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Incorporation of *Mudarabah*, *Musharakah* and *Musharakah Mutanaqisah* with Microfinance: A Sustainable Livelihood Approach to Poverty Alleviation

Reazul Islam[1] and Rubi Ahmad[2]

ABSTRACT

In this paper, we have conceptualised an integrated microfinancing model by using *mudarabah*, *musharakah* and *musharakah mutanaqisah* (MM&M) instruments. This model presumably, can ensure sustainable economic livelihoods for the poor entrepreneurs by enhancing their income through higher entrepreneurial exercises while providing them with the ownership of tangible assets. To assess the viability of this model, we conducted a study adopting the qualitative method. We took in-depth interviews of three experts in Islamic finance and banking by using an open-ended questionnaire articulated with the vital issues of MM&M financing. According to experts' opinions, relevant skills, religiosity, and product knowledge can be considered clients' primary attributes for letting them access these financing schemes. Nevertheless, the involvement of third-party guarantors, cash *waqf*, and technology usage will augment the usefulness of this financing approach. Outcomes of this study will help incorporate MM&M within the context of Islamic microfinance while opening windows for further research.

ملخص

في هذه الورقة البحثية، قمنا بوضع تصور لنموذج متكامل للتمويل الأصغر باستخدام أدوات المضاربة والمشاركة والمتناقصة (MM&M). ومن المفترض أن يضمن هذا النموذج سبل العيش الاقتصادية المستدامة لأصحاب المشاريع من فئة الفقراء عبر تعزيز دخلهم من خلال ممارسات ريادية أعلى مستوى مع تزويدهم بملكية الأصول الملموسة. ولتقييم جدوى هذا النموذج، أجرينا دراسة تعتمد

[1] School of Business and Social Sciences (SBSS), Albukhary International University (AIU), Kedah Darul Aman, Malaysia, Email: reazul.phd@gmail.com.
[2] Faculty of Business and Economics, University of Malaya (UM), Kuala Lumpur, Malaysia, Email: rubi@um.edu.my

الأسلوب النوعي. وأجرينا مقابلات متعمقة مع ثلاثة خبراء في التمويل الإسلامي والخدمات المصرفية باستخدام استبيان مفتوح يشمل تفصيلا عن القضايا الهامة للتمويل الذي يعتمد أدوات المضاربة والمشاركة والمتناقصة ووفقا لآراء الخبراء، يمكن اعتبار المهارات ذات الصلة والتدين والمعرفة بالمنتج سمات أساسية في العملاء للسماح لهم بالوصول إلى مخططات التمويل هذه. ومع ذلك، فإن إشراك جهات ضامنة خارجية، والوقف النقدي، واستخدام التكنولوجيا ستزيد من فائدة نهج التمويل هذا. وستساعد نتائج هذه الدراسة على دمج أدوات المضاربة والمشاركة والمتناقصة في سياق التمويل الأصغر الإسلامي مع فتح المجال لمزيد من البحث.

ABSTRAITE

Dans cet article, nous avons conceptualisé un modèle de microfinancement intégré en utilisant *les instruments mudarabah, musharakah et musharakah mutanaqisah* (MM&M). Ce modèle peut vraisemblablement garantir des moyens de subsistance économiques durables aux entrepreneurs pauvres en améliorant leurs revenus grâce à des exercices entrepreneuriaux plus poussés tout en leur permettant de posséder des actifs tangibles. Pour évaluer la viabilité de ce modèle, nous avons mené une étude en adoptant la méthode qualitative. Nous avons mené des entretiens approfondis avec trois experts de la finance et de la banque islamiques en utilisant un questionnaire ouvert articulé autour des questions vitales du financement du MM&M. Selon les avis des experts, les compétences pertinentes, la religiosité et la connaissance des produits peuvent être considérées comme les principaux attributs des clients leur permettant d'accéder à ces systèmes de financement. Néanmoins, l'implication de garants tiers, le *waqf* en espèces et l'utilisation de la technologie augmenteront l'utilité de cette approche financière. Les résultats de cette étude permettront d'intégrer le MM&M dans le contexte de la microfinance islamique, tout en ouvrant des perspectives pour de futures recherches.

Keywords: *Mudarabah, Musharakah, Musharakah Mutanaqisah*, Islamic Microfinance, Sustainable Livelihoods.

JCL Classification: D2, D6

1. Introduction

In the Islamic banking and finance portfolio, *mudarabah* and *musharakah* (M&M) are characterised as profit and loss sharing (PLS) based partnership agreements. M&M seek clients' entrepreneurial skills and good morals while demanding no physical collaterals (Eigindi et al., 2009; Ariffin et al., 2015). The provision of collateral-free financing encourages assetless entrepreneurs to be involved with these instruments, and the underlying risk-sharing mechanism decreases their financial burden if they encounter any loss during the business operation. Herein, another type of *musharakah* denominated as *musharakah mutanaqisah* offers clients the opportunity to own tangible assets through a diminishing lease-rental process (Meera et al., 2009). Tangible assets function as the collateral for future borrowing or can be liquidated to address the problem (Mok et al., 2007). Hence, asset ownership strengthens them to stand against economic adversities as well as lowers the chance of falling into the poverty trap. Nowadays, microfinance is notably becoming a viable source of finance for the entrepreneurial poor in the developing and least developing world (Ahmed et al., 2021). In the same vein, Islamic microfinance with a range of products is rapidly growing in its market niche. *Mudarabah*, *musharakah*, and *musharakah mutanaqisah* (MM&M) can be integrated within the context of Islamic microfinance to serve poor entrepreneurs better. MM&M instruments require business skills and partnership agreements.

Every business deal with social capital by committing interactions with stakeholders. Once the business generates financial capital through commercial exercises, it brings economic nourishment to individuals and society. Nonetheless, entrepreneurial capital, a combination of human capital and social capital, enormously contributes to business competitiveness. A collaboration between these two elements (human capital and social capital) strengthens desired economic growth (Prasetyo et al., 2020). In that light, MM&M financing schemes enhance clients' human capital since all of them require business skills at the first place. Entrepreneurs as well as the financing institutions very on maximising profit that brings higher competitive values while incentivising both. In the same vein, these instruments catalyse social capital and financial capital by increasing tangible assets and offering entrepreneurs the asset ownership. Since, they get operationalised through mutual efforts, and trust they build bondage among participating parties and financial institution. Hence, they extensively contribute to social capital as well (Saad & Razak, 2013).

