Innovative Financing Options For Islamic Microfinance Institutions –
A Case Study

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ABSTRACT

Islamic microfinance in this contemporary era requires to be supported in many countries at global level particularly in Indonesia, Bangladesh and Afghanistan. However, the issue of sources of funding of Islamic microfinance institutions has been a major challenge. This paper attempts to tackle this issue of liquidity shortage of financing the institutions. The paper finds that there are two main sources of funds which might be viable and vibrant financing instruments for the Islamic microfinance institutions. These sources of funds include internal, external and network sources of funds. This paper is unique in its context and might be helpful to the sustainability of Islamic microfinance institutions. Furthermore, it might play a significant role to facilitate more efficient liquidity management paradigm and increase the funds size of the Islamic microfinance institutions.

Keywords: Sources, funds, Islamic microfinance

1. INTRODUCTION

Islamic microfinance in this contemporary world is still in its infancy stage. According to the survey by the Consultative Group to Assist the Poor (CGAP) on Islamic microfinance, the global outreach of Islamic microfinance is about three hundred and eighty thousands (380,000) customers. This is equal to one-half percent of the total microfinance outreach. Meanwhile, this sector has emerged in few countries; the most widely known countries are Indonesia, Bangladesh and Afghanistan, amounting to eighty percent (80%) of global outreach.¹

However, Islamic microfinance requires support in implemented by many Muslims in their respective countries. For example, in Jordan, the survey of International Finance Corporation (IFC) and Foundation for International Community Assistance (FINCA, 2006) revealed that about thirty-two percent (32%) of those interviewed complained of not seeking for conventional loans because of religious purposes. Another survey in Algeria showed that about twenty-point seven percent

Meanwhile, the issue of liquidity shortage for funding Islamic microfinance institutions has been a major challenge. This has led to the lack of sustainability of some Islamic microfinance institutions. Against this backdrop, this paper attempts to provide coherent strategic fund raising methods as a guide line to minimise this issue. The paper acknowledges and proposes three main sources of funds for Islamic microfinance institutions in meeting their essential liquidity desideratum. The paper therefore breaks down into three main sections. The first section examines the internal sources of funds that include Islamic investment funds, namely, ījārah, murābāhah and muzāḥamah funds. The next section covers external sources of funds that embodies the zakāt, waqf and baytul māl funds. The third section highlights the network sources of funds that involve the Islamic securitization and cash line facility funds.

2. FUNDING CHALLENGES FOR ISLAMIC MICROFINANCE INSTITUTIONS

Islamic microfinance has witnessed rapid growth for the last decade across the world, particularly in Indonesia, Bangladesh, Afghanistan, Pakistan, Malaysia, Sudan, Yemen, Egypt, Iraq, Jordan, Lebanon, Palestine, Kazakhstan, Kyrgyzstan, Bosnia, Herzegovina and Kosovo. However, the overall outreach of Islamic microfinance is small compared to its conventional counterpart. In fact, Islamic microfinance presents less than 1% of total microfinance programmes. Meanwhile, lack of sources of funds for Islamic microfinance institutions demonstrates one of the potential obstacles for its expansion. Currently, there are several Islamic microfinance institutions are facing shortage of funds to provide productive financial services for their poor clientele. For instance in Yemen, the shortage of funds constitutes as one of the main hindrances for the expansion Islamic microfinance activities, particularly at the rural areas. Most of the Islamic microfinance institutions in Yemen are supported financially through the Social Fund for Development (SFD), which was created by the Yemeni government.

Meanwhile, the lack of enough fund mobilisation for Islamic microfinance activities is considered as one of the issues relating to the long-term sustainability of the institutions. Islamic microfinance institutions need to diversify its sources of funds in order to support its operations effectively for poverty alleviation. Depending on donations, particularly contributions by the volunteers, non-governmental organisations (NGOs) or governments are not enough to run its operations and activities. Islamic microfinance institutions need sustainable and effective funding strategies to generate more funds to support its activities, particularly at the early stage of its establishment. With enough funds others financial issues can be solves, such, high transactions costs, risks, administration and operational costs.

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1. Ibid.
3. Chapter 13: Islamic Microfinance – GIFR, @ http://gifr.net/gifr2014/ch_13.pdf @ 164-165
3. SOURCES OF FUNDING FOR ISLAMIC MICROFINANCE INSTITUTIONS

The sources of funds for Islamic microfinance Institutions can be classified into three main categories, the internal, external and network sources of funds. The internal resources refer to those means that are providing by Islamic microfinance institutions via its equity fund to ensure self-sustainability and self-sufficiency for financing the institutions.⁷ On the other hand, the external resources are based on the common practice of Islamic microfinance institutions where the institutions which depend on the outside contributors to provide financial means. The network sources refer to the subsidised funds associated with microfinance networking with outsiders. This could be any fund Islamic microfinance receive from outsiders such as, social or public saving funds, donations from any financial sector like banks, cooperatives and government based on joint venture linkage activities.⁸

3.1 Internal Sources of Funds

The internal sources embody the Islamic investment funds which include the *ijārah*, *murābā‘ah* and *muzārakah* funds. These funds can be other sustainable financial resources for the Islamic microfinance institutions. The term ‘Islamic investment funds’ in this section, refers to the joint venture business activities where the Islamic microfinance institutions contributes some of its properties or surplus; it could be in capital or asset for a specific commercial transaction investment purpose in order to gain lawful profits in line with the Sharī‘ah principles.⁹ The underlying investment properties will be used as a fund generating tool for the Islamic microfinance institutions. The below are some possible ways in which these funds can raise liable income and internal funds for Islamic microfinance institutions.

