p> <p>RM200 (10% of 2000) + 833.33 (price of share) = RM 1,033.33</p>

For the second month of the MF program will have a slight differ from the first month. As the program sold one lot of the share (RM 833.33 or 8.33%) from the total capital to *mudarib*, now the MF program will have balance of 91.67% of the total capital. Therefore the entitlement of profit shares according to its capital ownership will be RM183.34. Now suppose that micro enterprise earns a profit of RM 2,000 during second month as well. 91.67% of total profit will be shared according to profit sharing ratio. Total payment by *Mudarib* at the end of second month to the MF will be as below:

<p>Profit Share of MF program + Price of one Share from capital= Total Monthly Payment</p> <p>RM183.34 (10% (91.67% x RM 2,000)) + RM 833.33 (Price of share) = RM 1,016.67</p>

While the *mudarib* buys 8.33% of the shares from the capital monthly, it increases the *mudarib* ownership subsequently until the maturity date and the *rabbul mal* ownership reduces 8.33% concurrently at the same time. From the illustrated table it shows that the *mudarib* net profit gradually increase due to the entitlement of the capital ownership, meanwhile the payment to the *rabbul mal* decreases as the capital provider sell a lot of share monthly. At maturity of the contract month or the end of 12th month equity share of MF program will be zero and *Mudarabah* contract will be conclude. Then, *mudarib* will have full ownership of the capital.

In this study the objective emphasizes on the changing the poor social group wealth level. To make the objective realization the *mudarib* is need to have micro saving monthly with the fixed amount committed earlier. In this case the micro saving will be RM100 per month. The *Mudarib* will have his savings till end of the *Mudarabah*

MF repayment period of 12 months. Therefore the saving in the *Mudarib* account will be RM1200 at the end of the repayment period.

Mudarib also have to pay the management fee of 7% annually to the MF program. Whereby 0.58% needs to be paid monthly to the agencies together with *Mudarabah* MF repayment. As such *Mudarib* has to pay RM58.30 monthly for 12 months.

Foremost element to consider for the microfinancing is the eligibility of the person who approaches the MF. It is very important to identify, evaluate and decision making before proceed for with providing the capital. The officer of the MF department will filter the application made by the person who approaches the *Mudarabah* MF based on the criteria set. The qualified person will be interviewed by the officer to ensure the suitability of the product to the market. The product suitability information is vital to guarantee that the product is one of the current market demands; otherwise the person who approaches the *Mudarabah* MF will loss in his business and therefore the *Mudarabah* MF repayment will be default. If the business nature is accountability and high chances to calculate profits it will be adopted and the *Mudarabah* MF will be offered to the client. Since this study is a contribution to alleviate poverty as such the importance will be given to the eligible poor people. For an example, the prospective *mudarib* intend to do sell variety of famous traditional chips as a business nature, it is believed that the business will gain profit and easily can be calculated. In this case it is assumed that the prices and profit margin will remain the same over the span of *Mudarabah*, therefore the fixed profit will also be the same.

The *mudarib* will need raw material to produce chips, basic utilities such as water and electricity, packaging and delivery of the product to the shops/retailers. As such, we believe that *mudarib* able to calculate the cost incurred to produce one packet of the chips. In this case of beginning of the business the *mudarib* is not required to do conduct the business in a large range, it is advisable that the *mudarib* begin the business in small scale and later expand the business once the business is well manageable by innovating assorted flavours of chips, increase the quantity of the chips production, branding and exporting.

After the study and analyses, this research exposed the following findings. Islam teachings strictly encouraged individuals to live out of poverty, and to fight the poverty by all means of economic and social integration. Islamic teachings reveal that there will be social problems transpire in some country due to socio economic of the country. *Mudarabah* had played a vital role in fighting against poverty; this is because people who are financially ill still obtain opportunities to work in the production, agriculture, service and other related sectors.

Secondly, the financial and non financial institutions tend to have a long term relationship with their clients (debtors) based on their *Mudarabah MF* repayment behaviour case. The good pay master will have chance to obtain another cycle of *Mudarabah MF* by the initial financial and non financial institutions. The *Mudarabah MF* offered is to enable the prospect micro entrepreneur to enhance, develop and broaden their current business activities.