Thus, this financing instrument can enormously contribute to sustainable livelihoods of poor entrepreneurs. Based on this logical reasoning, we intended to develop a comprehensive MM&M microfinancing model. To articulate this model, we focused on two objectives as stated below:

1.1. Designing a comprehensive microfinancing model based on *mudarabah*, *musharakah*, and *musharakah mutanaqisah* principles.

1.2. Justifying this model's viability by the Islamic finance experts.

We will discuss the relevant literature, methodology, findings & discussion, and conclusion in the following sections.

2. Literature Review

For the sake of a comprehensive discussion and a better understanding of the relevant issues, we are going to review the relevant literature in the following sections. At first, we will cast light on sustainable livelihood and the Islamic perspective towards poverty. Then, we will narrate the concept of profit and loss sharing (PLS) microfinance. In the end, we briefly explain the client selection process, the importance of religiosity, knowledge, education, income, savings, and business experiences.

2.1. Sustainable Livelihood Approach to Poverty Alleviation

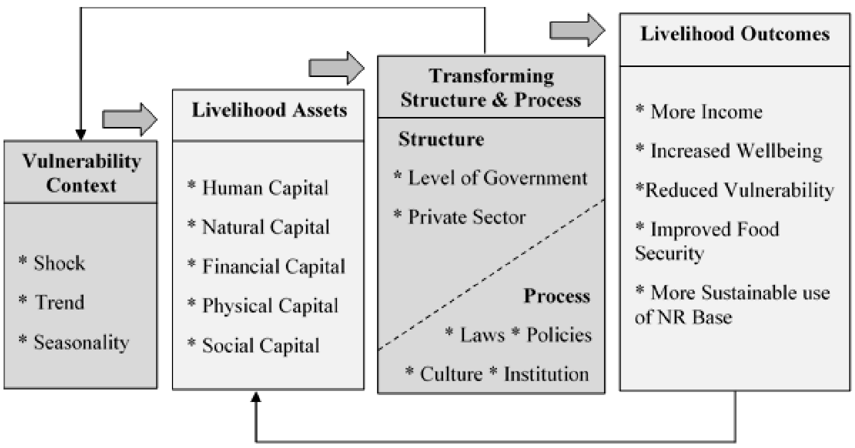
The sustainable livelihood (SL) approach was added to the body of development economics since the 1980s (Ashley & Carney, 1999). The concept of SL suggests that enhancing poor people's capabilities can enable them to achieve future livelihood goals (Adato & Meinzen, 2002). In this regard, Chambers and Conway (1992) offered a comprehensive definition.

"A livelihood comprises the capabilities, assets (including both material and social resources) and activities required for a means of living. A livelihood is sustainable when it can cope with and recover from stresses and shocks, maintain or enhance its capabilities and assets, while not undermining the natural resource base (Chambers and Conway 1992, pg. 1)".

Development thinkers have specified the essential elements for economically, ecologically, and socially sustainable living (Krantz, 2001). Hence, SL includes environmental sustainability, social sustainability, adequacy of livelihoods, and safety net. To achieve these goals, it prioritises capability, equity and sustainability. In this regard, capability corresponds to coping with stresses and shocks while responding to adverse changes. This attribute helps people find and make use of livelihood opportunities.

Similarly, equity means the relative distribution of income and opportunities; and sustainability refers to enduring into the long term future, meeting the current needs without compromising the ability of future generations to fulfil their own needs (Chambers & Conway, 1992; Robertson, 2017). The term ‘livelihoods’ refers to the living that can be accomplished by creating jobs (Adato & Meinzen, 2002). Thus, sustainable livelihood (SL) systematically analyses the causes of poverty while defining the necessary actions by explaining their implications and impacts. SL approach emphasises developmental practices placing people’s wellbeing as the priority (Ashley & Carney, 1999). For instance, SL gives priority to access to clean water, financial services, education, land, physical safety, gender issue, social relationship, economic security and vulnerability to natural calamity (Naraya et al., 2000). In this regard, the Institute for International Development Studies at the University of Sussex, Oxfam, and the Department for International Development (DFID) (UK) jointly designed a comprehensive SL framework as depicted below (Harvard Humanitarian Initiative [HHI], 2014).

Figure 1: Sustainable Livelihoods Approach to Poverty Alleviation



Source: Department for International Development, UK (DFID, 1999)

Figure (1) above displays the process flow of SL, which is set to achieve the specific 'livelihood outcomes' such as higher income, well-being, food security, reduced vulnerability, and improved environmental sustainability. It works on the 'vulnerability context' that comprises shock, trend, and seasonality to ensure outcomes. SL model emphasises enhancing natural capital, financial capital, social capital, physical capital, and human capital to eliminate vulnerabilities. Finally, this approach seeks the government's intervention and private sectors' involvement to accomplish the goals (DFID, 2001; HHI, 2014; DFID, 1999).

2.2. Islamic Perspective towards Poverty and Livelihood

Islam defines poverty as a social evil. This unwanted phenomenon degrades the socioeconomic condition by creating as well as catalysing numerous problems. It can even badly affect individuals' religiosity leading to *kufr* (infidelity). It is worth mentioning, Islam's Prophet (PBUM) sought Allah's bounty to be safe from the grip of poverty (Sadeq, 1997).

"O Lord, I seek your refuge from infidelity (kufr), poverty and destitution (faqr), and I seek your refuge from paucity (qillah) and humiliation (dhillah).”[3]

From the Islamic perspective, poverty means the scarcity of basic needs such as 1) food, 2) clothing, 3) shelter, 4) treatment, 5) education, and 6) a spouse. To set the benchmark of poverty, Islam considers two instruments: *urf* (the custom) and *zakat nisab*[4] (Sadeq, 1997). Even having a surplus amount of wealth, a person can be identified as poor if his/her asset is below *zakat nisab* (Sadeq 1997, Saladin et al., 2011). In this regard, the Islamic poverty indicator, termed as *had al kifaya* (HAK), is generally defined by the local *zakat* institution. To identify the poor household, HAK considers the size of the household, age, and the health condition of household members etc. (Saladin et al., 2011; Saladin & Ariffin, 2014). This scale measures poverty considering five essential elements: 1) religion, 2) physical self, 3) knowledge, 4) offspring, and 5)

