



CREATING SUSTAINABLE LIVELIHOOD OPPORTUNITIES FOR THE B20 COMMUNITIES THROUGH ISLAMIC MICROFINANCE PRODUCTS AND SERVICES

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ABSTRACT

It is crucial to establish sustainable livelihoods and distribute wealth in order to ensure inclusion across rural and urban regions as well as between various ethnic groups. Microfinance, as one of the social finance instruments, could help the underprivileged gain access to capital. Islamic microfinance, unlike conventional microfinance, avoids *riba* and is based on Shariah principles. The government of Malaysia categorises families according to their income, and it utilises this data to create policies targeted at bridging the income gap between the B40 and higher income groups as well as between rural and urban populations. In ensuring that all citizens, particularly B20 communities, have access to Islamic finance, the development of Islamic microfinance products based on profit and loss sharing is critical. Debt-based, interest-free loans and equity-based Islamic microfinance are available. The majority of debt-based instruments are based on *tawarruq* or commodities *murabahah*, with *qardhul hasan* being utilised for interest-free loans. However, equity-based instruments such as *musyarakah* and *mudharabah* are not used by any microfinance institutions. Specifically, *musharakah mutanaqisah* model is seen as a potential product that can be applied in Islamic microfinance. This paper proposes that Islamic microfinance through *musharakah mutanaqisah* as a viable mechanism for creating sustainable livelihood opportunities, especially for the lower B20 communities.

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1. INTRODUCTION

Sustainable development goals (SDGs) were set up by the United Nations General Assembly (UN-GA) in 2015 and aimed to be achieved by the year 2030. It has seventeen interlinked global goals as a “blueprint” to achieve a better and sustainable future for all. The first goal is no poverty, and the second goal is zero hunger which is related to the first goal. In Malaysia, poverty is still an issue that need to be solved and it is getting worse because of the pandemic covid-19 that plagues the world today. Based on the study done by the Department of Statistics, the number of poor households increased to 639.8 thousand household in 2020 as compared to 405.4 thousand households in 2019. The incidence of absolute poverty also increased from 0.4 percent in 2019 to 1.0 percent which involved 78 thousand households as compared to 27.2 thousand household in 2019 (Department of Statistics, 2021).

Due to the pandemic, most of the households faced a decline in income whereby many households from higher income group shifted to lower income group. The government has implemented a series of movement control orders (MCOs) starting on 18 March 2020 to curb the spread of the covid-19 virus. The MCOs encompassed restrictions on movement, assembly, and international travel, and mandated the closure of business, industry, government, and educational institutions that cause economic and social activities to cease. It gave negative impacts on jobs, incomes, and livelihoods and exacerbating inequalities, poverty, and hardships especially among the most vulnerable. Most of the hardcore poor in Malaysia depend on daily income jobs such as rubber tapper, fisherman, and selling local fruits and vegetables. They do not have a regular monthly income and enough saving to cover their daily expenses. Therefore, creating sustainable income is important to ensure that they have sustainable livelihood.

Sustainable livelihood is a concept that has been debated by many scholars nowadays within the context of rural development, poverty alleviation, and environmental management. The concept was developed by Chambers and Conway in 1991 to capture the livelihood and the nature of poverty. Chambers and Conway were defined livelihood as comprise of 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 & Conway, 1992). The main aim of sustainable livelihood was to study in depth the actual condition of the poor and determine the suitable livelihood for the poor by planning new programmes for livelihood sustainability (DFID, 2001).

Microfinance has been proven as a tool in helping eradicating poverty around the world. It is a financial service offered by the microfinance institutions to the poor to start up a business or for working capital purposes. The loan is small as low as RM1,000 with a tenure of 1 month to a maximum 7 years. The approval time from submission of full documentation just take 2 to 6 working days only. However, most of the microfinance institutions charge high interest rate because of high transaction cost where to maintain the sustainability of the microfinance institutions, usually, they will charge high administration costs up to 20% (Murdoch, 2000; Rosenberg, 2002; Obaidullah, 2008).

