Innovative Financing Options for Islamic Microfinance Institutions

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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 and external 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

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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 380,000 customers. This is equal to 1.5 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 80 percent of global outreach.[1]

However, Islamic microfinance requires support implementing 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) revealed that about 32 percent of those interviews complained of not seeking for conventional loans because of religious purposes. Another survey in Algeria showed that about 20.7 percent of microenterprise owners did not seek for loans on the ground of religious reasons; while in Yemen about 40 percent of the poor demanded Islamic financial service.

Meanwhile, the issue of financial 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 two 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 highlights the funding challenges facing by Islamic microfinance institutions. The second section examines the internal sources of funds that include Islamic investment funds, namely, *ijarah*, *murabahah* and *muzara'ah* funds. The next section covers external sources of funds that embodies the *zakah*, *waqf*, *baytul mal* and Islamic securitization funds.

2. FUNDING CHALLENGES FOR ISLAMIC MICROFINANCE INSTITUIONS

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 percent of total microfinance programmes.[2] Meanwhile, the 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 facing shortage of funds to provide productive financial service for their poor clienteles. For example in Yemen, the shortage of funds constitutes 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.[3]

Meanwhile, the lack of enough fund mobilisation for Islamic microfinance activities is considered as

[1] *Nimrah, Karim, Michael, Tarazi, & Xavier, Reille : 2013).*

[2] *Chapter 13: Islamic Microfinance – GIFR, @ http://gifr.net/gifr2014/ch_13.pdf @ 164-165*

[3] *Alshebami, A. S., & Khandare, D. M,(2015:17,20)*

one of the issues relating to the long-term sustainability of the institutions. Islamic microfinance institutions need to diversify its sources of funds in other 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.[1]

3. SOURCES OF FUNDING FOR ISLAMIC MICROFINANCE INSTITUTIONS

The sources of funds for Islamic microfinance Institutions can be classified into two main categories, the internal and external 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.[2] On the other hand, the external resources are based on the common practice of Islamic microfinance institutions where the institutions depend on the outside contributors to provide financial means. 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.[3]

3.1 Internal Sources of Funds

The internal sources embody the Islamic investment funds which include the *ijarah*, *murabahah* and *muzara'ah* 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 contribute some of their 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 *Shari'ah* principles.[4] 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.

3.1.1 *Ijarah* Fund

The *ijarah* 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.[5] 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.[6] Under this arrangement, the Islamic microfinance institutions can use the *ijarah* method to purchase productive asset and lease it out

[1] *Rashidah Abdul Rahman and Faisal Dean, (2013: 294-296).*
[2] *Tariq Al-Haj, 2010: 26; Mohammed Obaidullah and Tariqullah Khan, (2008,: 38)*
[3] *Tariq Al-Haj, 2010: 26; Mohammed Obaidullah and Tariqullah Khan,(2008,: 38)*
[4] *Usmani,:(93)*
[5] *Muhammad Ayub,(2009):79; Zaid Hamzah,, (2011, 466).*
[6] *466–467.*

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.

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. 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 Foundation in Pakistan.[1]

3.1.2 *Murabahah* Fund

The *murabahah* 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.[2] For example through *murabahah*, 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 *murabahah* 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.[3] The settlement of the price of the

[1] *Wasil Foundation provides a variety of Shari'ah-compliant instruments incorporating a margin of profit for the institution, such as, salam (advance against future delivery), istisna' and murabahah (cost plus mark-up), diminishing musharakah (diminishing partnership), and ijarah (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 'CWCD' means Centre for Women Co-Operative Development. It was established as a Non-Governmental Organization (NGO) in 1992. 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.*

[2] *Alexander von Pock, 2007: 29; Hamzah,: (474.)*

[3] *von Pock, Strategic Management in Islamic Finance, 70; Hamzah, Islamic Private Equity and Venture Capital Principles and Practice, 474.*

subject matter could be in cash payment or in instalments profit margin basis according to the agreement by the both parties.[1] 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.[2] For examples, the Hodeibah Microfinance program (HMFP) in Yemen using *murabahah* 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.[3]

3.1.3 *Muzara'ah* Fund

The *muzara'ah* fund raising method can be another essential source of financing for the Islamic microfinance institutions. *Muzara'ah* 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.[4] This instrument may involve two contracts, namely *mudarabah* and *musharakah* contracts. For this, the Islamic microfinance institutions will either be the investor and other party will be entrepreneur based on *mudarabah* or profit sharing contract concept; or the both parties (the Islamic microfinance institutions and the other party) will be partners based on *musharakah* partnership contract concept.