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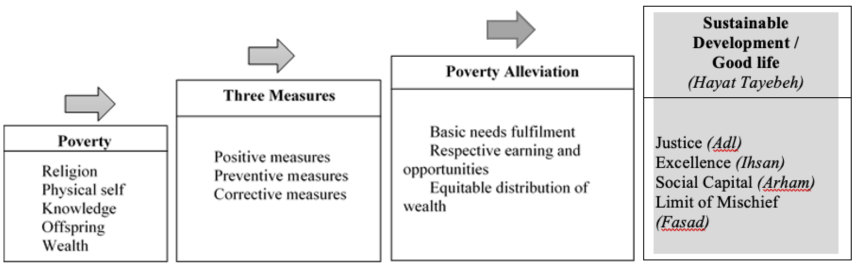
[3] *Sunan an-Nasa'i* 5485 (Sunnah.com 2018, Sadeq 1997)

[4] *Zakat nisab* refers to the sufficient amount of wealth that makes obligatory for an individual to pay *zakat.*

wealth (Saladin & Ariffin, 2014; Ashraf & Hassan, 2013). Further, the Islamic poverty alleviation approach combines three initiatives such as:1) basic needs fulfilment, 2) respective earning opportunities, and 3) equitable distribution of income and wealth (Akhtar & Arif, 2000). Islam highly emphasises the mutual sharing of resources based on the principles of brotherhood and trusteeship. It further advocates collective duties for addressing social needs and poverty. Besides, Islam prioritises equal opportunities and social safety net while promoting compassion and selflessness. It pays optimum importance to the elimination of social inequality. In this regard, it obligates *Zakat* while promoting *Sadaqah, Waqf, Infaq* and benevolent loans such as *Qardul Hassan* (Akhtar and Arif, 2000; Mulyany and Furqani, 2019). Hence, Islam suggests three specific measures: 1) positive measures that deal with income distribution and its growth and equal opportunities for all; 2) preventive measures that prevent unlawful ownership, malpractices in economics, trade, and commerce; and 3) corrective measures that assure the fair transfer of payment and state responsibilities (Sadeq, 1997; Sadeq, 2002). Islam suggests income growth, functional distribution of income, and equal opportunity as positive measures for poverty alleviation. It emphasises moderate consumption behaviours at an individual level while stressing the need for halal earning. Islam also gives importance to equitable distribution of income. Hence it prioritises the production functions based on justice and fairness. This is why Islam promotes profit sharing and forbids *Riba* (usury). Similarly, to abolish the wealth concentration and prevent malpractices, Islam takes control over asset ownership. It dogmatises that ownership of everything belongs to Allah (SWT), and human beings are entitled to utilise them as trustees. Thus, natural resources are identified as public property. However, Islam also recognises private ownership with the condition of underlying ethical codes and norms. In the end, it obligates compulsory transfer of wealth (such as Zakat) in order to alleviate poverty. This transfer occurs from all well-off Muslims to worse-off people. Further, recommended transfer (charity) for the deprived to abolish disparity and poverty. And at the end, it emphasises states' responsibilities for ensuring a favourable environment for sound economic activities as well as creating equal opportunities for all (Ashraf and Hassan, 2013). Islam further invasions a sustainable society through good governance and justice (*Adl*), excellence (*Ihsan*), social capital (*Arham*), and integrity without corruption (*Fasad*). Good governance (*Adle*) is the primary device for attaining sustaining progress. Adle corresponds to ecological, cosmic, and human justice and harmony. In the same vein, Ihsan refers to the inner beauty and excellence of individuals, organizations, and society. *Arham* refers to social networks that connect people to the global community. In the end, Islam reinforces limiting mischief (*fasad*) to balance ecological and ethical values and enhance social progress. Thus, Islam paves the way forward to sustainable development and ensures a good life (*Hayat Tayebeh*) (Al-Jayyousi, 2016). Based on the above discussion Islamic approach to poverty alleviation can be portrayed as below:

Figure 2: Poverty Alleviation and Sustainability in Islam (by Authors)



Islam defines poverty based on five fundamental elements of human life such as religion, physical self, knowledge, offspring, and wealth, that implies the Islamic view towards poverty is seemingly wider and more holistic compared to the conventional one (Ashraf & Hassan, 2013). After meeting the basic needs, Islam offers wellbeing by extending earning opportunities and distributing wealth equitably. Nonetheless, by establishing justice (*Adl*), excellence (*Ihsan*), social capital (*Arham*), and integrity without corruption (*Fasad*) Islam envisions to achieve sustainable development (*Hayat Tayebeh*).

2.3. PLS Microfinancing

In the realm of Islamic finance, profit and loss sharing (PLS) is a provisional business partnership agreement that occurs between two or more parties. Herein, involved parties are committed to sharing the profit and loss that may result from the exercise of their joint ventures (Karsten, 2007). The proportional distribution of profit share incentivises the investors and thus, inspires them to undertake risky ventures and pay higher effort. On the other hand, the underpinning condition of sharing the loss rationalises fair judgement and mutuality. Therefore, the profit and loss sharing (PLS) approach in business expectedly yields a better outcome. *Mudarabah* and *musharakah* (M&M) are the most authentic profit and loss sharing (PLS) instruments in Islamic finance (Chong & Liu, 2009; Khan, 1987). *Mudarabah* business agreement relies on the fiduciary relationship (*aqd al amanah*) between two parties. One party provides financial capital for starting a business enterprise, and another party takes sole responsibility to run it. The capital provider is called *rab-al-mal* and the entrepreneur or the client, who manages the business, is called *mudarib*. *Rab-al-mal* capitalises the business with the condition of sharing a part of the profit but bearing the entire loss. But if the loss occurs due to *mudarib's* misconduct (*ta`addi*), negligence (*taqsir*), or breach of specified conditions (*mukhalafah al-shurut*) *mudarib* must carry the total or a portion of the loss (Sapuan, 2016 & BNM, 2012)[5]. Otherwise, *mudarib's* loss remains confined to his/her contributed time and efforts. The profit is distributed between the parties based on the pre-agreed ratio. *Mudarib* can claim his share of the profit at the end of the business cycle (Rosly, 2005; Borhan, 1997; Usmani, 1999).

On the other hand, *musharakah* is similar to the term *shirkah* that means *sharing.* In this contract, two or more parties contribute capital for running an existing or new venture on a temporary or permanent basis. This partnership is formed under the condition of sharing profit, loss, and liabilities. Partners are entitled to share, control, and manage the investment (Noraziah & Ghafar, 2010). The share of loss is distributed based on the proportion of the invested capital. Both parties are authorised to manage the business jointly; though, it is not mandatory always. Nevertheless, the profit-sharing ratio must be set upon mutual agreement, and this ratio might be different from the investment ratio (Abu-Umar & Rafique, 2016).