On the other hands, the microfinance institutions need to maintain the repayment rate to secure the funds because most of them are non-government organizations

(NGOs) that received funds from the government and donors. It drags them to give loans to not very poor to ensure they can pay back the loans. Thus, the main aim of microfinance was not achieved and could not help the hardcore poor out of the poverty trap. There is also self-exclusion from the poor because of the nature of the product that does not meet their expectation (Adewale & M. Daud, 2010). Most hardcore poor do not want to get involved with debt because they are afraid of not being able to pay it back and some of them do not involve because of the product is not shariah compliant.

In Islamic finance, the potential of Islamic social finance for serving financial inclusion is largely untapped and underutilized. There is a perception that Islamic social finance is only for religious and charitable purposes such as *waqf* and *sadaqah*. Islamic social finance is not utilized for related productive activities, in the contemporary Islamic economy, in which Islamic social finance is more to corporate social responsibility (CSR) activities and outside from the commercial Islamic financial services industry. Commercial bank has difficulty to provide financial services to the hardcore poor because of lack of “cost-efficient” model to make it sustainable (BIMB, 2021).

Therefore, Islamic social finance services such as *waqf* and *sadaqah* are mostly offered by the Islamic religious council and NGOs. Meanwhile, Islamic microfinance is mostly offered by the government agencies such as TEKUN, MARA and PUNB where funds are obtained from the government in the form of grants. They need to pay back to the government within the stipulated period. Besides, there are also NGOs that offer Islamic microfinance services such as Amanah Ikhtiar Malaysia (AIM) and Yayasan Usaha Maju (YUM) where the funds are from the government and donors.

The Islamic microfinance product offered by these institutions is a debt-based product using *tawarruq* contract. *Tawarruq* is a type of *murabahah*, mark up cost or commonly known as commodity *murabahah*. It consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis (BNM, 2018). *Tawarruq* is a controversial Islamic financial product as it is believed by some of the scholars that it contains elements of usury and *hilah* (legal stratagem) (Ahmad et al., 2017; Yusuf & Ndiaye, 2017). Ibn Qayyim is of the view that *tawarruq* is impermissible, and he strongly believes that it is as a fraudulent practice against Allah (SWT) and Shariah (Meera, 2015; Ahmed et al, 2012). Despite, the disagreement between the permissibility of *tawarruq* between Islamic scholars, *tawarruq* is an improvement from Bai al-inah contract and thus provide an alternative financing compared to *riba* financing. Nevertheless, the use of equity-based could be explored in order to provide a better financing instrument in Islamic finance especially for micro financing.

Thus, this paper tries to explore equity-based Islamic microfinance products that suit to the bottom 20 percent of household income (B20). The rest of the paper is structured as follows. Section 2 discusses classification of household income in Malaysia while section 3 discusses the incidence of poverty in Malaysia. Section 4 explores the criticism of conventional microfinance and section 5 discusses the potential of application of Islamic microfinance that based on equity financing. This paper ends with a conclusion in section 6.

2. CLASSIFICATION OF HOUSEHOLD INCOME IN MALAYSIA

In Malaysia the household income is categorized into three major categories namely T20, M40 and B40. The name of T20, M40 and B40 represent percentages of the country's population which is Top 20%, Middle 40% and Bottom 40% respectively. The group categories are then subdivided into ten categories based on ten percentiles. Table 1 shows that the bottom 10 percent (B10) held 2.4 percent of total income with a mean income of RM1849 and it is below the poverty line index in Malaysia which is RM2208. Whereas the bottom 20 percent (B20) held 3.5 percent of total income with a mean income of RM2803. The B20 and B10 are categorised as hardcore poor. With an inflation rate rise to around 4 percent in 2022, the useable income is decreasing especially to the B20 and B10.

The values may increase or decrease year-to-year, in which the median household income is used as the determinant. The government has implemented this categorisation since the 10th Malaysian Plan to ensure no group is left behind or missed the opportunity to enjoy the current development of the country. This categorisation is used by the government for the purpose of policy development and implementation for example regarding financial assistance to the citizens. Besides, it also been used for poverty monitoring where the government can plan and implement strategies to lessen the gap of each household's gross income.