The *ijārah* fund raising approach can be one of the useful source of financing tool for the Islamic microfinance institutions. This includes the leasing of any asset or equipment or commodity to benefit from its usufruct for a specified period in return with a specified permissible consideration.¹⁰

In this regards, the lessor bears the ownership of the asset or equipment or commodity with all liable rights while the lessee is permissible to use it.¹¹ Under this arrangement, the Islamic microfinance institutions can use the *ijārah* method to purchase productive asset and lease it out to the client, it could be company or institution or individual. In this case, the Islamic microfinance institutions will be the financier (lessor) and client will be the lessee. The ownership of the underlying asset will remain under the financier who is liable for its maintenance in order for the asset to continue to provide service for which it was leased till the end of the contract. The profits gained from such venture can be channelled to the Islamic microfinance institutions’ activities.

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⁹ Usmani, *An Introduction to Islamic Finance*, 93.


¹¹ Ibid., 466–467.
Similarly, the Islamic microfinance institutions can identify and purchases valuable equipment (examples rice-roll processing machine, computers, printers, bending machine) and vehicles that are of great demand to various companies and institutions located in their place of business. It can then rent out these equipment and vehicles to these interested companies and institutions.12 The profits obtained from such a venture can be directed to the Islamic microfinance institutions’ micro finance activities. It can also engage in Public Private Partnerships (PPP) with the government by building much needed infrastructure and charging users a rental amount until the long-term contract is exhausted before handing over ownership of such infrastructure to the government as per the terms of the PPP agreement. The proceeds from such a PPP contract would bolster the funds available for microfinance activities. This experience has been adopted by Wasil Foundation13 in Pakistan.

The murābāhah fund raising mode can be another integral source of financing for Islamic microfinance institutions. This involves the cost plus profit sale transaction between contracting parties where one party sales the property or asset and the other party purchases it from its partner based on the agreed cost and profit margin.14 For example through murābāhah, the Islamic microfinance institutions can engage in real estate activities utilizing sale at a specified profit margin. The scenario is that, the Islamic microfinance institutions will purchase land, and then add value to such land such as providing basic infrastructure and then selling the land to interested individuals at a premium price. The profit obtained from such ventures can now be channeled to pursuing the institution’s microfinance activities. To add to the discussed scenario, the Islamic microfinance institutions can also build houses on such land and sell them off to interested parties, examples individuals and corporate bodies.

Another potential for raising funds through murābāhah concept is for the Islamic microfinance institutions to enter into mining of natural minerals and resources and then exporting these minerals to the global market at a profit. It is a cost and profit margin financing scheme where the Islamic microfinance institutions purchase a goods or asset and resells it to its client based on mark-up basis.15 The settlement of the price of the subject matter could be in cash payment or in instalments profit margin basis according to the agreement by the both parties.16 This approach has been adopted by many countries across the globe like Afghanistan, Bangladesh, Indonesia, Sudan, Syria and Yemen as well as Iraq for the microfinance activities.17 For examples, the Hodeibah

13 Wasil Foundation provides a variety of Sharī‘ah-compliant instruments incorporating a margin of profit for the institution, such as, sa‘ād (advance against future delivery), īstinā‘ and murābāhah (cost plus mark-up), diminishing mushar‘akah (profit-and-loss sharing), and ījara (leasing). See Khadija Ali, “Islamic Microfinance in Pakistan: The Experience so Far,” 2013, http://www.cgap.org/blog/islamic-microfinance-pakistan-experience-so-far. Wasil Foundation, it is formerly known as ‘CWCDF’ means Centre for Women Co-Operative Development. It was established as a Non-Governmental Organization (NGO) in 1992 and regulated under the Voluntary Social Welfare Agencies (Registration & Control) Ordinance 1961. Currently, it is registered as a company under section 42 of the Companies Ordinance, 1984 by the name of “Wasil Foundation”. It has successfully transferred its assets and liabilities to Wasil Foundation in 2012. Their main objective is to alleviate poverty through enterprise development and the creation of value chains. It has become the pioneer organization in Islamic Microfinance operations in Pakistan. Under Islamic Microfinance, See “About Wasil,” accessed June 26, 2016, http://wasil.org.pk/home.aspx.
15 von Pock, Strategic Management in Islamic Finance, 70; Hamzah, Islamic Private Equity and Venture Capital Principles and Practice, 474.
16 Ibid.
17 Murābāhah involves a finance party (for example, an MFI) purchasing tangible assets from a seller and then re-selling them to a buyer (for example, a microfinance client) at a predetermined profit margin or mark-up. See “Iraq’s Experience with Al-Murabaha Islamic Microfinance,” 2010, 8, http://pdf.usaid.gov/pdf_docs/PA00PHPF.pdf.
Microfinance program (HMFP) in Yemen using *murābāh* as a financing tool. This approach has also been extended to some banks in Sudan, such as the Nile Bank, SSDB, ICDB, Agriculture Bank and Al-Baraka banks for their microfinance activities.\(^{18}\)

The *muzāraḥ* fund raising method can be another essential source of financing for the Islamic microfinance institutions. *Muzāraḥ* is a contract essentially based on agricultural farming where the investor provides land or funds in return for a share of the of harvest or share of the agricultural products, such as, crops, fruits, vegetables or the usufruct gained from the products.\(^{19}\) This instrument may involve two contracts, namely *mualārah* and *mushārakah* contracts. For this, the Islamic microfinance institutions will either be the investor and other party will be entrepreneur based on *mualārah* or profit sharing contract concept; or the both parties (the Islamic microfinance institutions and the other party) will be partners based on *mushārakah* partnership contract concept.