Musharakah mutanaqisah (diminishing *musharakah)*, a type of *musharakah* contract, takes place between two parties. In this partnership, one party gradually buys the whole property/ asset from another party through a gradually decreasing (diminishing) lase-rental process. The asset owner leases the asset to the client based on *ijarah* (lease) contract.

[5] BNM: Bank Negara Malaysia (Central Bank of Malaysia)

The client, as an owner-tenant, entails the property for a certain period under *ijarah* that gradually increases his/her share. After paying the total lease-rental, the client owns the asset, and thus, this partnership ends (BNM, 2007, 2010; Shanmugam et al., 2008).

Nevertheless, M&M financing schemes may encounter unsystematic risks such as idiosyncratic risks, agency problems, information asymmetry, and moral hazard (Chong & Liu 2009; Dar & Presley 2001; Akin et al., 2016; Mili & Abid, 2017). To reduce these risks, this study suggests looking for specific attributes of the clients such as religiosity, product knowledge, education, income, savings, and business experiences. The following sections are casting light on the importance of these attributes.

2.4. Importance of Religiosity

Religiosity teaches us ethical behaviour, cultural values while motivating us to do entrepreneurial exercise (Woodside et al., 2020). Nonetheless, faith and religion encourage entrepreneurs to be hopeful, courageous, and patient when they are in a turbulent time (Daou et al., 2019). According to Muslims' faith, Islam is *Ad-Din*[6], a complete and comprehensive guideline for leading a harmonious life here, on the Earth and hereafter (El-Gamal, 2006, Hmoud Al-Lahem & Ridha-Murad, 1995). Muslims generally obey Shariah rules in their day to day lives, though the extent of their rule abidingness depends on the adherence to religiosity (Adhikari & Agrawal, 2016). Moreover, pietism enormously influences Muslims' decision making (Tepe et al., 2016). Several studies affirmed that religiosity also inspires Muslims to engage with the Islamic financial system (Abou-Youssef et al., 2015; Adhikari & Agrawal 2016; Amaliah et al., 2015; Johan & Putit 2016; Rulindo & Mardhatillah 2011; Tepe et al., 2016). Because the principles of Islam promote fairness in financial transactions and thus, decrease idiosyncratic risks and volatility of the investment (Adhikari & Agrawal, 2016; Amaliah et al., 2015; Amin, 2010; Johan & Putit, 2016). Islam also plays a significant role in bettering Muslims' entrepreneurial behaviours by offering a unique set of codes of behavioural conduct. Hence, practising Muslims are firm in keeping the commitment while being more inclined to risk-taking but less likely to seek worldly pleasure and sensual gratification. These positive attributes of pectising Muslims might lead them to generate higher profit in business

[6] Islam *Ad-Din* means Islamic rules and principles can guide every aspect of human life on Earth and hereafter.

(Gursoy et al., 2017). Besides, Islam highly encourages conducting business activities, and it provides guidelines for financial transaction, business management, and partnership agreements (Rulindo & Mardhatillah, 2011). Therefore, religious clients would be safer and more reliable in business dealings and financial transactions (Chen et al., 2016). In light of the above discussion, *mudarabah* and *musharakah*-based investments seem appropriate for religious Muslim entrepreneurs. Clients' religiosity will effectively reduce idiosyncratic risks, moral hazards, and agency problems. As a result, these investments may remain safe while yielding better returns. However, this parameter would be measured in many ways such as. For instance, some latent variables such as *akhlak*, belief, commitment, influence, intellect, practice, and experience can be measured based on the appropriate observable variables (Dali et al., 2019).

2.5. Importance of Knowledge and Education

Clients' knowledge of financial products positively influences their decision to be involved with the financing institution (Chen et al., 2017). Better product knowledge positively impacts entrepreneurial practices as well (Clark et al., 2014). Because a savvy client knows how to utilise a particular financial product better. Therefore, M&M would be well accepted by the people who have enough knowledge of these products. Besides, clients who know how to utilise these capitals can gain better earnings from the investment.

Similarly, education positively influences clients' performance with the microfinance schemes (Atmadja et al., 2016). Because educated people generally have better numerical knowledge, and they can do good bookkeeping and cost-value-profit analyses. They presumably outdo the uneducated ones in terms of collecting market information and linking with the social network. So, educated people seem to be able to generate better income from the investment.

2.6. Importance of Income, Savings

The income and savings influence clients' borrowing behaviour (Rokhim et al., 2016). If microentrepreneurs can generate better income from their loan-based projects, assumingly, they can ensure higher savings and reinvest it in their businesses (Chowa et al., 2012; Nasrin et al., 2017).

Besides, savings can enable *mudarib* to be involved with the *musharakah* project after completing a cycle of *mudarabah* investment. Further, savings increases purchasing power and thus, can lead clients to be engaged with *musharakah mutanaqisah* if s/he intends to own assets.

2.7. Importance of Business Experience

Business experience works as a catalyst in borrowing money from financial institutions for investment purposes. Experienced people are more interested in taking the loan for capitalizing on their businesses (Levie & Autio, 2013). This attribute positively impacts their loan-related activities as well. Experienced clients can generate better income from the loan-based business and make repayment duly (Addo & Twum, 2013). Hence, it can be assumed that clients with business experiences would also better perform in MM&M financing schemes.

To conclude, the MM&M financing system looks at sustainable livelihoods from the Shariah aspect. This approach tends to improve livelihoods by ensuring economic, personal, social, and spiritual wellbeing. Besides, profit and loss sharing (PLS) businesses are socially responsible, ethically justified, and mutually conducted. Therefore, MM&M financing can be effective and efficient to alleviate poverty sustainably. MM&M microfinancing can be regarded as the sustainable livelihood approach to poverty alleviation. Hence, client selection can be strategized based on clients' religiosity, product knowledge, education, income, savings, and business experience need to be considered.