Table 1: Household income classification in malaysia in 2019

Decile Group	Income Share (%)	Median Household Income (RM)	Mean Household Income (RM)	Income Threshold (RM)	
T20	T2	30.7	19,781	24,293	More than 15,039
	T1	16.1	12,586	12,720	10,960 - 15,039
	M4	12.3	9,695	9,730	8,700 - 10,959
M40	M3	9.9	7,828	7,841	7,110 - 8,699
	M2	8.2	6,471	6,477	5,880 - 7,099
	M1	6.8	5,336	5,346	4,850 - 5,879
	B4	5.6	4,387	4,395	3,970 - 4,849
B40	B3	4.5	3,556	3,561	3,170 - 3,969
	B2	3.5	2,786	2,803	2,500 - 3,169
	B1	2.4	1,929	1,849	Less than 2,499

Source: Department of Statistics, 2020

Based on the survey done by the Department of Statistics (DOS) in 2019, it shows that mean monthly household income for B40 is lower than median income. This indicates that the income distribution in the B40 household group is skewed to the right where most low-income households affect the value of average income. The situation is different for the M40 and T20 household groups where each recorded a higher average income compared to the median income. M40 households recorded mean income of RM7,348 while the median income was RM7,093. T20 households recorded mean income and median income of RM18,506 and RM15,031 respectively

(Department of Statistics, 2020). These findings indicate that the income distribution is negatively skewed or skewed to the left where high-income households are mostly accumulated on the right side of the distribution causing the median income to be lower than the average income. It shows that there is an income gap between B40 and M40 and T20 in Malaysia.

3. THE INCIDENCE OF POVERTY IN MALAYSIA

In general, the absolute poverty rate in Malaysia shows a significant decrease to only 0.4 per cent in 2016 compared to 49.3 per cent in 1970 (Department of Statistics, 2020). The absolute poverty is a situation in which household income is insufficient to meet basic needs of food, shelter, and clothing. It indicates the poverty alleviation program done by the government was successful. However, in terms of relative poverty, it showed upward trend since 2014. Based on the Household Income Survey (HIS) in 2019, the poverty rate is quite high which is 16.9 per cent, increased by 1.3 per cent as compared in 2016. The relative poverty is defined as households who are relatively poor when the average monthly income is less than 50 per cent of the national median income. The threshold value of relative poverty depends on the distribution of household income. It takes into account the changes in the quality of life in line with the economic development. In 2019, the number of households categorised as relatively poor is 1.24 million households compared to 1.1 million in 2016 and 1.04 million in 2014 (Department of Statistics, 2020).

It is an alarming sign and action needs to be taken where it can become worse after the covid-19 pandemic. When the government implement a series of MCOs in 2020 and 2021, paid employment and self-employment which were the main sources of household in Malaysia recorded a decrease of negative 16.1 percent and negative 9.7 percent respectively (Department of Statistics, 2021). This is due to the many household experience loss and reduction of income not because of job loss but also because of reduction of working hours and increase in skill-related underemployment. Thus, many households from higher income decile group shifted to lower income group. Total B10 who income less than RM2500 was increased by 12.5 percent in 2020. Meanwhile, 20 percent of households from the M40 group shifted to the B40 group that make the gap between T20 and M40 and B40 become larger.

In terms of ethnic inequality, it shows that Bumiputera still far behind compared to other races Chinese and Indian. A study done by Ravallion (2020) revealed that despite the progress against relative inequality, Malaysia's absolute disparities by ethnicity are larger than 50 years ago. The rising absolute ethnic disparities reflect the extent of the initial ethnic inequality, as well as the pattern of growth by ethnicity. Based on the HIS 2019, the mean monthly income for Bumiputera is far below the other ethnics and national mean monthly income since 1974. It shows that in the past 5 decades, Chinese received the highest income and followed by Indian as shown in Figure 1 despite many programs have been implemented to reduce the gap.