In *muzāraḥ* via *mualārah* concept (*muzāraḥ*-based *mualārah*) for an example, the Islamic microfinance institutions can enter into agricultural products business venture like food, as it is a necessity for everyone and as agriculture is always a worthwhile business. The Islamic microfinance institutions can venture into agriculture. The Islamic microfinance institutions can partner with expert farmers’ associations. In this Islamic microfinance institutions provide the capital as an investor and the farmers’ associations provide the expert labor as an entrepreneur in order to produce high quality food and cash crops for export to the global market.\(^{20}\) The concept is built on a mixed venture in which one person provide the funding and the other provide the labor where the profits are distributed in accordance to the agreement of the contracting parties.\(^{21}\) Such a venture could provide high returns for the Islamic microfinance institutions, thus reducing its dependence on external sources of financing, and providing it a platform to excel in its primary business of providing microfinance to the poor. The same strategy described above can be utilised...

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\(^{18}\) Hodeibah Microfinance program (HMFP) was established in 1997. Hodeibah is a port city, characterized by having an active economy based on trading, fishing, food production, small industries handcraft and transportation. The program was the first of its kind in Yemen. See Davood Manzur, Hossin Meisami, and Mehdi Rouyaei, “Banking for the Poor in the Context of Islamic Banking and Finance,” *Journal of Contemporary Management* 2, no. 2 (2013): 56.

\(^{19}\) Maatallah, *Principles of Islamic Finance Riba and Murabaha*, 12. There are difference between the terms “muzāraḥ”,”*musāqat*” and “*mushārakah*”. *Muzāraḥ* refers to the agricultural contract where one party works the land of another party in return for a share in the produce of the land. See Hamzah, *Islamic Private Equity and Venture Capital Principles and Practice*, 476. It is a contractual agreement between the owner of the land and the farmer, the product realise would be divided between both of them in accordance with what they agree upon at the time when they are making the obligation. See Ahmad Ibrāhīm Bēk, *al-MuNēmaīt ash-Shārīniyyah al-Mēliyyah* (Cairo: Dar al-Ansar, 1936), 217. However, *musāqat* refers to a contract of agricultural partnership whereby a person agrees to water and maintain the trees owned by a landlord under a landlord and the farmer will have ownership in the land. The farmer will share the agreed share (profit). See Ahmad Hidayat Buang, *Studies in the Islamic Law of Contracts: The Prohibition of Gharar* (Kuala Lumpur: International Law Book Services, 2000), 155. *Mushārakah* is where owner of the land offer his land to a second party to cultivate in it and if there is any gain or product or crops from the farm shall be divided according to the agreed ratio. In this, all the expenses of the farm land will be on the farmer not the original owner of farm land. The farmer will also have ownership in the farm land. In this sense, one can conclude that *muzāraḥ* is an agricultural co-operative contract based on partnership approach. While, *musāqat* is a farming lease contract or agricultural irrigation partnership approach. And *mushārakah* is farming in another person land. In other words, *muzāraḥ* is mainly about joint partnership on farming while *musāqat* is a joint partnership on irrigation. And is the joint partnership in the product of the farm land. However, there may be similarity between *muzāraḥ* and *musāqat*. See Muhammad Nābdū al-xaādī Al-Faqīh, *al-Aqīdah* *al-Iqtiṣādīyah Lil-Muʿāṣir al-islāmillīyyah Wa-Aṭharuh Fī ‘Adillīyah at-Tanmiyyah al-Iqtiṣādīyah: Dirāšah Fī qīṣāh Iqtiṣādīyyah* (Cairo: Nūlām al-Kutub, 2010), 245–247 & 250–254.


with expert livestock producers.\textsuperscript{22} Similarly, in mužÉraÑnah through mushÉrakah concept (mužÉraÑnah-based mushÉrakah) for instance, the Islamic microfinance institutions can go into partnership contract with these expert farmers and livestock producers by providing them with the much-needed equipment,\textsuperscript{23} such as, plough, tractors, trucks, infrastructure and other valuable resources that would ensure high profits to both the Islamic microfinance institutions and its partners. This scenario has been practiced by the Sudanese Islamic Bank (SIB) in Sudan\textsuperscript{24}

3.2 External Sources of Funds

The external resources include the zakÉh, waqf and bayytul mÉEl funds.\textsuperscript{25}The Islamic microfinance institution has an advantage of using these external funds as its source of funds generating tools. These funds can be used to invest in productive activities in order to accumulate enough income for the institution. The followings are some of the potential and feasible methods through which these funds can be used. This is to help mobilize sustainable external financial sources of funding for the Islamic microfinance institution.

ZakÉh fund can be one of the useful tools as a fund generating source for Islamic microfinance institution. ZakÉh,\textsuperscript{26} is an obligatory contribution on the wealth of every Muslim based on clear-cut criteria which to be paid or distributed to specified groups of people. These groups include the: hardcore poor (fuqarÉ), needy (masÉkÉn), zakÉh collectors (ÑamilÉnaylahÉ), those who convert to Islam (mu´alafah quíÈbuhum), slave (riqÈb), debtors (ghÉrimÉn), one who attends to activities

