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



**MASTER OF SCIENCE (FINANCE)
UNIVERSITI UTARA MALAYSIA
AUGUST 2017**

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

By

JANICE SOUNDARI A/P SAVARI DASS



UUM
Universiti Utara Malaysia

**Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia
in Partial Fulfillment of the Requirement for the Master of Science (Finance)**



Pusat Pengajian Ekonomi,
Kewangan dan Perbankan

SCHOOL OF ECONOMICS, FINANCE AND BANKING

Universiti Utara Malaysia

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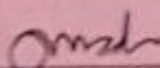
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ABSTRACT

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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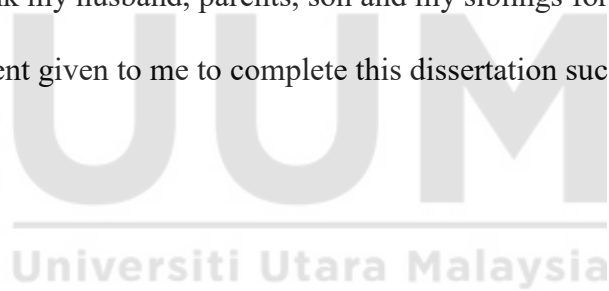


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CHAPTER 1

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

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APPENDICES

Appendix A: Respondent A

Interview Script

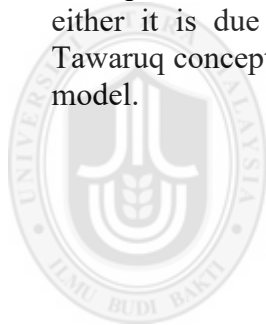
Mudarabah as an Effective Tool to Alleviate Poverty Through Microfinance

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