3. Methods

We combined critical realism (CR) and qualitative method to achieve our objectives. We utilised the CR approach to interpreting the ontological and epistemological values of *mudarabah, musharakah* and *musharakah mutanaqisah* (MM&M) instruments (Rees & Smith, 2017). The positivist approach of CR helped explain the implication of MM&M-based equity-financing (McGhee & Grant, 2017). From the theoretical point of view, MM&M deem befitting as micro-equity instruments to address poor entrepreneurs. To justify this ontological claim, in mid of 2018, we carried out a qualitative study interviewing three Islamic finance experts[7] of two academic scholars and one Islamic finance and banking expert. We

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[7] In this case, the sample size three (3) is considered sufficient (Daniel, 2012; Rapley, 2014).

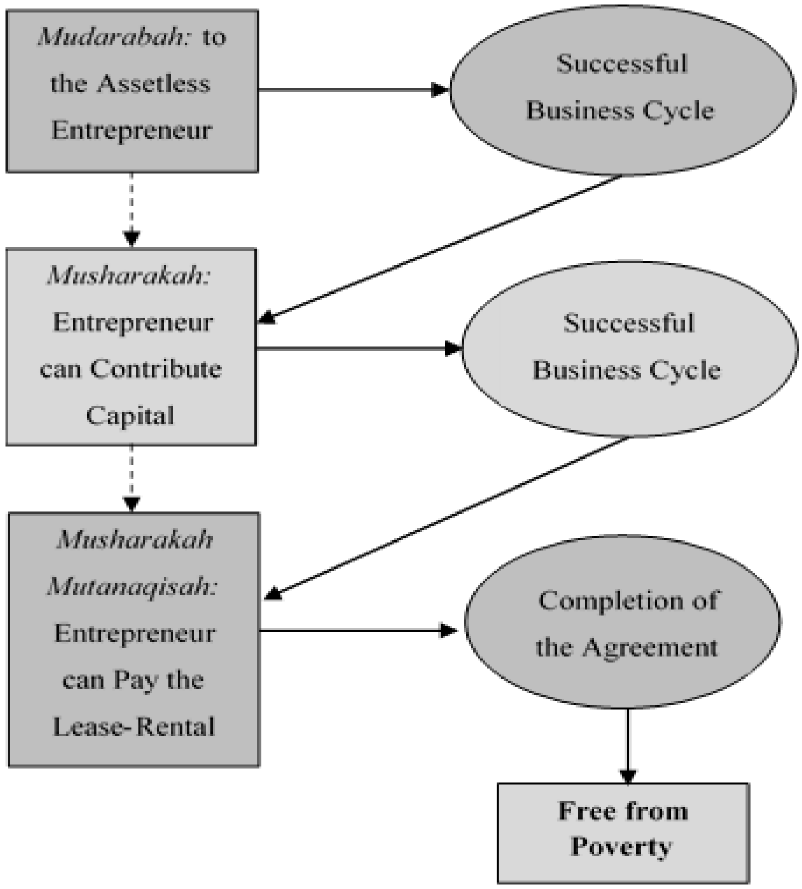
deliberately chose them based on their academic excellence, experiences, and distinguishing expertise (Anderson, 2010). To take a one-on-one interview, we instrumentalised an open-ended semi-structured questionnaire comprising some critical issues of MM&M microfinancing. Respondents opined on the client-recruitment process that includes religiosity, knowledge, and entrepreneurial skills. Besides, we looked for their assumption on the possible influence of Shariah rules on clients' entrepreneurial exercise. We sought their opinions on the importance of clients' academic education, income, savings, and business experiences to be eligible for MM&M financing. At last, we requested their suggestions for managing the possible risks in these financing approaches. Every interview session lasted about 30-35 minutes and was recorded with a digital voice recording device. To interpret the interviews, we transcribed the data and then adopted the multiple case studies method. We reported the findings by using thematic coding and classification techniques (Mills, 2010; Stake, 2013). Notably, all respondents gave us verbal and written consent to publish their opinions.

4.0 Findings

4.1. MM&M Microfinance: A Conceptual Model

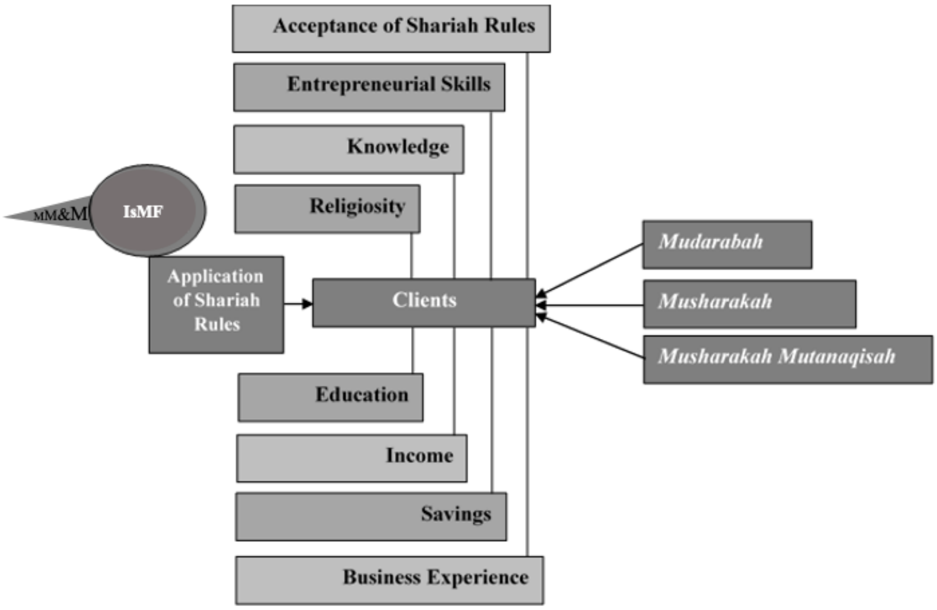
From the theoretical standpoint, *mudarabah, musharakah and musharakah mutanaqisah* (MM&M) can be offered as micro-equity products to poor entrepreneurs. In terms of providing *mudarabah* scheme the financing institution (*rab-al-mal*) needs to investigate clients' (*mudarib*) business skills and Shariah-compliant business proposals. After completing this contract, clients would be eligible for the *musharakah* scheme by contributing a share in the business capital. In the meantime, the microfinance institution would offer them the opportunity of acquiring tangible assets through diminishing *musharakah* (*musharakah mutanaqisah*) financing. The asset ownership would strengthen them to stand against economic shocks and vulnerabilities if they ever encounter them. Thus, this group of people would get rid of poverty sustainably.