\textsuperscript{22} Norma Md Saad, “Microfinance and Prospect for Islamic Microfinance Products: The Case of Amanah Ikhtiar Malaysia,” \textit{Advances in Asian Social Science} 1, no. 1 (2012): 31.
\textsuperscript{23} Manzur, Meisami, and Roayaaee, “Banking for the Poor in the Context of Islamic Banking and Finance,” 56.
\textsuperscript{24} The SIB established special micro-credit windows called “productive family branches” in 1992. These branches mostly practice partnership financing, among other Islamic methods of finance. In the SIB experience, the user of funds does not have to contribute in cash to the proposed investment, rather, his share might be in kind (input), labor, or rent of machines or equipment. The SIB however, did not pursue the experiment to the end due to the central bank regulations on one hand and the change in the management of the SIB on the other hand. See Ibid., Maatallah, \textit{Principles of Islamic Finance} Ribá and Murábahá, 12.
\textsuperscript{25} Wilson, “Making Development Assistance Sustainable through Islamic Microfinance,” 203–207; Manzur, Meisami, and Roayae, “Banking for the Poor in the Context of Islamic Banking and Finance,” 57–58.
\textsuperscript{26} AllÉh imposes zakÉh on the wealth of the rich in order to help the needy people like the poor, those in debt, the wayfarer and so on. The term “zakÉh” literally means to purify, to develop and to cause to grow. Technically, it denotes a system of control constructed by a quantified share in specified properties in a specified period which is distributed to specified directions. See Mu`aalamad Al-NAráb Él-QuraWÉ, al-KhulÉhah al-Fíqhiyyah NÁÉ MadhÉhb as-SÉdah al-MÉlkiyyah (Beirut: DÉr al-Kutub al-Ñilmíyyah, 2006), 127; KamÉl bn Sa`NÉd SEím AbÉ MÉlik, ÒaÉl Fqîsh as-Sunnah Wa-Aadiñlah Wa-TawWÉl MadhÉhbi al-AbaÑnah, vol. 2 (al-Maktahb at-TawqÉlyyah, n.d.). 5; Yusuf al-QardaWí, Fqîsh Az-Zakáh: A Comparative Study, the Rules, Regulations of the Qur`án and Sunnah (London: Dar at-TawqÉ, 1999.), 221. In other words, the zakÉh designates the annual amount in kind or coin which a Muslim must distribute among the rightful beneficiaries. It is the prescribed share of one’s wealth to be distributed among the categories of those entitled to receive it. See Obaidullah, \textit{Introduction to Islamic Microfinance}, 26. The zakÉh system is equipped with the instrument backed by philosophy which aims to mobilize the needy people in order to become self-reliant and generator in the society. In Islam, the payment of zakÉh is an obligation on the wealth of every Muslim based on clear-cut criteria as AllÉh says to the effect: “And perform prayers and give zakÉh ...” See “Qur`Én, al-Baqaraah, 2: 43;” Al-QuraWí, Al-Khulasaah Al-Fíqhiyyah Ala MadhÉhhab Al-Sudah Al-Málikiyah, 127. The obligation of payment of zakÉh has been further mentioned by the xÁÈdÉh as the Prophet (PBUH) says: “Islam is built on five; to bear witness that there is no deity worthy to be worshiped except AllÉh and Mu`aalamad is the Messenger of AllÉh, establishment of prayer, paying the zakÉh, the performing of xÉjy to who is capable and fasting in the month of RamágÉn ...” See Ibn xajár, Fat’hu al-BÉrÉ Sharìl ÒaÉl Fqîsh al-BukhÉrÉ, vol. 5, vols. 1, ed. 2003: 67–68. Meanwhile, the minimum threshold of zakÉh on money is 2.5% (two and half percent) of the savings over a period of one year according to the SharÉnáh. See Obaidullah, \textit{Introduction to Islamic Microfinance}, 28. Its dispensation is regulated by different rates for different items. ZakÉh is obligatory alms with prescribed rate, which rate of contribution varies according to the kind of property owned. In the same vein, it occupies a central position in Islam and it is ranked as the third among five pillars of Islam. See AbÉ MÉlik, ÒaÉl Fqîsh as-Sunnah wa-Aadiñlah wa-TawWÉl MadhÉhbi al-AbaÑnah, 2:6.
in the cause of Islam (jÊ̄sabÊ̄li AllÊ̄h) and those who travel in the course of Islam and has run out of money or survival (waibn as-sabÊ̄l).27 On the side of sustainability of Islamic microfinance institution, zakÊ̄h can be used as a source of funding.28

In this sense, the Islamic microfinance Institution can mobilize social services by using zakÊ̄h fund to fulfil the basic needs covers all the necessities of life for the poor, such as, food, clothing, house, household belongings, education, health care and means of transportation. Meanwhile, a credit guarantee scheme can also be mobilize via a zakÊ̄h fund; since zakÊ̄h may legitimately be used to pay-off unpaid debt of the poor. However, care must be taken to ensure that the coverage of such a scheme is restricted to the extremely poor and the destitute only.29

In addition, the Islamic microfinance can institutionalize the zakÊ̄h fund in order to guarantee the sustainability of the assets and its income generating abilities; which is considered as a primary issue of zakÊ̄h and Íadaqah-based institutions as they are essentially rooted in voluntarism.30 Moreover, the zakÊ̄h fund can also be used for a commercial approach which entails charging and sharing of profits.31 For example the Islamic microfinance institution can use the zakÊ̄h fund through sale and profits sharing concepts to raise adequate fund for microfinance activities. In this case, the Islamic microfinance institution will purchase any asset like a land to invest in farming where it makes a specific deal with a famer. It will then hand over the land to the so-called farmer for a specific period of time. The famer will share the output of the farm land with Islamic microfinance institution based on agreed proportion.32 This concept has been practiced by Baitul Maal Muamalat Indonesia (BMMI) and Baitul Qiradh of Badan Amil Zakat Nasional or Badan Amil Zakat Nasional (BAZNAS) in Indonesia.33