In 2019, the income gap of average household between Bumiputera and Chinese is RM2,802. Meanwhile Indian to Chinese is RM1,679. Regarding the income strata, the gap between urban and rural is huge about 58 percent where the income gap of average household between rural as compared to urban was RM3,631 in 2019 (Department of Statistics, 2020). Thus, it is crucial to help the rural poor to break themselves free from the cycle of poverty and shared together the prosperity of Malaysia.

The government has set up 2030 Shared Prosperity Vision (SPV 2030) to make Malaysia a sustainable developing country which associate with equitable, fair, and inclusive economic distribution across all levels of income, ethnicities, regions, and supply chains. The SPV 2030 aims to provide a decent standard of living to all Malaysians by 2030. It targets to address economic disparities across income groups, ethnicities, regions, and supply chains to protect and empower the citizens in ensuring that no one is left behind.

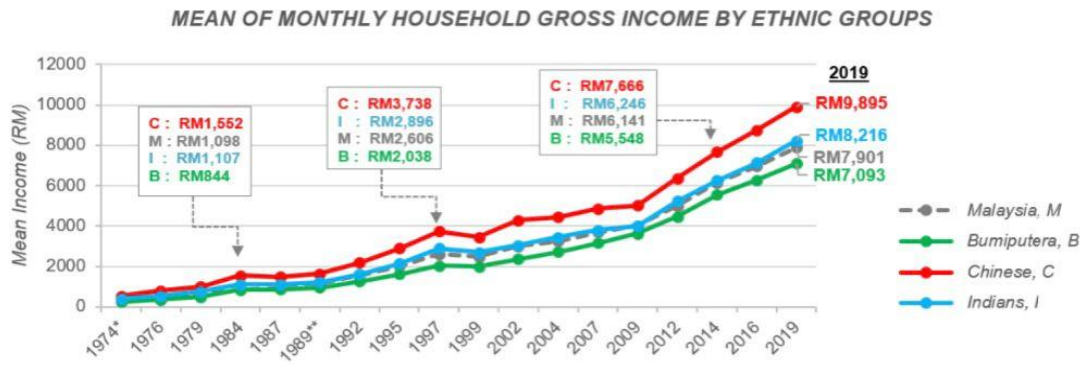


Figure 1: Mean monthly household gross income by ethnic groups in Malaysia
Source: Department of Statistics, 2020

Referring to the Incidence of absolute poverty by ethnic group, strata and state, Malaysia, 1970 – 2019 published by Economic Planning Unit, Prime Minister’s Department (EPU, 2022), the highest poverty rate is Sabah (19.5 percent), Kelantan (12.4 percent), and Sarawak (9.0 percent). The median income for Sabah is RM 4,235, Kelantan is RM 3,563, and Sarawak is RM 4,544. The median income for all Malaysia states is RM 5,873 and the state highest median income is Putrajaya with RM 9,983 while Kelantan recorded with the lowest median income with RM 3,563 (Department of Statistics, 2020). The high median income for people living in urban Malaysia like Kuala Lumpur, Putrajaya, Penang, and Johor indicates that the issue of income inequality and poverty have been widening in Malaysia.

4. THE CRITICISM OF CONVENTIONAL MICROFINANCE

Microfinance's involvement in poverty alleviation is a hot topic among academics and practitioners studying emerging nations. Microfinance mainly refers to microcredit, is a financial service provided to unemployed or low-income individuals or groups who are excluded from the normal banking services. Microfinance give opportunity to the unbankable person to acquire credit, save money, have insurance, and make payments on their debt. Underprivileged people have access to finance through microfinance, achieving the goal of financial inclusion. Microfinance is based on ‘trust’, loans are not pledged by collateral, or legally enforceable contracts (Yunus, 2007).