In *muzara'ah*-based *mudarabah* 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.[5] The concept is built on a mixed venture in which one person provide the funding and the other provide the labor where the

[1] *Ibid.*

[2] *Murabahah 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/PA00HPHF.pdf.*

[3] *Hodeibah Microfinance program (HMFP) was established in 1997. It was the first of its kind in Yemen. See Davood Manzur, Hossin Meisami, and Mehdi Roayaee, "Banking for the Poor in the Context of Islamic Banking and Finance," Journal of Contemporary Management 2, no. 2 (2013): 56.*

[4] *There are difference between the terms "muzara'ah", "musaqat" and "mugharasah". Muzara'ah 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; see also Ahmad Ibrahim Bik, al-Mu'amalat ash-Shari'iyyah al-Maliyyah (Cairo: Dar al-Ansar, 1936), 217. However, musaqat refers to a contract of agricultural partnership whereby a person agrees to water and maintain the trees owned by a landlord on the agreement that any fruit produced by the trees are shared between them according to an 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. And mugharasah is farming in another person land. For more details, see Muhammad 'Abdu al-Haid Al-Faqi, al-Ada' al-Iqtisadi Lil-Masarif al-Islamiyyah Wa-Atharuh Fi 'Amaliyyah at-Tanmiyyah al-Iqtisadiyyah: Dirasah Fiqhiyyah Iqtisadiyyah (Cairo: 'Alam al-Kutub, 2010), 245–247 & 250–254.*

[5] *Rodney Wilson, "Making Development Assistance Sustainable through Islamic Microfinance," International Journal of Economics, Management and Accounting 15, no. 2 (2007): 210–211; Maatallah, Principles of Islamic Finance Riba and Murabaha, 12.*

profits are distributed in accordance to the agreement of the contracting parties.[1] 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 with expert livestock producers.[2] Similarly, in *muzara'ah*-based *musharakah* 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,[3] 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[4]

3.2 External Sources of Funds

The external resources include the *zakah*, *waqf*, *baytul mal* and Islamic securitization funds.[5] The Islamic microfinance institutions have 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.

3.2.1 *Zakah* Fund

Zakah fund can be one of the useful tools as a fund generating source for Islamic microfinance institution. *Zakah*[6] 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 (*fuqara'*), needy (*masakin*), *zakah* collectors (*'amilinalayha*), those who convert to Islam (*mu'alafah qulubuhum*), slave (*riqab*), debtors (*gharimin*), one who attends to activities in the cause of Islam (*fi sabili Allah*) and those who travel in the course of Islam and has run out of money or survival (*wa ibn as-sabil*).[7] On the side of sustainability of

[1] *David Eisenberg, Islamic Finance: Law and Practice (OUP Oxford, 2012), 184–185.*

[2] *Norma Md Saad, "Microfinance and Prospect for Islamic Microfinance Products: The Case of Amanah Ikhtiar Malaysia," Advances in Asian Social Science 1, no. 1 (2012): 31.*

[3] *Manzur, Meisami, and Roayaee, "Banking for the Poor in the Context of Islamic Banking and Finance," 56.*

[4] *The SIB established special micro-credit windows called "productive family branches" in 1992. See Ibid., Maatallah, Principles of Islamic Finance Riba and Murabaha, 12.*

[5] *Wilson, "Making Development Assistance Sustainable through Islamic Microfinance," 203–207; Manzur, Meisami, and Roayaee, "Banking for the Poor in the Context of Islamic Banking and Finance," 57–58.*

[6] *The term "zakah" 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 Muahammad Al-'Arabi Al-Qurawi, al-Khulasah al-Fiqhiyyah 'Ala Madhahib as-Sadah al-Malikiyyah (Beirut: Dar al-Kutub al-'Ilmiyyah, 2006), 127; Kamal bn Sa'id Salim Abu Malik, Sahih Fiqh as-Sunnah Wa-Aadilatih Wa-Tawdih Madhahib al-Aaba'ah, vol. 2 (al-Maktabah at-Tawqifiyyah, n.d.), 5; Yusuf Al-Qardawi, Fiqh Az-Zakah: A Comparative Study, the Rules, Regulations of the Qur'an and Sunah (London: Dar at-Taqwi', 1999.), 221. For more details see "Qur'an, al-Baqarah, 2: 43;" Al-Qurawi, Al-Khulasah Al-Fiqhiyyah 'Ala Madhhab Al-Sadah Al-Malikiyyah, 127, see also Ibn Hajar, Fat'hu al-Bari Sharh Sahih al-Bukhari, vol. 5, vols. 1, ed. 2003: 67–68. Meanwhile, the minimum threshold of zakah on money is 2.5% (two and half percent) of the savings over a period of one year according to the Shari'ah. See Obaidullah, Introduction to Islamic Microfinance, 28.*