Next, the Muslims opting for *Syariah* compatible financing methods and products are supposed to be devout to this *Mudarabah* MF program. The Muslims that believes in the everlasting concept of life, whereby the honesty is important in living days will gain benefits with this program and this MF will get overwhelming approaches as the earnings through these business activities is lawful.

The *Mudarabah* MF program and repayment method illustrated in this study, will enable the wealth circulation among poor people. As there is a contribution fee paid to the *Wakalah* it can be used for a future development of the poor young kids or for the skill development or guidance of the poor group people to run their business activities.

4.3.5 Advantages and Disadvantages of the Proposed Model

There are advantages and disadvantages of the model proposed. The advantages and disadvantages in Malaysia are tabulated as below:

Advantages	Disadvantages
The Malaysia 11 th Plan can be achieved by eliminating poverty in the country.	There might be default <i>Mudarabah</i> MF repayment by the participant.
Poor people may upgrade their lifestyle from hardcore poor to next level.	Fund rolling period will be longer as the repayment will be just once a month.

There will be an educated, healthy and well to do nation.	Bias among the family members.
The country economy may boost as there will be more micro entrepreneur in the country.	To enforce special task force team to monitor the participants activity and therefore added more human resources
Profit will be shared by the involving parties, the capital provider and the participant.	Business loss will be bear by the capital provider only and the participants will only loss his efforts.

4.4 Chapter Summary

Analysis is done based on the objective of the study. MF model used in Bangladesh and Malaysia are the same. Malaysia replicate MF model of Bangladesh, both the model aims to help the poor people by giving micro loans to upgrade their life style. Therefore it really helps to alleviate poverty in the country. The MF do not impose interest towards the micro loan but management fee is charged on annual basis as the operational cost. The MF in Malaysia is subsidies by the government the bodies run the activities are NGO. The MF organization in Malaysia identifies the poor people throughout Malaysia and provide them loan to help to overcome the poor level.

There also issues faced by the MF in Malaysia, the most common problem is repayment of the loan amount, natural disaster, attitude of the borrowers, lack of knowledge and skills and also low return on the investment. The participant in some cases fails to repay the loan amount and cause default. Some borrowers do not pay

the loan even their business is successful; this is because of their attitude problem and irresponsibility. Unpredictable situation such as natural disaster become one of the reason the borrower fails to repay the loan to the organization, but the borrower is given second loan and the initial loan will be waived by one of the MF program in Malaysia. Some borrowers are even lack of knowledge and business skill, as such their business tends to fail and is not sustainable for long term, therefore the loan becomes default. Finally the borrower invests in the low return business and they unable to role for the business and the return is not sufficient to pay back the loan also for their own use.

The model of the microfinance based to *Mudarabah* contract developed to suit the need of the current MF program. The model may help the participant to loan the money and also have micro saving for their future use. This model developed to tackle the MF issues in Malaysia with the hope to provide solution to the poor people, the participating organizations and to alleviate poverty in Malaysia.

CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Introduction

This study investigates and provides solutions that can be implemented to alleviate poverty in Malaysia. Poverty is an evil economic condition that a person lives in. It has proven history that poverty effect and being the root cause for negative impact towards the economic, social and political of a country. In Islam poverty is not encouraged and praised to live and every Muslims are advised to be far from the poverty and the Prophet SAW has sought refuge to Allah from the evil of poverty. The Islamic teaching encourages and strictly wants its people to work, eat proper food, well dressed, and live in prosperity morally and physically. This can come true by earning in right way and help the needy ones to fight the poverty to earn income from a lawful business activity.

5.2 Discussion of Major Findings

Mudarabah plays an important role in reducing poverty as it reduces unemployment rate, promotes resources allocation and increase in productivity, skills development, promotes wealth circulation, created integration among people and increases GDP of the country that become indicator of healthy economic growth in country.

Microenterprises also has a role to play in economic development of country, it can enable to generate country economics activities, increase employment, and supply demand and can contribute positively to the economic development. Poor nation group people can move from their current living state to a better condition and promote a better lifestyle. It is important for the entrepreneur to ensure their business is sustained for a better future and cash flow cycle. The poor people will also have access to financial source and maintain a good cash flow and this will automatically alleviate poverty with the existence of the MF institutions. Moreover the group lending program of MF encourages the participant to input their hard work and in return gain income that helps to fight botheration. The *Mudarabah* MF can also achieve their target on collection of the funds and default rate reduces as the group lending payment pattern is great.