Another fund raising source for Islamic microfinance institution is the waqf fund.34 Waqf entails the use of assets such as cash, land, and real estate for charitable purposes. One of the characteristics of


27 Mohd. Nasir Mohd. Yatim and Amirul Hafiz Mohd Nasir, The Principles and Practice of Islamic Banking & Finance (Pearson Malaysia, 2008), 113; Hamzah, Islamic Private Equity and Venture Capital Principles and Practice, 484. In reference to the role of zakÊ̄h in Islamic microfinance, it seeks to avoid the rotation and exchange of wealth in the hands of few individuals in the Muslims community. As for the important and role of zakÊ̄h in social relation building, it ensures and manifests the equitable distribution of income, social justice and empowerment of the poor or low-income people, closing the gap between the rich and the poor or low-income families with rooted charity assistance. See Obaidullah, Introduction to Islamic Microfinance, 17–19.
28 Ibid., 17–19’.
29 Ibid., 28 & 37.
31 ZakÊ̄h has been variously described by scholars as a tool of redistribution of income, a tool of public finance, and of course, as a mechanism of development and poverty alleviation. The first foremost category of potential beneficiaries of zakÊ̄h is the poor. See Obaidullah and Khan, “Islamic Microfinance Development: Challenges and Initiatives,” 15; Institute, “Islamic Financial Services Industry Development: Ten-Year Framework and Strategies,” 24; Obaidullah, Introduction to Islamic Microfinance, 16.
32 Maatallah, Principles of Islamic Finance Riba and Murabaha, 12.
33 Baitul Maal Muamalat Indonesia (BMMI) is “licensed zakÊ̄h organization in Indonesia that can collect Islamic charities (zakÊ̄h, Íadaqah and waqf) and disburse the funds for the society purposes. BMMI has been engaged in various projects including education, emergency aids for natural disaster, and direct support for the poor as well as economic empowerment programs.” Similarly, Baitul Qiradh of BadanAmil Zakat Nasional or BadanAmil Zakat Nasional (BAZNAS) is zakÊ̄h organization owned by the Indonesian government. As the social organization, BAZNAS has created several programs including education, health, economic and aid for natural disaster.” See Aimatul Yumna and Matthew Clarke, “Integrating Zakat and Islamic Charities with Microfinance Initiative in the Purpose of Poverty Alleviation in Indonesia,” in Proceeding 8th International Conference on Islamic Economics and Finance, Center for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Qatar Foundation, 2011, 11–12.
34 Waqf is used for religious and charitable purposes. It is perpetual alms which rewards are sustainable. The term “waqf” literally means to hold or to preserve and to deprive or deny. According to the scholars, waqf is also termed as
waqf instruments is its perpetuity that does not allow waqf’s asset to be disposed of and its ownership cannot be transferred. Thus, waqf creates and preserves long-term assets that generates income flows or indirectly help the process of production and creation of wealth.  

Meanwhile, the Islamic microfinance institution can be integrated with Waqf Fund which may be called as waqf-based Islamic microfinance institution. This institution can invest in productive activities in order to empower the poor and low-income people. The type of financing product will be based on the type of financing funds that are granted. For instance, in mushārakah principle, both waqf-based Islamic microfinance institution and the entrepreneur contribute capital towards the financing of the project and share the profits on pre-agreed ratio, while the losses are shared on the basis of equity participation. Similarly, in muā‘ārakah approach, the waqf-based Islamic microfinance institution provides the capital for the project called rabb al-mīl (the owner of the capital) and the muā‘ārib (client or micro-entrepreneur) manages the project using his entrepreneurial skills. Profits are disbursed based on the predetermined ratio. If any losses occur it would be borne by the capital provider.

All in all, the profits earned in these divert activities can be used for some purposes. The profits can be used for charitable purposes for which the waqf was created. Also, it can be used to cover the administrative costs. The remaining can be added to the original endowment funds to protect the real value from inflation, as it was practiced in the era of the Ottoman state. The waqf-based Islamic microfinance institution also needs to reserve special reserve funds for risk management like the risks arising from negative shocks.  

For example, creating takāfūl reserve via small weekly or monthly contributions of the beneficiaries; this reserve can be used to assist the recipients who are unable to pay their dues on time due to some emergency problems like a natural calamity or death in the family.

A profit equalizing reserve can also be established by deducting a small percentage of the profit-share of depositors during the relatively profitable periods of operations. This reserve is used to boost rates of returns on deposits during periods when the returns get depressed. Furthermore, the surplus from the economic capital reserve can be used to cushion any negative shock that may affect the financial position of the institution adversely.

The mode of using waqf as a source for fund generating product has been adopted by Indonesia Waqaf Institution (BWI), Islamic Relief in the United Kingdom, the Islamic Solidarity Fund for Humanitarian Aid (CONPHA) 2017.

“Adhaqah jā‘iriyah or continuous charity”. Technically, Imām Abī ‘amīr al-Maddānī al-Mas’ūdī defined waqf as the act of holding the property under the ownership of the al-wāqf (testator) by al-ta‘ālaq bi-manfūqatīh (donating its usufruct) as charity through any charitable institution; the donation can be at the spot or deferred. Based on this definition, Imām Abī ‘amīr al-Maddānī al-Mas’ūdī argued that, the property after declaring as waqf remains in the ownership of the testator who can use it for any purpose. He can also sell it or donate it; and if he dies, the properties can be declared as estate to his heirs. See Ahmad Faraj Husain, Ahkam Al-Wasaya Wa Al-Awqaf Fi Al-Shari’ah Al-Islamiyyah (Alexandria: Dar Al-Janī’ah Al-Jaddādah Li-Nashir, 2003), 235. In another words, waqf refers to a legal and religious institution wherein a person dedicates some of his properties for a religious or a charitable purpose. Based on this definition, the properties after being declared as waqf are no longer remained in the ownership of the testator. Usmani, An Introduction to Islamic Finance, 105.