Figure 3: Poverty Alleviation through MM&M Financing (by authors)



From the institutional perspective, a client of MM&M financing needs to be recruited based on some specific criteria. By synthesising the existing theories and empirical studies, we have conceptualised that a *mudarib* can be chosen based on four main attributes: religiosity, knowledge of MM&M, entrepreneurial skills, and the acceptance of Shariah rules. In the same vein, some other parameters such as education, income, savings, and business experience need to be considered. In this light, a comprehensive model is delineated below:

Figure 4: Financing Process (by authors)



4.2. MM&M Model as an SL Approach

The profit and risk-sharing principles distinguishably characterise Islamic finance, and *mudarabah* and *musharakah* (M&M) practices manifest the central tenets of this financing system. The MM&M investment can ensure greater benefits to the Islamic microfinance institutes and the clients in the long run. The integrated financing model (**Error! Reference source not found.**) can presumably assist the entrepreneurial poor to overcome poverty while acquiring tangible assets. Poor entrepreneurs can get access to *mudarabah* financing with no collateral. Afterwards, the success of the venture can lead *mudarib* to *musharakah* partnership. Once *mudarib* is involved with the *musharakah* contract as a partner, s/he will be proven capable of managing the business masterfully. The share of clients' investment in *musharakah* scheme will complement the collateral too. Therefore, shifting from *mudarabah* to *musharakah* contract will make the investment more secure and stable. Besides, people with high entrepreneurial qualities can handle riskier businesses, which probably yields a higher profit margin. As a result, the profit share of MM&M could be higher than the amount of predefined interest. Therefore, IsMFIs would gain higher financial benefits than interest-based conventional MFIs.

4.3. Experts' Opinions for MM&M Model Justification

To validate and justify our conceptual model (Figure. 4), we took one-on-one in-depth interviews of three Islamic finance experts (their brief biographies are available in Appendix 1., Appendix 2., and Appendix 3) by adopting the qualitative method. Five (5) themes were combined to make a comprehensive discussion. Theme (1): MM&M based micro-equity financing; Theme (2): selection criteria based on religiosity, knowledge and entrepreneurial skills; Theme (3): selection criteria based on education, income, savings, and business experience; Theme (4): influences of Shariah principles on business, and Theme (5): suggestion for the risk management. The comments of the experts are graphically presented below by using specific thematic codes [See Figure (5); Figure (6) and Figure (7)].

Figure 5: Thematic Codes (Academic Scholar One)

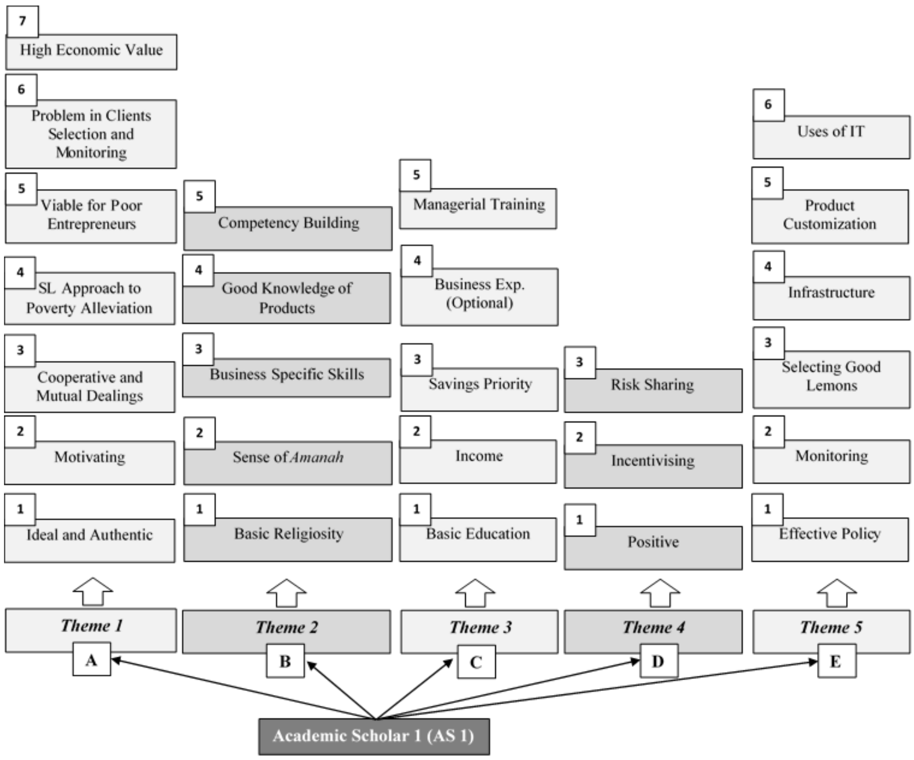


Figure 6: Thematic Codes (Academic Scholar Two)