5.3 Implication of Findings

This microfinancing will give opportunity to rise in the evolution of Islamic Banking to serve the Muslim population without violating their religious beliefs. Islamic finance is needed to view in a very broad way. It promotes risk sharing, develops entrepreneurship, materiality, and non exploitation. As the Islamic prohibits involving in business activities which are harmful for the society as a whole, its Islamic financial services have a good degree of compatibility with MF. If a correct measure is taken to promote and developed Islamic MF properly, it will have a big impact to the poverty alleviation, also can eradicate the poverty and generate a good country economic.

Meanwhile the Islamic law allows space for financial modernization, and several Islamic contractual arrangements combination can enable to generate a new Islamic product. Islamic MF needs support and backup especially by Islamic financial institutions that are developed and readily available over decades due to Islamic capability to absorb and adopt MF practice without need to comprising to *Syariah* compliances to gain fruitful contribution to poverty reduction and significantly to step towards the Millennium development goals. The policy for the MF should be standardize and harmonised. This is to ensure that the Islamic practice is guarded and in line so that the Muslims will able to cater themselves with the MF facility.

The analysis shows that MF brings the positive impact to the poor people to move to a better living lifestyle. The poor people and not so poor people have access to financial service and help themselves to improve their living style. They have enough money for medical expenses, education, better shelter and good food to eat.

The repayment of fund is one of the problems faced by the MF institutions. The participant in some event fail to repay the amount funded to them, it is may be due to certain causes such as attitude problems that refrain from paying back, natural disaster, death or business failure. Even though there are cases of default payment but the major MF institutions in Malaysia AIM still able to achieve 99.8% of collection of the loaned amount.

5.4 Limitation of Thesis

This thesis is limited with the collection of data. The statistic data for this study is inadequate; therefore interview was conducted with the field experts. The experts provides feedback and share their knowledge toward the studies. It helps to identify the problem and issues with the MF thus enable to create a model that can overcome the issues faced currently by the existing MF institutions in Malaysia. There was also time constraint in conducting this study. Ample of time needed and allocated to perform the study to ensure the importance of the Islamic finance, role and issues of MF can be determined to shape out an ideal model that can aid and alleviate the poverty in Malaysia.

5.5 Recommendation for Future Study

This study focused on the MF as a tool to alleviate poverty and *Mudarabah* contract as a finance policy. *Mudarabah* contract was chosen because that contract benefits both parties as it is a partnership contract. The profit or loss will be shared between the capital provider and entrepreneur. This study identifies several limitation in the current practice of MF in Malaysia as such the article suggests the possibility of using *cash-waqf and Qard al-hasan* as a source of funding for Islamic MF in extending the credit to the poor people in Malaysia.

The new concept and application in Islamic MF proposed, it may be able to enhance the growth of MF to reach more poor people to combat poverty and generates income and increase in socio economics.

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APPENDICES

Appendix A: Respondent A

Interview Script

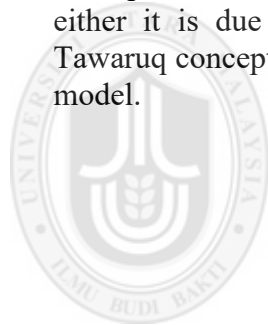
Mudarabah as an Effective Tool to Alleviate Poverty Through Microfinance

Name of Respondent	En. Azman Yusuf
Position	Head of <i>Syariah</i> Department TEKUN
Date	20 April 2017

Interview Questions:

1. What microfinance model is used in your organization or the country is practicing?
Concept *Tawaruq* and *Qard al hassan* is used in the organization. So any other concept is not used as of to date in the organization. The *Mudarabah MF* is given to Male and Female whose poverty status is poor and not so poor.
2. How does your organization filter the participant?
Applicant to apply the *Mudarabah MF* by filling in the form. The TEKUN officer will do the site visit and the application will be filtered to eligible participant and forward the same to next level for final approval. The application should be committed to the business at least 30%, such as the participant should have either valid business licence, own a shop or land
3. How the fund collected from the participant?
The funds are collected once a week or twice a week.
4. What are the advantages of this model?
The *Mudarabah MF* is given to the group of a people, therefore due to the peer pressure each of the member perform well and the *Mudarabah MF* repayment is better. The repayment percentage is high compare to the repayment done by the individual.