Ibid.


Ibid.


Islamic Relief has been providing emergency aid and long term help to some of the world’s most deprived people for over two decades. The Waqf Future Fund is one of Islamic Relief projects which were set up on 2000, aimed to set up a

Development (ISFD) in Senegal and Awqāf Properties Investment Fund (APIF) under Islamic Development Bank (IDB), Jeddah.

Furthermore, baytul māʾl fund can be another integral source of funding for Islamic microfinance institutions for its financial activities. This refers to the public treasury funds where the property belongs to Muslims, such as, land, buildings, mineral, money, merchandise or revenues of Islamic states, such as, zakāt, charity are kept for any in coming expenditure which shall take place for the best interest of the Muslim public. In this regard, Baytul māʾl can mobilize funds for various purposes, such as, for financing public schools, public hospitals, public wells, public roads, and for Islamic finance institutions such as Islamic microfinance institutions that provide financial services to the micro-entrepreneurs.

Baytulmāʾl funds can play a significant role to the development of Islamic microfinance sector. This fund can be disbursed and utilised for financing various Islamic microfinance activities, such as, training programs examples educating the poor, self-reliant or empowerment, solidarity and income generating abilities programs for the poor, administrative cost of the Islamic microfinance sector, risk management in case of default, profitable business venture, such as, mushārakah, muṭārakah and any other activities for that matter that can contribute to the development and sustainability of Islamic microfinance sector. Pursuant to the above discussion, baytul māʾl can be a major, suitable charity that continues to benefit the needy for many future generations. Waqf has become a significant source of funding for Islamic Relief in saving and improving lives of the world’s neediest people. See Waseem Yaqub, “Waqf Future Fund Working towards a Better Future.” Waseem Yaqub IRUK Manager Revised, 2006, b(2/22), http://www.irwaqf.org/wp-content/uploads/2014/10/WAQF_A4.pdf.

The concept of Waqf (Trust) implies that only the income which will be made from the investments of the Fund’s sources will be available to finance its operations. The ISFD was established as a Special Fund within the IDB following a decision made by the December 2005 Extraordinary Summit of the Organization of the Islamic Conference (OIC) in Makkah, Saudi Arabia, and officially launched in Dakar, Senegal, in May 2007. As a Waqf (examples Trust) Fund, the ISFD has been conceived as a “solidarity fund” to combat poverty in the OIC member states, whereby all members would contribute to its capital sources.” Islamic Development Bank, “Progress Report of the Activities of Islamic Solidarity Fund for Development (ISFD),” 2013, 1., http://www.comcec.org/wp-content/uploads/2015/02/Latest_progress_report_on_ISFD_May_2013.pdf.

Islamic Development Bank Group, “Islamic Development Bank Group in Brief,” 2013, 10–11., http://www.isdb.org/irj/go/km/docs/documents/IDBDevelpments/Internet/English/IDB/CM/Publications/IDBGroupBrief2013.pdf. The Awqāf Properties Investment Fund (APIF) was established in Dhul Qada 1421H (February 2001) under Article 23 of the Articles of Agreement establishing the Islamic Development Bank (the IDB or the Bank) with the objective of investing in and developing Awqaf real estate properties that are socially, economically and financially viable, both in IDB-member countries and for Islamic communities in non-member countries, in accordance with the principles of Sharīʿah. See Islamic Development Bank, “Progress Report of the Activities of Islamic Solidarity Fund for Development (ISFD),” 1.

The term “baytul māʾl” in its literal meaning derived from two Arabic words, namely, “bayt” means house and “al-māʾl” means money or property. In its technical meaning, it refers to every property which belongs to the citizens of an Islamic state. They have some beneficial right in the baytul māʾl. It is an asset of the public known as public exchequer or public property or treasury. In this regard, it is the responsibility of baytul māʾl to provide financial services for any expenditure incurs in the interest of the public. The expenditure should be paid out from the baytul māʾl funds. See S A Siddiqui, Public Finance in Islam (Adam Publishers, 2007), 139; Usmani, An Introduction to Islamic Finance, 105.


The BMT in Indonesia is an Islamic microfinance institution that converged two different activities, profit and non-profit oriented. BMT collects funds from the society also functioning as a funding institution, which lends money for consumptive or productive like margin mark-up for consumptive goods but and managing funds for expenditure, Zakat
and essential source of funding for Islamic microfinance sector in the ambit of poverty alleviation since zakēḥ and waqf funds are some of the sources of baytul mēl. This scheme has been practiced by Baitul Maal Wat Tamwil (BMT) or House of Expense in Indonesia.46

3.3 Network Sources of Funds

The network resources in this section may be called as Islamic microfinance network venture capital funds. It involves the Islamic securitization funds and cash line facility fund. This approach can be another integral funds generating engine for Islamic microfinance institutions. The foregoing are some possible ways in which the aforesaid funds can be designed to raise resources for Islamic microfinance institutions. It can be classified into Islamic securitization and Cash Line Facility Funds.

3.3.1 Islamic Securitization Funds

Islamic securitization funds in this section involve Ḣukēk muṭērbah, Ḣukēk mushērakah and Ḣukēk Ijērah funds.47 The word ‘securitization’ refers to the process in which the ownership of existing assets is transferred to the investors in the form of Ḣukēk or certificates. 48 The term ‘Ḥukēk’ refers “to securities, notes, papers, or certificates, with features of liquidity and tradability.”49 The below are some feasible ways in which the above mentioned Ḣukēk can be used as sources of financing for Islamic finance activities. They can play essential role to facilitate more efficient liquidity management for Islamic microfinance institutions and increase its funds for microfinance activities.