[7] *Mohd. Nasir Mohd. Yatim and Amirul Hafiz Mohd Nasir, The Principles and Practice of Islamic Banking & Finance (Pearson Malaysia, 2008),*

Islamic microfinance institution, *zakah* can be used as a source of funding.[1]

In this sense, the Islamic microfinance Institution can mobilize social services by using *zakah* 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 mobilise via a *zakah* fund; since *zakah* 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.[2]

In addition, the Islamic microfinance can institutionalize the *zakah* fund in order to guarantee the sustainability of the assets and its income generating abilities; which is considered as a primary issue of *zakah* and *sadaqah*-based institutions as they are essentially rooted in voluntarism.[3] Moreover, the *zakah* fund can also be used for a commercial approach which entails charging and sharing of profits.[4] For example the Islamic microfinance institution can use the *zakah* 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.[5] 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.[6]

3.2.2 *Waqf* Fund

Another fund raising source for Islamic microfinance institution is the *waqf* fund.[7] *Waqf* entails the use of assets

113; Hamzah, Islamic Private Equity and Venture Capital Principles and Practice, 484. In reference to the role of zakah in Islamic microfinance, it seeks to avoid the rotation and exchange of wealth in the hands of few individuals in the Muslims community. See Obaidullah, Introduction to Islamic Microfinance, 17–19.

[1] *Ibid., 17–19'.*

[2] *Ibid., 28 & 37.*

[3] *Islamic Research and Training Institute, "Islamic Financial Services Industry Development: Ten-Year Framework and Strategies," 24, accessed June 28, 2016, http://www.ifsb.org/docs/10_yr_framework.pdf; Obaidullah, Introduction to Islamic Microfinance, 46.*

[4] *Zakah 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 zakah 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.*

[5] *Maatallah, Principles of Islamic Finance Riba and Murabaha, 12.*

[6] *BMMI is "licensed zakah organization in Indonesia that can collect Islamic charities (zakah, sadaqah and waqf) and disburse the funds for the society purposes. Similarly, BAZNAS is zakah 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.*

[7] *Waqf literally means to hold or to preserve and to deprive or deny. According to the scholars, waqf is also termed as "sadaqah jariyah or continuous charity". Technically, Imam Abu Hanifah defined waqf as the act of holding the property under the ownership of the al-waqif (testator) by al-tasaduq bi-manfa'atiha (donating its usufruct) as charity through any charitable institution; the donation can be at the spot or deferred. Based on this definition, Imam Abu Hanifah argued that, the property after declaring as waqf remains in the*

such as cash, land, and real estate for charitable purposes. One of the characteristics of *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.[1]

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 *musharakah* 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 *mudarabah* approach, the *waqf*-based Islamic microfinance institution provides the capital for the project called *rabb al-mal* (the owner of the capital) and the *mudarib* (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.[2]

All in all, the profits earned in these diverted 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.[3] For example, creating *takaful* 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.[4]

The mode of using *waqf* as a source for fund generating product has been adopted by Indonesia Waqaf Institution (BWI),[5] Islamic Relief in the United Kingdom,[6] the Islamic Solidarity

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-Jami'ah Al-Jadtdah Li-Nashir, 2003), 235; see also Usmani, An Introduction to Islamic Finance, 105.

[1] *Masudul Alam Choudhury and Asyraf Wajdi Dusuki, "Banking for the Poor: The Role of Islamic Banking in Microfinance Initiatives," Humanomics 24, no. 1 (2008): 9.*

[2] *Ibid.*

[3] *Habib Ahmed, "Waqf-Based Microfinance: Realizing the Social Role of Islamic Finance," World Bank, 2007, 10.*

[4] *Ibid.*

[5] *The BWI is the country autonomous institutions. See Izzuddin Abdul Manaf, "Development Strategy Waqf with Sukuk for Infrastructure Development Project in Indonesia," 2013, https://www.linkedin.com/in/zudin.*

[6] *The Waqf Future Fund is one of Islamic Relief projects which were set up on 2000, aimed to set*

Fund for Development (ISFD) in Senegal[1] and *Awqaf* Properties Investment Fund (APIF) under Islamic Development Bank (IDB), Jeddah.[2]

3.2.3 *Baytul* Mal Fund

Furthermore, *baytul mal* fund[3] 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, *zakah*, charity are kept for any incoming expenditure which shall take place for the best interest of the Muslim public. In this regard, *Baytul mal* 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 service to the micro-entrepreneurs.[4]

Baytul mal 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, *musharakah*, *mudarabah* and any other activities for that matter that can contribute to the development and sustainability of Islamic

up a 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.