5. What are the weaknesses of the model?
Repayment of the *Mudarabah MF* amount borrowed. This is because the attitude of the participant. Some pay due to the pressure, and some because of the religious
6. What are the issues and challenges faced by the microfinancing?
The *Mudarabah MF* payment if defaulted the individual will be brought to court by issuing the Letter of Demand.
7. How effective is this model in increasing the countries socio economic.
Yes, microfinance increases the socio economic of the individual. It upgrade the individual lifestyle to a better position.
8. Can the *Syariah* based model function well in this model?
Syariah based model can function in this model based on the Islamic finance concept that is selected. In this case *Mudarabah* may not be the most suitable concept because if a business fail it is not easy to detect the fault of the party either it is due to entrepreneur negligence or the other causes. As such *Tawaruq* concept is considered the best option to be used in this microfinance model.



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Appendix B: Respondent B

Interview Script

Mudrabah as an Effective Tool to Alleviate Poverty Through Microfinance

Name of Respondent	En. Mohd Sablee Mohd Noor,
Position	Deputy Head of Financing Management Department TEKUN
Date	12 May 2017

Interview Questions:

1. What microfinance model is used in your organization or the country is practicing?
There are various product in our organization such as Teman Tekun Niaga for individual, next is the Teman Tekun for the group lending of 5 people and maximum up to RM20,000. I kontrak for the project with the government, Tekun Teman Nita for the group lending for the women with five person in a group for maximum RM20,000 and finally for the graduate.
2. Are there any changes in the trend of financing? How about the repayment
The financing is increasing compare to the previous from the year 1998. As of to date 4.7 billion *Mudrabah MF* finance to the participant with 566,000 account holders. The group lenders pay on time compare to the individual participant. The officer in each area will do the collection daily according to their schedule.
3. Are there any issue during the collection of the *Mudrabah MF*?
Some of the entrepreneur will repay the *Mudrabah MF* when their business is good, there are also entrepreneur that do not pay because the business is not successful and even though some business man is successful, they fail to repay the *Mudrabah MF*. The officer in charge will negotiate, do site visit to ensure the participant pays the *Mudrabah MF* amount. The negotiation will result in the restructuring of the *Mudrabah MF* repayment to ease the participant. In the event no changes and participant refuse to pay the *Mudrabah MF*, notice and Letter of Demand will be issued to the participant.

4. What are the advantages of this model?
The *Mudarabah MF* documentation is less compared to the bank, next the management fee is also less that is about 4% per annum and 5% for the savings. The participant can also with withdraw the savings when required. 4% management fee is used for the organization operating.
5. What are the weaknesses of the model?
The *Mudarabah MF* repayment by the individual is the major weaknesses in this program. The participant are easily finance but the collection of fund become one issue. Therefore other micro credit product introduced by the institute to reduce the default *Mudarabah MF*. The group lenders repayment flow is very good compared to the individual participant.
6. What are the issues and challenges faced by the microfinancing?
Collections of the *Mudarabah MF* become one of the issue faced by the microfinancing. Even though site visit is conducted and filtered according to the requirement before giving the *Mudarabah MF*, individual still fail and refuse the repay the *Mudarabah MF* to the organization
7. Can the *Syariah* based model function well in this model?
Yes the *Mudarabah* contract can function well in the microfinance program.
8. How if the participant fail in their business?
If grant offered to the participant it will not be a problem if the business fails, because the grant can be withdrawn. The government will absorb the loss if there is natural disaster. The government will waive the *Mudarabah MF* given to the participant. The participant will offered a new *Mudarabah MF* without any extra cost (management fee of 4% per annum).

Appendix C: Respondent C

Interview Script

Mudharabah as an Effective Tool to Alleviate Poverty Through Microfinance

Name of Respondent	Dr. Amirul Faiz bin Osman
Position	Lecturer, School of Islamic Finance UUM
Date	22 April 2017

Interview Questions:

1. Microfinance model that used in Bangladesh and Malaysia
Both the microfinance objective in Malaysia and Bangladesh is same and they are focusing in lower income and middle income group people.
2. What are the advantages of this model?
Current model is good for SME.
3. What are the weaknesses of the model?
The microfinance model need to more focus to the targeted people such as SME. Good model that need improvement in term of effective of the microfinance towards the SME to ensure the financing reach to the targeted group. There should be control measure to monitor the SME and conduct the training with the SME.
4. What are the issues and challenges faced by the microfinancing?
The participant should learn to sustain their business if not they will fail and remain in the same poverty line.
5. How effective is this model in increasing the countries socio economic.
Yes because the program will enhance the life of the participants, because it reduces the poverty level. It increase and enhance the lifestyle of the participants. The organization should also ensure the recipient have

credibility and capacity in conducting their business for a long lasting and sustainable as the sustainability of a business will help to overcome poverty.