3.3.1.1 IMF Ḩukēk Muṭērbah Fund

 שאתםKh muṭērbah refers to the certificates issued to represent investment activities based on profit sharing contract principle by appointing one of the partners to run the project.50 Under Islamic microfinance institutions’ Ḩukēk muṭērbah scheme, the issuer of the certificates acts as muṭērib (manager) while the rabul mēl (subscribers) are the capital provider and the identified muṭērbah is the Special Purpose Vehicle (SPV).51 The assets will be under the ownership of the certificate

and charity and distribute it in forms of educational scholarship, public facilities, and others. While productive means lending capital to the small and medium enterprises. BMTs are grass-roots developments programmes supported by funds from Islamic community members. BMTs usually operate on the principle of profit-loss sharing instead of charging interest rates, and use Islamic moral values and group solidarity to encourage repayment of loans. Zakēḥ (a type of religious tax payable by Muslims on their net worth) funds also form an integral part of BMTs. They can play essential role to facilitate more efficient liquidity management for Islamic microfinance institutions and increase its funds for microfinance activities.

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holders while the capital owners will be entitled to the agreed upon share profits and may bear the risk in case of any loss. As regards, the manager (Islamic microfinance institutions) will then issue the İlkEk mülÈrbah to attest or prove the proportionate capital contribution by the subscribers to the SPV and their subsequent rights in it. The Islamic microfinance institutions will then invest the capital into an agreed project.52

In the case where the project starts to generate profit, the Islamic microfinance institutions will apply the profit sharing proportion and pay the profit share of the subscribers as periodic coupon distribution based on the expected profit rate. However, in case of default or loss of the underlying project the subscribers shall bear the consequence except if it was caused by the negligence or mismanagement of the Islamic microfinance institutions.53 This mechanism has been practiced by DP World ØukÈk (An SPV established in Cayman Islands on 17 May 2007 as a charitable trust to facilitate the İlkÈk issuance).54

3.3.1.2 IMF ØukÈk MushÈrakah Fund

ØukÈk mushÈrakah refers to the partnership certificates issued for each party (subscriber) to represent his proportionate ownership in the assets of the project.55 Under Islamic microfinance institutions’ İlkÈk mushÈrakah structure, the Islamic microfinance institutions enter into a specified equity partnership investment project against which the İlkÈk have been issued. When the project resumed, the İlkÈk can be treated as negotiable tools. The profit resulting from the so-called project shall be shared according to the agreed ratio while the loss shall be shared on a pro rata basis. The intermediary or manager or SPV of the project will receive funds from the investors and will give in return the İlkÈk based on mushÈrakah principles. Islamic microfinance institutions will then advance (invest) his property like land where the project will be constructed. In this regards, each

accounting or legal purposes. The legal form for an SPV may be a limited partnership, a limited liability company, a trust, or a corporation (Gorton and Souleles, 2005). In case of Malaysia, SPV normally takes the legal form of a trust and governed by Trustee Act. SPV is a trust set up to fulfil specific purposes. In this regards, it can perform specific microfinance activities to benefit certain beneficiaries. The trustee will be appointed by the sponsoring bank to oversee the operations and activities outlined in the trust deed. More importantly, the designated funds channelled by the bank as a form of trust should be used only for the prescribed objectives. See Alam Choudhury and Wajdi Dusuki, “Banking for the Poor: The Role of Islamic Banking in Microfinance Initiatives,” 58.


54 The “DP World” is the holding company for ports-related commercial activities of Dubai World (owned by the Government of Dubai). It was established in the Dubai International Financial Centre (DIFC) on 9 August, 2006. On 2 July 2007, DP World tapped into the İlkÈk market to raise $1.5 billion using a mülÈrbah structure. DP World ØukÈk (a Cayman Islands-based SPV as a charitable trust to facilitate the İlkÈk issuance) first issued the İlkÈk and forwarded this to DP World as mülÈrbah capital on behalf of the investors. DP World as mülÈrbah invested the capital in its business operation (i.e. port related activities). Among others, the investment plan includes developing Terminal 2, a second terminal adjacent to the current Jebel Ali Terminal within the Jebel Ali Free Zone. DP World was also entitled to commingle its own assets with mülÈrbah assets. The profit sharing ration between the SPV and DP World was 99:1. The mülÈrbah was expected to generate an profit-sharing ratio, the investors expected to receive 6.25% per annum.” See Ibid., 26 & 427.

55 This mode can be useful for Islamic microfinance institutions big project investment. The İlkÈk may be issued for many purposes, such as, for employment, or for commercial activities like purchasing automobiles or vehicles or for the establishment of clinics or hospitals or estate, factories or industries, trading centres or shopping mall. See Ayub, Understanding Islamic Finance, 399. In İlkÈk mushÈrakah transaction, both the issuer and investor may contribute to the capital of the mushÈrakah project. The mushÈrakah is normally managed by either the issuer or a third party. Alternatively, İlkÈk mushÈrakah transaction can also be structured with all investors contributing capital in a mushÈrakah project and then appointing the issuer as their agent to manage the mushÈrakah. This structure can also be classified as İlkÈk mushÈrakah bi isithmÈr (an investment agency İlkÈk). See Dusuki, “Islamic Financial System: Principles & Operations,” 428.
investor will receive certain amount of shares based on his proportional contribution. This Ḥukūk structure has been practiced by Cagamas MBS (An SPV incorporated on 8 June 2004 for the purposes of undertaking the purchases of the mortgage assets and Islamic mortgage assets from the Government of Malaysia and the issuance of residential mortgage-based securities and Islamic residential mortgage-based securities to finance the purchases.).