Microfinance has been welcomed by economists as an alternative to the traditional moneylending who is typically perceived as being exploitative by charging exorbitant interest charges. Since the late 1990s, microfinance has been highlighted as a successful program, resulting in the recognition of the 2006 Nobel Peace Prize to the founder of Grameen Bank, Professor Muhammed Yunus but then it started to become heavily criticized. The precipitous decline in popularity is partially due to an

increase in thorough analyses of microcredit's effects, which reveals that effect sizes are considerably less than predicted and non-transformative (Hermes & Lensink, 2021).

Furthermore, the commercialization of microfinance has sparked outrage since it has the potential to lead to mission drift, a process in which wealthier clients are favoured over poorer ones (Cull, Demirguc-Kunt & Morduch, 2007). As a result of commercialization, microfinance institutions increased interest rate as high as 50 percent on a yearly basis, which has resulted in serious ethical concerns (Hudon & Sandberg, 2013). Lending to the poor is high risk caused lack of credit history, collateral, and documented records that make it difficult to assess creditworthiness of the borrower (Sengupta & Aubuchon, 2008). Therefore, many microfinance institutions apply group-based lending approach that need borrowers to form self-selected teams before received microcredit. Group members will guarantor among themselves in the event of default using joint liability contract. Even group-based lending can eliminate moral hazard and adverse selection problems, the previous studies also show that group-based lending give negative impact to the borrowers.

In group-based lending, a defaulter's loan became a financial burden for other members and give peer pressure to the group members (Paxton et al., 2000; Nandhi, 2012; Haldar and Stiglitz, 2016). Each member is exposed to the risk of additional costs generated by the failure of the other members' projects (Nandhi, 2012). Besides, a lack of efforts by some of the group members makes group loan repayment more problematic, which weakens the performance incentives for other. In addition, the borrower who defaults is visible to the entire village, which imposes a sense of shame and there are cases the borrowers end their life with suicide.

Microfinance requires borrowers to repay in small amounts but fixed repayment schedule, usually weekly repayment. For group-based lending, they are compulsory to attend group meetings at the stipulated centre every week to pay the loan. This makes the loan unattractive due to the high transaction cost of having to attend group meetings. The weekly repayment is also unattractive to the farmers because their income is irregular and uncertain depends on the crop cycles. Similar to the microentrepreneurs whose return on investments take time to materialise that make them self-exclusion from the microfinance service. Moreover, the group lending model is not of interest for some borrowers because of the commitment they need to hold along the borrowing period.

Microfinance has two objectives namely outreach and financial sustainable. Achieving both objectives is referred to as microfinance promise (Morduch, 1999). However, in practical, achieving both objectives may be difficult. Providing services to the poor is relatively high cost where most of the poor live in rural areas, do not have collateral, small loan amount that increase the risks and costs of lending. At the same time, microfinance institutions have limited funds. Their funding comes from donors, grants, and aids from the government and international institutions. Thus, the trade-off between outreach and financial sustainability leads to mission drift, shifting from focusing on poverty and outreach to financial sustainability (Mersland & Strom, 2010; Armendariz & Szafarz, 2011).

Mission drift occurs when microfinance institutions increase the provision of financial services to the wealthier clients at the cost of providing these services to poorer clients (Hermes & Lensink, 2021). Besides, to maintain their sustainability

many microfinance institutions have been accused of offering extreme lending rates, pushing borrowers to borrow from other microfinance institutions, to repay their debt.

In terms of products, in general, microfinance institutions offer simple and standardised products. They offer small loans with a fixed repayment schedule, no collateral, fast approval, and fewer documents needed. The loans are for business start-ups and working capital purposes. Besides microcredit, there are other products offered such as micro saving, and microinsurance. The main challenges faced by the poor is cash flow management. Their main inflows come from income, gifts, family and aids and the inflows are small, irregular, and uncertain. Whereas, for outflows, they need to pay basic needs, school fees, medical expenses, and others. Usually, the outflows are more than the inflows make the poor afraid to borrow and reject the microfinance. On the other hands, conventional microfinance charges lending rate using interest rate and it is prohibited in Islam. Interest or known as *riba* is literally means “to grow” or “expand”. In Shariah, it refers to the “premium” that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity (Chapra, 1986). Thus, the conventional microfinance is rejected by Muslims for not shariah compliant.