6. Do you think return can be given to the participant for the micro saving they have with the organization?

The return can be enjoyed by the participant if it is a profit gain from the business transactions. In Islamic interest is prohibited as such the organization is not advised to pay interest return to the participants.

7. Do you think micro insurance and micro saving should be included in this model?

Yes it is a need, because the participant will have additional savings in their account as the medium and lower income group people may not have much funds in their account.

8. Can the *Syariah* based model function well in this model?

Of course it will work, however in order to mitigate the risk there should be a third party could guarantee the fund to the capital provider. The capital provider should also get to know the business flow and plan of the entrepreneur. There should be a measure to the entrepreneur to ensure the business conducted is in line and profitable.



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Appendix D: Respondent D

Interview Script

Mudarabah as an Effective Tool to Alleviate Poverty Through Microfinance

Name of Respondent En. Kharul Azhar bin Ramli

Position Lecturer School of Economics, Finance and Banking UUM

Date 26 April 2017

Interview Questions:

1. What microfinance model is used in your organization or the country is practicing?
The microfinance practice in Malaysia is very helpful to the lower income group people. The participant also intends to pay back the *Mudarabah MF* on time.
2. Microfinance model that used in Bangladesh and Malaysia
The microfinance model in Bangladesh and Malaysia is not same because the Islamic teaching is differ for the both countries therefore the model is different. So according to the Islamic teaching in Malaysia micro saving and micro insurance cannot be included because the Islamic religious principal. Meanwhile in Bangladesh, micro saving and micro insurance can be combined with the microcredit..
3. Why the repayment is also not good, is that due to attitude of the participant?
It is because of the intention of the participant and the influence from other factors.
4. What are the advantages of this model?
Microfinance aid the poor people because the requirement for *Mudarabah MF* application is flexible.

5. What are the weaknesses of the model?
Objective and target is differ for each of the organization. As such the microfinance institute in Malaysia should standardize their criteria, terms and condition, business practices and repayment method. The difference should be the channel of financing.
6. How to make the sure the weakness is overcome
The model should be more systematic and should be standardize.
7. What are the issues and challenges faced by the microfinancing?
No issue faced by the microfinance program, if the participant fail to repay the *Mudarabah MF*, the organization should not give second *Mudarabah MF* to the participant until the defaulted *Mudarabah MF* is settled fully by the participant. The microfinance organization should strengthen the policy, standardize and help the entrepreneur to upgrade and grow their business.
8. Can the interest imposed to the microfinance *Mudarabah MF*? How does the organization cover their management fee?
No interest can be imposed to the micro finance *Mudarabah MF* as this is Islamic finance. The management fee can be absorb from the fees that imposed to the participant.
9. How effective is this model in increasing the countries socio economic.
Indirectly these models help to increase the socio economic of the participant, whereby the entrepreneur may apply for the micro *Mudarabah MF* to role this business transaction when they needed.
10. Do you think micro insurance and micro saving should be included in this model?
Micro saving and micro insurance should be separate from the micro *Mudarabah MF* given to the participant it cannot be combined in one package. As in Islamic finance product principal are differ, therefore it cannot be combined it must be offered separately.
11. Can the *Syariah* based model function well in this model?
Yes it can function well in Malaysia if the profit and loss is bear equally by the participant and the capital holder. *Mudarabah* contract can be an option to the participant.

Terminology

- Islamic Finance: Finance According to Islam law, value and norm.
- Quran: Holy Book for Muslims; revelation of God given to Prophet Muhammed
- Sunnah/Hadith: actions and sayings of Prophet Muhammed
- *Syariah*: Islamic Law
- *Riba*: Interest
- *Gharar*: speculation; deception
- Fatwa: legal opinion of a learned person
- Halal: Permissible
- Haram: forbidden
- Sighat : Verbal agreement
- Ijab: Offer
- Qabul: Acceptance