[1] *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 (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.*

[2] *Islamic Development Bank Group, "Islamic Development Bank Group in Brief," 2013, 10–11., http://www.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IDB/CM/Publications/IDBGroupBrief2013.pdf. The Awqaf 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 See Islamic Development Bank, "Progress Report of the Activities of Islamic Solidarity Fund for Development (ISFD)," 1.*

[3] *The term "baytul mal" in its literal meaning derived from two Arabic words, namely, "bayt" means house and "al- mal" 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 mal. 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 mal to provide financial services for any expenditure incurs in the interest of the public. The expenditure should be paid out from the baytul mal funds. See S A Siddiqui, Public Finance in Islam (Adam Publishers, 2007), 139; Usmani, An Introduction to Islamic Finance, 105.*

[4] *Bayu Taufiq Possumah and Gunawan Baharuddin, "Governing Baitul Mal towards 2020; Issues and Challenges: Indonesia Experiences," International Journal of Bussines and Management Tomorrow 2, no. 10 (2012): 2. al-Jizyah, al-kharaj, al-'ushr, luqatah, estate of the deceased and diyah are also considered the revenues of Islamic states (properties of baytul mal. See Mohamad Asmadi bin Abdullah, "The Entitlement of the Bayt Al-Mal to a Muslim Praepositus' Estates; an Analysis on the Right of a Muslim to Bequeath without Obtaining a Consent from the Bayt Al-Mal," International Journal of Social Sciences and Humanity Studies 4, no. 1 (2012): 270., http://irep.iium.edu.my/30550/1/3)_ICSS_on_Bayt_al-Mal_presented_Oct_2012.pdf.*

microfinance sector. Pursuant to the above discussion,[1] *baytul mal* can be a major, suitable and essential source of funding for Islamic microfinance sector in the ambit of poverty alleviation since *zakah* and *waqf* funds are some of the sources of *baytul mal*. This scheme has been practiced by *Baitul Maal Wat Tamwil* (BMT) or House of Expense in Indonesia.[2]

3.2.4 Islamic Securitization Funds

Islamic securitization funds in this section involve *sukuk mudarabah*, *sukuk musharakah* and *sukuk ijarah* funds.[3] The word 'securitization' refers to the process in which the ownership of existing assets is transferred to the investors in the form of *sukuk* or certificates. [4]The term '*sukuk*' refers "to securities, notes, papers, or certificates, with features of liquidity and tradability."[5] The followings are some feasible ways in which the above mentioned *sukuk* 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. This approach can be another integral funds generating engine for Islamic microfinance institutions.

3.2.4.1 Islamic Microfinance *Sukuk-based Mudarabah Fund*

Sukuk mudarabah 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.[6] Under Islamic microfinance institutions' *sukuk mudarabah* scheme, the issuer of the certificates acts as *mudarib* (manager) while the *rabul mal* (subscribers) are the capital provider and the identified *mudarabah* is the Special Purpose Vehicle (SPV).[7] The assets will be under the ownership of the certificate 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 *sukuk mudarabah* to attest or prove

[1] *The BMT in Indonesia is an Islamic microfinance institution. It 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. Zakah (a type of religious tax payable by Muslims on their net worth) funds also form an integral part of BMTs. See Overy L L P Allen, "Islamic Microfinance Report," International Development Law Organization, 2009, 21–22; Possumah and Baharuddin, "Governing Baitul Mal towards 2020; Issues and Challenges: Indonesia Experiences," 3.*

[2] *Allen, "Islamic Microfinance Report," 21–22; Possumah and Baharuddin, "Governing Baitul Mal towards 2020; Issues and Challenges: Indonesia Experiences," 3.*

[3] *The sukuk can be classified into three main categories, namely, Sale-based sukuk (includes: bay' bithamani ajjil, Murabahah, Salam, Istisna), Lease-based sukuk (include IjÉrah) and Equity-based sukuk (comprises of musharakah, mudarabah and wakalah)…. See Asyraf Waajdi Dusuki and Nurdinawati Irwarni Abdullah, Fundamentals of Islamic Banking (Kuala Lumpur: IBFIM, 2011), 287.*