3.3.1.3 IMF Ḥukūk ijīerah Fund

Ḥukūk ijīerah refers to the certificates issue to represent the ownership of the lease assets tied up to a lease contract, rental of which is the return payable to the holders of the certificates. It is the certificates issue to indicate the undivided shares in ownership of lease assets; it could be tangible assets, usufructs, and services, assets of particular projects or combination of many tangible assets and intangible assets. Under Ḥukūk ijīerah scheme, the issuer (lessee) or Islamic microfinance institutions will initiate the selling of his asset to the lessors (investors) for the financing amount. After, the existing asset is then leased back to the issuer against a lease rental. This periodic lease rental constitutes periodic distributions to the investors. The ijīrah certificates will then be issued by the issuer as evidence of commitment to pay the periodic rentals to the investors. This concept has been practiced by Malaysian government known as Malaysian Global Ḥukūk (SPV).

3.3.2 Cash Line Facility Fund

Cash line facility is a short term financing resource or means use for the purpose of working capital, asset acquisition or personal consumption, or purchase of assets or to get extra cash flow. It also can be used to create additional funds for capital injection or investments. It may be used for vehicle financing, personal financing, house or fixed asset financing and acquisition of properties. The Islamic microfinance institutions can apply the Bank Islam Malaysia Berhad operational mode for cash line facility based on tawarruq concept (commodity murābi‘ah). Under this mechanism, the

57 Meanwhile, “Since 2005, Cagamas has issued two Islamic Residential Mortgage Based Securities (IRMBS) based on mushārakah. The first issuance was done in August 2005 for RM2.05 billion while the second issuance was done in May 2007 for RM2.11 billion. Both deals were rated AAA by RAM and MARC (the Malaysian rating bodies), which translated into strong demand, with four to five times over-subscription. The second Ḥukūk mushārakah had a tranche with 20 years maturity, which at the time of issuance, was the longest maturity in Malaysia. Both Ḥukūk utilised the same structure. The issuer was Cagamas MBS Brhd, a wholly owned RM2 subsidiary of Cagamas with capital, established for the purpose of the securitisation. The originator was the Government of Malaysia (GOM), namely the Treasury Housing Loan Division that provides home financing to government servants.” See Dusuki, “Islamic Financial System: Principles & Operations,” 429–430.
58 Ayub, Understanding Islamic Finance, 400–401.
59 Asyraf Wajdi Dusuki and Nurdinawati Irwanni Abdullah, Fundamentals of Islamic Banking, 291.
60 Under Ḥukūk ijīrah, the Federal Land Commissioner (FLC) of Malaysia sold the beneficial title. In other words, the FLC still holds the legal title but it was for the benefit of the investors or it means that FLC was just a bare trustee of the assets. The SPV funded the purchase by issuing a floating rate trust certificate, representing beneficial ownership of the asset. The SPV acted on behalf of the investors then leased the asset to the Malaysian government. The lease was priced at LIBOR+95bps, which reflects the credit rating of the Malaysian government (BBB) at the time of the issuance. In addition to the lease contract, the Malaysian government also gave an irrevocable undertaking (purchase undertaking) to the SPV, which said that at maturity or event of default, it would buy back the assets at par value. The purchase undertaking implied that in the government and no other third parties. As lessee, the government of Malaysian paid rental semi-annually to the SPV, which in turn paid semi-annual floating rate distribution to investors. This Ḥukūk utilized bullet redemption upon maturity; thus the periodic rental only represented the profit payment to the investors. The investors obtained back their principal amount only upon maturity. See Ibid., 291 & 420–421.
61 Ibid., 243–244.
62 Commodity murābi‘ah involves purchase and sale of asset whereby a vendee purchases an asset from a seller on deferred payment and sells the same asset to a third party for cash at a price less than the deferred price. See Ayub,
client applies cash line facility product to the bank based on commodity murābāhah approach. The bank then purchases the commodity through Broker A at Bursa Suq al-Sila. The bank will then sell the commodity to the client at bank’s selling price (cost plus profit) on deferred payment term under murābāhah contract. The client will then order the bank under wakālah (agency) contract to sell the commodity to which was bought from broker A in the market. The bank will then sell the commodity to broker B as agent to the client. After, the bank credits the selling price of the commodity into the client’s account. At last, the client pays to the bank on cost plus profit based on the agreement as instalment basis.63

4. CONCLUSION

The shortage of funds for Islamic microfinance institutions constitutes one of the main obstacles and challenges facing the institutions. This issue has hindered the development of the institutions in terms of its sustainability and its ideal impact on poverty alleviation. In other resolve this issue, there is a need for an innovative and suitable income generation mechanisms that will assist the institutions to minimise the issue. In this regard, the study proposed three kind of sources of funds, namely, internal, external and network sources of funds. The internal sources comprise of ijārah, murābāhah and muzārah funds. The external sources include the zakāt, waqf and baytul mal funds, while the network sources contain the Islamic securitisation and cash line facility funds. The above-mentioned sources of funds have great potential to generate enough funds for the institutions. Any profit gain from the funds can disbursed and mobilised in microfinance activities. For examples, it can be utilised to minimise the high transactions costs, risks, administration and operational costs.

Understanding Islamic Finance, 233; Asyraf Waajdi Dusuki and Nurdinawati Irwani Abdullah, Fundamentals of Islamic Banking, 119.

63 Ayub, Understanding Islamic Finance, 246.
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