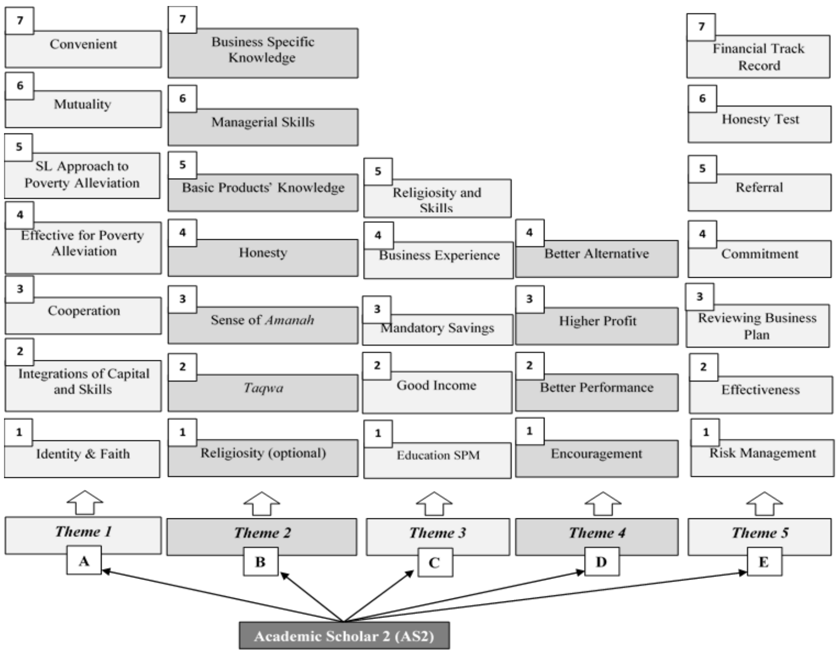
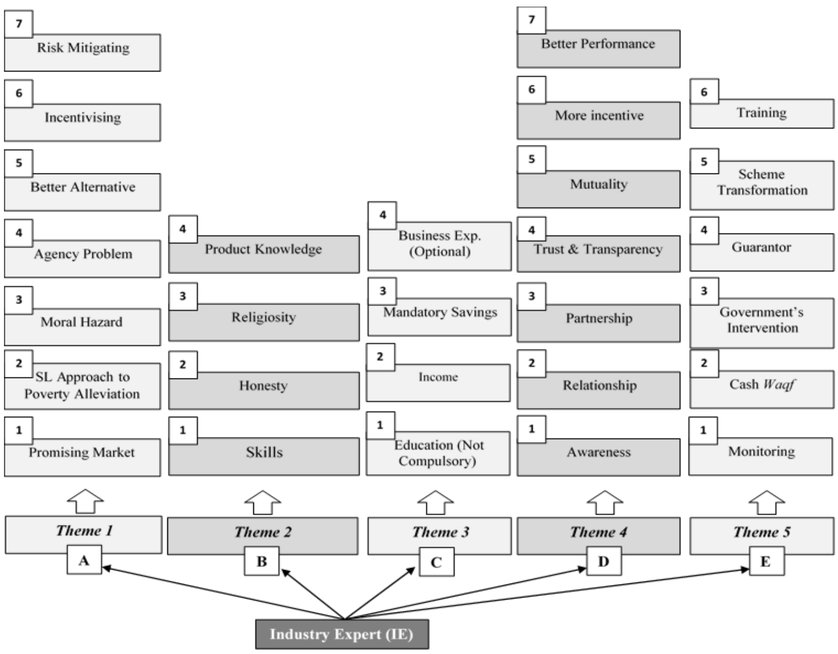


Figure 7: Thematic Codes (Industry Expert)



5. Results and Discussion

5.1. Theme (1): MM&M Based Micro-Equity Financing

The first academic scholar (**Error! Reference source not found.**: AS1. $A_{1, 2, 3, 4, 5, 6 \& 7}$) defined *mudarabah, musharakah* and *musharakah mutanaqisah*-based micro-equity financing as an ideal system for poverty alleviation. This profit and loss sharing (PLS) financing mainly functions with cooperation and collaboration between the financer and clients. The incorporation of *musharakah mutanaqisah* in microfinancing can be regarded as the sustainable livelihood approach to poverty alleviation. Because this instrument offers the ownership of tangible assets to poor people. This opportunity as a motivating driver can enhance clients' economic performances. MM&M as micro-equity instruments can stimulate microenterprises and thus, positively impact the economy. Some challenges might appear in the case of identifying the appropriate clients and monitoring them during business operations.

According to the second academic scholar (**Error! Reference source not found.**: AS2. $A_{1, 2, 3, 4, 5 \& 6}$), this financing model can manifest Muslims' identity and faith well. By using these instruments, it would be easier to integrate the capital of one party and the skills of another. Both parties would be cooperative in these partnership businesses because of having bilateral interests. He affirmatively opined that the application of *musharakah mutanaqisah* could be a way forward to poverty alleviation in a sustainable manner. The practice of this financing can reinforce mutuality in the socio-economic paradigm. But moral hazard could be a potential threat to this financing mechanism.

According to the industry expert (**Error! Reference source not found.**: IE. $A_{1, 2, 3, 4, 5, 6 \& 7}$), this model is easy to implement in the promising and ready marketplace. Many Muslims, specifically, who are currently involved with Islamic commercial banks, are familiar with *mudarabah, musharakah* and *musharakah mutanaqisah* instruments. Besides, the sustainable livelihood approach can be exercised through *musharakah mutanaqisah* instrument. The ownership of tangible assets/ fixed properties will strengthen poor people to stand against vulnerabilities and economic shocks while improving their financial status. This model could be a better alternative to conventional microfinancing. It can provide a higher incentive to the poor. But there are possibilities of moral hazard and agency problems.

It is worth mentioning, according to the Shariah law, in the *Mudarabah* financing *rab-al-mal* is not authorised to participate in the business management and take legal actions against *mudarib* even if the business yields any loss (Bacha, 1997; Khan, 2008). Therefore, reluctant or demoralised *mudarib* may take advantage of these rules. Besides, there are possibilities of adverse borrower selection, moral hazard, and the exposition of the discretionary power of entrepreneurs in both types of financing (Khalil et al., 2000; and Khan and Ahmed, 2001). With the view to grasping a higher profit margin than the agreed ratio, immoral entrepreneurs may hide business-related information while concealing the actual amount of profit. In the same way, agency problems might appear due to entrepreneurs' (*mudarib*) overconsumption, under-reporting profit, and shirking risks (Khalil et al., 2000). Intrapreneurs might provide imperfect and asymmetric information that would also cause *ex-ante* and *ex-post* hazards. Consequently, the financer would get less than the investment's expected profit (Iqbal and LIewellyn, 2002).

5.2. Theme (2): Knowledge, Religiosity, and Entrepreneurship

The thematic codes presented in Figure (5), Figure (6), and Figure (7) point out that all three experts unanimously agreed with the proposed client-selection methods that include knowledge, religiosity, and entrepreneurial skills (AS1. $B_{1, 3 \& 4}$; AS2. $B_{1, 5 \& 6}$; & IE. $B_{1, 3 \& 4}$). But they stressed clients' skills and honesty (AS1. B_3 & B_5; AS2. $B_{4 \& 6}$; & IE. B_1). In addition, one academic scholar prioritised their sense of *Amanah* (AS1. B_2) and another scholar shed light on *Taqwa* along with *Amanah* (AS2. $B_{2 \& 3}$). All experts neither totally denied nor fully accepted religiosity as the sole criterion of honesty. They emphasised the necessity of having skills and knowledge. They also suggested that microfinance institutions should conduct certain programmes to improve the skills and knowledge of the clients.