[4] *Ayub, Understanding Islamic Finance, 393. It is "the financial operation resulting from the originator's assignment of assets belonging to it, to a legal entity created for that purpose according to the provisions of this law, with or without the help of a financial intermediary." See Ghassan Chammas, "Islamic Finance Industry in Lebanon: Horizons, Enhancements and Projections," 2006, 10.*

[5] *Asyraf Waajdi Dusuki and Nurdinawati Irwarni Abdullah, Fundamentals of Islamic Banking, 140.*

[6] *Ayub, Understanding Islamic Finance, 398.*

[7] *An SPV is a legal entity created by a firm (known as the sponsor or originator) to undertake some specific purpose or restricted activity spelt out by the sponsoring firm. It may be a subsidiary of the sponsoring firm or it may be an independent SPV. In the case of Malaysia, SPV normally takes the legal form of a trust and governed by Trustee Act. It is set up as a trust to fulfil specific purposes. See Alam Choudhury and Wajdi Dusuki, "Banking for the Poor: The Role of Islamic Banking in Microfinance Initiatives," 58.*

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.[1]

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 will was caused by the negligence or mismanagement of the Islamic microfinance institutions.[2] This mechanism has been practiced by DP World *Sukuk* (An SPV established in Cayman Islands on 17 May 2007 as a charitable trust to facilitate the *sukuk* issuance).[3]

3.2.4.2 Islamic Microfinance *Sukuk-based Musharakah Fund*

Sukuk musharakah refers to the partnership certificates issued for each party (subscriber) to represent his proportionate ownership in the assets of the project.[4] Under Islamic microfinance institutions' *sukuk musharakah* structure, the Islamic microfinance institutions enter into a specified equity partnership investment project against which the *sukuk* have been issued. When the project resumed, the *sukuk* 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 *sukuk* based on *musharakah* principles. Islamic microfinance institutions will then advance (invest) his property like land where the project will be constructed. In this regards, each investor will receive certain amount of shares based on his proportional contribution.[5] This *sukuk* 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.).[6]

[1] *Asyraf Wajdi Dusuki, "Islamic Financial System: Principles & Operations," International Shari'ah Research Academic for Islamic Finance (ISRA): Kuala Lumpur, 2011, 288; Chammas, "Islamic Finance Industry in Lebanon: Horizons, Enhancements and Projections," 78.*

[2] *Dusuki, "Islamic Financial System: Principles & Operations," 288–289.*

[3] *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 sukuk market to raise $1.5 billion using a mudarabah structure. DP World Sukuk first issued the sukuk and forwarded this to DP World as mudarabah capital on behalf of the investors. DP World as mudarib invested the capital in its business operation (i.e, port related activities). See Ibid., 26 & 427.*

[4] *This mode can be useful for Islamic microfinance institutions big project investment. The sukuk 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. The musharakah is normally managed by either the issuer or a third party. Alternatively, sukuk musharakah transaction can also be structured with all investors contributing capital in a musharakah project and then appointing the issuer as their agent to manage the musharakah. This structure can also be classified as sukuk musharakah bi isithmar (an investment agency sukuk). See Dusuki, "Islamic Financial System: Principles & Operations," 428.*

[5] *Chammas, "Islamic Finance Industry in Lebanon: Horizons, Enhancements and Projections," 72–75.*

[6] *Meanwhile, "Since 2005, Cagamas has issued two Islamic Residential Mortgage Based Securities (IRMBS) based on musharakah. The first issuance was done in August 2005 for RM2.05 billion while the second issuance was done in May 2007 for*

3.2.4.3 Islamic Microfinance *Sukuk-based Ijarah Fund*

Sukuk ijarah 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.[1] 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.[2] Under *sukuk ijarah* 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 *ijarah* 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 *Sukuk* (SPV).[3]

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 order to resolve this issue, there is a need for an innovative and suitable income generating 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 *ijarah*, *murabahah* and *muzara'ah* funds. The external sources include the *zakah*, *waqf*, *baytul mal* and Islamic securitisation 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 instance, it can be utilised to minimise the high transactions costs, risks, administration and operational costs.

RM2.11 billion. Both deals were rated AAA by RAM and MARC (the Malaysian rating bodies). See Dusuki, "Islamic Financial System: Principles & Operations," 429–430.

[1] *Ayub, Understanding Islamic Finance, 400–401.*

[2] *Asyraf Waajdi Dusuki and Nurdinawati Irwarni Abdullah, Fundamentals of Islamic Banking, 291.*

[3] *Under sukuk ijarah, 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. See Ibid., 291 & 420–421.*

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