5. THE POTENTIAL OF APPLICATION OF ISLAMIC MICROFINANCE THAT BASED ON EQUITY FINANCING

Islamic microfinance is a new area in the Islamic finance that has not been fully tapped such as the Islamic banking and Islamic financial market. Islamic microfinance is seen as the Islamic social finance product that is being offered by religious and charitable institutions only. Islamic social finance activities fell outside the regulatory of the financial sector. In Malaysia, Islamic microfinance is largely offered by the microfinance institutions such as AIM, and TEKUN, and government agencies such as MARA, and PUNB. There are banking institutions that offered Islamic microfinance under the microfinancing scheme such as Maybank, Bank Islam, Bank Muamalat and CIMB Bank.

These products are offered to micro -entrepreneurs for start -up businesses and for working capital purposes. The size of the financing is as low as RM1,000 to RM50,000 with a financing period of 1 month to a maximum of 7 years. The financing rates charge by these institutions is high up to 15% per annum due to the high transaction cost. Since the average microfinancing is small in size hence the transaction cost on a percentage basis is high. High transaction costs result in charging high administration/financing costs up to 30% (Fersi & Boujelbéne, 2016).

In terms of shariah contract, almost all institutions offered debt-based financing namely *tawarruq* (commodity *murabahah*). *Tawarruq* is a popular product offered by the Islamic banking nowadays (Ismon, 2012). Salwana et al., (2013) revealed that many Islamic financial institutions prefer to use *murabahah* because it requires no credit record of the clients, there is the existence of well-defined contracts, and lower administrative costs. *Tawarruq* was officially endorsed as a permissible instrument to be used in financial market especially for personal financing by the Shariah Advisory Council of Bank Negara Malaysia on 28 July 2005 (Dusuki, 2007). The purpose of this contract is to obtain cash immediately from another party (Zuhaily, 2007).

Tawarruq contract is controversial and is not accepted by some scholars such as Omar ibn Abdel Aziz and Ibn Taimiyyah because it contains elements of usuary and *hilah* (Ahmad et al., 2017; Yusuf & Ndiaye, 2017). Other scholars forbid *tawarruq*

because of *mafasid* overwhelm *masalih*. Among the harmful effect of *tawarruq* are it leads to creation of debt where it results in exchange of money now with more money in future, which is unfair in view of the risk (Ismon, 2012) especially to the poor. Therefore, the application of *tawarruq* contracts in Islamic microfinance is not the best way even though it is permissible according to the Shariah Advisory Council. Ahmed et al (2012) concluded that *tawarruq* is categorized as *shubuhah* because of a conflict of views between scholars of Shariah, the religious councils, and the bodies to the legitimacy issues of *tawarruq*, as indicated by the presence of Imam al-Ghazali's *shubuhah* due to a mismatch (contradiction) between the evidence and the lack of clarity to this *tawarruq*.

In Islamic finance *qardhul hasan* (benevolent loan) is the best financing for the poor. It's an interest free loan where the clients only repay the principal without any extra charges. The Quran clearly encourages Muslims to provide *qardhul hasan* to "those who need them" as mentioned in the Surah Al-Baqarah, Ayah 245.

"Who is he that will lend to Allah a goodly loan so that He may multiply it to him many times, And it is Allah that decreases or increases (your provisions), and unto Him you shall return on the Day of Resurrection"

However, in practical, it is allowed to charge a service charge for the administration of the financing. The service charge is not a profit, but actual costs related to the financing. According to Shahinpoor (2009), the scheme is relevant for micro-entrepreneurs who need immediate cash and has good potential to make a full settlement. Here, the Islamic microfinance institutions will bear the credit risk and they need to choose the right technique to ensure repayments will be received as agreed. Therefore, this type of financing is suitable for NGOs who offer Islamic microfinancing and less suitable for banking institutions unless under the CSR program like has been done by the Bank Islam Malaysia Berhad (BIMB).