5.3. Theme (3): Education, Income, Savings, and Business Experience

Experts were univocal [according to the thematic codes depicted in Figure (5), Figure (6), and Figure (7)] to the importance of clients' education, income, savings, and business experience (AS1. $C_{1, 2, 3 \& 4}$; AS2. $C_{1, 2, 3 \& 4}$; & IE. $C_{1, 2, 3, \& 4}$). Notably, one academic scholar opined that business experiences should be taken as an optional criterion (AS1. C_4) since entrepreneurial skills can be developed by providing training (AS1. C_5). Another scholar modestly prioritised the importance of institutional (formal) education (AS2.C_1). He opined that poor people might not get enough privilege to get access to higher education. But a minimum qualification, which is sufficient for bookkeeping and managing business-related accounting, should be accepted. He also suggested for keeping a balance between religiosity and skills (AS2.C_5). In the same vein, the industry expert opined that education and business experience could be regarded as optional factors (IE. $C_{1 \& 4}$). He assumed that people might have good entrepreneurial qualities even without having higher education and experience.

In brief, all respondents agreed, education, income, savings, and business experiences are the essential parameters to recruit clients for M&M financing. But none of these attributes should be expected at the optimum level. They stretched on ‘savings’ so that clients can switch from *mudarabah* to *musharakah* scheme. From the organisational point of view, this transformation can lower the risk in MM&M financing. Besides, clients might get a higher share of the profit by contributing capital to the business (in *musharakah* agreement). Savings can help clients to be involved with *musharakah mutanaqisah*. And thus, they will get the opportunity to own assets.

5.4. Theme (4): Impact of Shariah Principles on Entrepreneurship

All the respondents asserted [according to the thematic codes as portrayed in Figure (5), Figure (6), and Figure (7)] that Shariah principles would positively impact clients’ enterprising exercise. In this regard, one academic scholar pointed out two specific reasons: incentive offering and risk-sharing. Shariah principles seemingly offer a higher incentive for the poor *mudarib* while sharing the business risk (AS1. $D_{2 \& 3}$). In the same vein, another scholar underscored three causes: encouragement by loss sharing, offering higher profit margin, and being the better alternative in terms of sharing capital, managerial skills, and risks (AS2. $D_{2, 3, \& 4}$). Above all, PLS principles encourage entrepreneurs to pursue or rejuvenate business by offering risk sharing. For these reasons, *mudarib* dares to take the riskier venture to gain higher profit. However, the industry expert delivered different insights. He pointed out various features of Shariah principles such as incentives, trust and relationship-based business agreement, partnership, mutuality, transparency, and performance orientation (IE. $D_{1, 2, 3, 4, 5, 6, \& 7}$). These attributes should have positive impacts on the business. Based on the above discussion, it can be concluded that Shariah principles of MM&M financing will positively impact clients' enterprising exercises that must yield better outcomes. Therefore, the poor entrepreneur will presumably, accept the underlying Shariah rules of these financing instruments.

5.5. Theme (5): Suggestions

At the end of each interview session, respondents were asked for suggestions for implementing MM&M-based microfinancing. One academic scholar suggested (**Error! Reference source not found.**) that efficient policies need to be formulated for a sound financing mechanism and effective monitoring system. This respondent also stressed the proper client selection, robust organizational infrastructure, product customization (needful amount of capital for each business), usages of information technology, and government intervention (AS1. $E_{1, 2, 3, 4, 5, 6, \& 7}$). In this regard, another academic scholar (**Error! Reference source not found.**) gave importance to risk management and operational effectiveness. He also emphasized the thorough review of business proposals that clients will produce reliable referrals to nominate the appropriate clients and the sound examining process of clients' honesty (AS2. $E_{1, 2, 3, 4, 5, \& 6}$). The industry expert (**Error! Reference source not found.**) stressed the effective way of monitoring, integrating cash *waqf* to mitigate financial risk, government's involvement in reducing the administrative cost as well as the cost of capital, third-party guarantor to resolve clients' risk, the proper process of scheme transformation (switching one from *mudarabah* to *musharakah*), and providing entrepreneurial training to enhance clients' skills and knowledge (IE. $E_{1, 2, 3, 4, 5, \& 6}$).

6. Conclusion

In light of the above discussion, it can be concluded that from the ontological point of view, MM&M based microfinancing can be regarded as a sustainable livelihood approach to poverty. The experts were univocal about the implications of these instruments for poverty alleviation. They unwaveringly supported the attachment of *musharakah mutanaqisah* as an effective tool for the sustainable livelihood approach to poverty reduction. This instrument was univocally accentuated as efficient for availing ownerships of tangible assets to poor entrepreneurs. They defined religiosity, knowledge, and entrepreneurship as the essential parameters for client selection. They also added clients' honesty could be measured by other criteria rather than religiosity. In this case, proper referrals, long-term observation (when clients are involved with other financial schemes), reviewing their previous financial transactions etc. can be considered. They stressed more on training programmes to enhance clients' entrepreneurial skills. Besides, clients should have formal literary, income, savings habits, and business experiences. However, these attributes seem to be less necessary conditions. Every respondent opened that Shariah principles should have a positive impact on the entrepreneurial exercise. They further added that if clients are taught the core meaning and purposes of Shariah principles, they (clients) will accept the rules of MM&M financing more spontaneously. Proper policy formulation, infrastructure building, client selection process, government intervention, installation of information technology and good management can help build a robust organisational infrastructure.

Similarly, referral, honesty-test, and close monitoring can effectively regulate clients' activities. Some other factors such as education, income, savings, and business experiences of the clients can be taken into account. Effective policy formulation for risk-leveraging and risk-mitigating is crucial. In this regard, involving the third-party guarantor, incorporation of *cash-waqf*, and the use of information technology can ensure organisational sustainability. Thus, MM&M financing can be extended to poor Muslim entrepreneurs to bring them out of poverty in a sustainable manner.

6.1. Limitations

This study has certain limitations. It was confined to three equity instruments namely, *mudarabah*, *musharakah* and *musharakah mutanaqisah*. We intentionally avoided *muzarah* (one kind of *mudarabah*) and *mushakah* (one type of *musharakah*) those are applicable to agrarians. Besides, our model does not adopt *shirkat-ul-a'mal and shirkat-ul-wujooh.* Notably, in the *shirkat-ul-a'mal* agreement, all partners render services to earn fees. Under the *shirkat-ul-wujooh* agreement, partners purchase the commodities at a deferred price and sell them on the spot. We vetted our proposed model by the selected experts. Hence, experts' opinions were somehow limited to a certain extent. They might not exercise unbound liberty to opine on other peripheral issues. Besides, this financing model might encounter numerous risks in practice. We might overpass the potential risk factors. Therefore, further research is needed to scrutinise the issues unaddressed by this study.

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