BIMB has introduced new Islamic microfinancing known as Mikro Bangkit through crowdfunding platform namely Sadaqah House in 2020. The funds come from public donations. The product is offered to unbankable people who want to start a business or to expand their business. The purpose of financing is for working capital and capital expenditure. For this product, Bank Islam works with appointed Implementing Partners to identify potential micro-entrepreneurs among members, beneficiaries, or stakeholders. The microentrepreneurs are compulsory to attend business training and coaching program organized by the Implementing Partner before financing disbursement. It used a *qardhul hasan* contract with a 0% financing rate. The financing amount as low as RM500 to RM3,000 for start-up a new business and RM3,000 to RM20,000 for business expansion. The financing period is between 6 months to 3 years. This is a good initiative taken by Bank Islam to meet the objective of value-based intermediation and can be copied by other Islamic microfinance providers.

Besides *qardhul hasan*, equity-based financing is seen as the other best option for the poor and can be offered by all types of Islamic microfinance institutions. There are two types of equity-based financing namely *mudharabah* and *musharakah*. *Mudharabah* and *musharakah* are ideal mode of financing meanwhile *murabahah* is the most prevalent mode of financing that deserve serious thinking (Usmani, 2002). *Mudharabah* and *musharakah* are based on profit and loss-sharing partnership

contracts. Therefore, it helps the poor to run the business and decreases the financial burden if the business loses. *Mudarabah* is a type of financing where one party (the financier) will contribute the capital and the other party (the entrepreneur) will run the business. Both parties will share the profit but in terms of losses, only the financier will bear the losses unless it is due to the entrepreneur's misconduct, negligence, or breach of specified terms. *Mudarabah* is a contract based on fiduciary relationship. The concept of *mudarabah* has been applied in investment in the share where investors buy shares of the company and share the profit of the company. In terms of losses, they will bear the losses depending on their total investment only. Securities Commission Malaysia has offered Peer to Peer (P2P) financing to small-medium enterprises (SMEs) through crowdfunding platforms where investors can invest in SMEs and get returns from their investment which is similar to *mudarabah* concept. This concept can be applied in Islamic microfinance where interested investors can invest in microentrepreneur's business through Islamic microfinance institutions or Islamic microfinance institutions act as investor in microentrepreneur's business

Meanwhile, *musharakah* means sharing or partnership where two or more persons invest some of their capital in a joint commercial venture (*shirkatul-amwal*). The proportion of profit to be distributed must be agreed by all partners during the inception of the contract. Not only profit, but the partners also share the losses. According to Imam Shafi'i, the ratio of the share of a partner in profit and loss must both conform to the ratio of his investment (Usmani, 2002). Both partners are entitled to share, control, and manage the investment (Noraziah & Ghafar, 2010). This product is suitable for start-up a business where usually the poor lack capital and expertise in running a business. Through *musharakah*, the risk of losses will be reduced since both partners will manage the business.

On the other hands, some scholars also proposed *musharakah mutanaqisah* (diminishing partnership) such as Nawai (2021); Saad & Razak (2013); Samsudin & Ab Ghani (2015). *Musharakah mutanaqisah* (MM) is an instrument under *musharakah* that combines with *ijarah* (renting). Bank Negara Malaysia (2016) defines *musharakah mutanaqisah* may be entered into by two or more parties on a particular asset or venture which allows one of the partners to gradually acquire the shareholding of the other partner through an agreed redemption method during the tenure of the *musharakah* contract. MM is usually applied in home financing by Islamic financial institutions (Osmani & Abdullah, 2010). However, it also can be applied in other services such as trade, and business services while maintaining Shariah principles (Usmani (2002).

Meera and Razak (2009) showed that MM can be better alternative to replace the famous and controversial Bai` Bithaman Ajil (BBA) contract and MM is often cited as a fair and efficient Islamic financing (Smolo and Hassan, 2011). In the case of MM, capital is not permanent and every repayment of capital by the entrepreneur will diminish the total capital ratio for the capital provider. This will increase the total capital ratio for the entrepreneur until the entrepreneur becomes the sole proprietor for the business. The repayment period is dependent upon the pre-agreed period. However, as of now, the MM model has not yet been implemented by any Islamic microfinance providers in Malaysia. Table 3 shows the comparison between the Islamic microfinance products. It shows that in terms of risk and return, *musharakah* is seen as the best financing product for the poor. Both parties are responsible towards the business and will share the profit and loss together.

Table 3: Comparison between the Islamic microfinance products

Instrument	Role of Islamic MFI	Role of client	Suitable for	Return mechanism	Bearer of risk
Tawarruq	Seller	Buyer	Fixed assets, working capital	Fix rate (mark-up price)	Client
Mudarabah	Investor	Executer	Fixed assets, working capital	Profit sharing	Islamic MFI
Musharakah including musharakah mutanaqisah	Investor	Partner	Fixed assets, working capital	Profit sharing	Shared
Qardhul Hassan	Lender	Borrower	All purpose	None (zero financing rate)	Client

Source: authors' compilation

6. CONCLUSION

Creating sustainable livelihood and sharing prosperity are important in SDGs ensuring inclusivity between rural and urban areas, and different ethnics. Microfinance as one of the social finance instruments could play a role in providing access to funding for the poor. Unlike conventional microfinance, Islamic microfinance avoid *riba* and based on Shariah principles.

Malaysian households are categorised according to income and the government uses the categorization to formulate policies especially in reducing the income gap between the B40 and the higher income groups and between rural and urban settlers. Poverty incidents were identified in several states in Malaysia such as Kelantan, Kedah, Sabah, and Sarawak. Even though the absolute poverty in Malaysia has reduced significantly, the relative poverty remains a challenging issue for balance nation building. Income inequality remain the major challenge moving forward in addition to the impact of COVID-19 pandemic.

Microfinance could be one of the solutions for reducing the income gap between the have and the underprivileged by providing opportunities to the poor to gain access to capital and funds. In term of ethnicity, the gap between Malays, Chinese and Indians have widened since 1970s and majority of the B40s are Malays. Therefore, in providing access of funding via microfinance, the instruments offered should be affordable, participants' friendly and shariah compliance. Islamic microfinance can come in the form of debt based, interest free loans and equity based. Majority of debt-based instruments are based on *tawarruq* or commodity *murabahah* and the interest free loans used *qardhu hasan*. Nevertheless, not any institutions offering microfinance financing use equity based such as *musharakah* and *mudarabah*.

Specifically, based on the exploratory observation of some selected villages in the district of Baling, Kedah Darul Aman, the researcher has identified several practical approaches that could be adopted by relevant government agencies at federal and state level as well as private bodies. Some of the initiatives are highlighted below.

First, Islamic microfinance model by using *musharakah* especially *musharakah mutanaqisah* could be applied as practical financing tool to bridge inequality. Nonetheless, the status of borrower as *asnaf* in the category of *fuqara'* and *masakin* should not change. Therefore, in this case the application of collateral should not be imposed upon the community since they are not considered to be eligible for any

financing based on Islamic finance and banking perspectives. The risk must be borne by relevant socio and economic agencies such from the federal and state government or any private bodies or foundations.

Secondly, the application of *musharakah mutanaqisah* is mainly intended to ensure the cycle of economic and business activities of the community continue based on the real needs and interest of the people. This is to ensure the creativity of respected community as well as their knowledge and effort to free themselves from continuous poverty does not diminish and even fostered by the system. Direct financial contribution through *Zakah*, *Sadaqah*, or any other social supports system must be continued.

Thirdly, support systems to ensure community enterprises in the study area to grow must be strengthened. This includes the engagement of relevant parties that could help the community market their village products at a higher price with lower cost of production.

Education in term of economy, business, and social skills including psychological supports should be continuously offered to the community. One main issue that must be taken into consideration is community motivation to respond to any social initiatives by relevant agencies including universities. Social psychological support must take place with respect, humility, and care. Relevant parties or individuals that join this effort must be free from any hidden agenda to gain any political, economic, or social benefits to avoid any prejudice and trust issues at the community level.

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