

## Partnership Based Microfinance in Islamic Banks: Need, Application and Commandments in Modern Age

**Salman Ahmad Khan\***

Department of Islamic Thought and Civilization,  
University of Management and Technology, Lahore

**Ejaz Aslam**

Institute of Islamic Banking and Finance,  
International Islamic University Malaysia

### Abstract

There is no doubt that through endorsing different Islamic modes of financing, Islamic banks are showing the right way to people to free themselves from the menace of interest. However, it is equally necessary for Islamic banks to invest on poor members of the society. A keen observation of Islamic banks reveal that their greatest shortcoming is their inability and lack of interest in financing as well as investing on poor individuals of the society. The term 'Islamic banking' not only reflects the transitional modes of financing but also highlights the ideal modes of financing. Welfare of underprivileged members of the society is an important goal of the *Shari'ah*. Dr. Muhammad Younus founded Grameen Bank with the aim of providing capital to the underprivileged segment of the society, giving two dollars each, which also earned him a Noble prize. Unfortunately, a banker with an interest-based background felt the dire necessity of providing loans to the poor, regardless of the fact that this loan was interest-based and prohibited by the *Shari'ah*. His efforts were also appreciated worldwide. On the contrary, Islamic banks promoting Islamic financing still hesitate to invest on poor people, accusing them of default. Historically, this is an erroneous assumption, as poor people have the lowest level of default, while rich industrialists, politicians etc. usually have the highest level of default. So, it is the need of the hour to initiate microfinance in Islamic banks and its immediate launch should be closer to the goals of the *Shari'ah*. This article discusses the potential of microfinance and also proposes practical methods of microfinance, especially the methods that focus upon partnership. If Islamic banks adopt these modes of microfinance they can speedily grow in this field as well.

**Keywords:** Islamic banks, Partnership, *Salam*, *Istisna*, *Maqasid-e-Shari'ah*, *Muzara'ah*

### Introduction

The term 'Islamic banking' is not only a reflection of the transitional modes of trading but also demonstrates the ideal modes of trading. The central motive of *Shari'ah* is to help the needy or underprivileged members of the society and hence Islamic banks

---

\*Correspondence concerning the article should be addressed to Salman Ahmad Khan, (PhD), Assistant Professor, Department of Islamic Thought and Civilization, University of Management and Technology, Lahore, Pakistan, [salmana313@yahoo.com](mailto:salmana313@yahoo.com).

are responsible for investing on this segment of the society. Currently, a major shortcoming of Islamic banks is lack of financing initiatives at the micro level. Failure of Islamic banks in operating according to *Maqasid al-Shari'ah* (Goals of *Shari'ah*) can cause numerous obstructions in the path of *Shari'ah*. Dr Muhammad Younas<sup>1</sup> was awarded the noble prize, for setting an inspirational example and serving the poor segments of the society through micro crediting and microfinancing schemes. He provided each individual an amount of two dollars as a credit/loan. It is worth mentioning here that Dr Muhammad Younas was a banker by profession. Even coming from a traditional banking system which flourishes upon interest, he felt the need of financing the poor for their rehabilitation. On the contrary, Islamic banks claim of interest-free Islamic banking but are still diffident towards giving credit to the poor segments of the society. Moreover, at times they look for a resort by asserting that investing on poor people can be risky most of the times and can lead to financial losses. They are accused of high defaults whereas historically prominent business owners etc. have the highest level of default rates. So, it is imperative for Islamic banks to start microfinancing with immediate effect. This can help the underprivileged segment to start their own businesses with this capital, i.e., they can become vendors, tailors or can get involved in other such business prospects. There is no valid reason of why Islamic banks cannot invest on relatively poor segments of the society that are either working in fruit markets or use wheel carts, just because of having trust issues with them. According to Muhammad Umer Chapra:

Justice demands that some suitable innovation is introduced in the financial system to ensure that even small borrowers are able to get adequate credit at affordable terms to realize their dream of owning their own homes, pursuing education and vocational training and establishing micro enterprises.<sup>2</sup>

A report issued by the State Bank of Pakistan, 2016, highlighted that 60% of the bank deposits are drawn from 99% of accounts holders in Pakistan, while approximately 70% of advances go to those borrowers who are less than 1%. This shows that a small account holder receives a tiny portion of this amount. This situation is worse in national banks, where influential people get their debts waived off.<sup>3</sup>

Islamic banking should not be an 'only means' to avoid interest, as neglecting the '*Maqasid-e-Shari'ah*' and other modes of Islamic businesses can be very risky. These institutions which are introducing Islamic rules and regulations pertaining to the operation of Islamic banks should make sure that these banks abide by their authority and avoid unfair means or activities within their premises.

---

<sup>1</sup>[https://en.wikipedia.org/wiki/Muhammad\\_Yunus](https://en.wikipedia.org/wiki/Muhammad_Yunus)

<sup>2</sup>Muhammad Umer Chapra, *The Global Financial Crisis* (Kyoto: Centre for Islamic Area Studies at Kyoto University, Japan, 2009), 20.

<sup>3</sup>Ibid.

### 1.1. Objectives of this Research

1. To encourage Islamic banks to invest in microfinance industry.
2. To overcome the potential problems faced by Islamic banks in the field of microfinance.
3. To provide partnership-based modes of financing between Islamic banks and the poor.
4. To achieve the goals of the *Shari'ah* through microfinance.
5. To make the poor self-sufficient and alleviate them from poverty.

## 2. Literature Review

The term microfinance indicates "...the offer of financial services to clients with low-income level."<sup>4</sup> Microfinance is not a financing system but a tool for social change that plays a significant role in the advancement of the economy through distinct ways such as poverty alleviation, financial inclusion, financial stability, development of skills, mobilization of savings, and women empowerment etc.<sup>5</sup>

The micro-financing programs were initiated as commercial loans and were not intended at helping people who lacked financial assets. A majority of financial organizations believe that micro-financing poses serious threats such as increasing risks, high transactional cost, and inability of providing security.<sup>6</sup> The diverse nature of micro-crediting is opposing to the provision of commercial loans that do not require any guarantee or underwriter. Instead, it depends on trust and is generally reimbursed within a time period of six months to a year and are reused to maintain cash flow, ensuring its circulation in the hands of the borrowers.<sup>7</sup> Researchers in the present times believe that the primary aim of Islamic financing is to assist Islamic banks in becoming more powerful and effective in terms of providing financial services to the poor segments of the society.<sup>8</sup>

Micro-finance is still in the developing stages and lack resources as well as capabilities for handling numerous issues. It is interesting to note here that Grameen Bank is also facing criticism for charging more cost/fee/mark up from their clients.<sup>9</sup> The

---

<sup>4</sup>Y. F. Nader, "Microcredit and the Socio- Economic Wellbeing of Women and their Families in Cairo," *The Journal of Socio-Economics* 37 (2) (2008): 644-656.

<sup>5</sup>D. Shrivastawa and R. Singh, "Microfinance and its Role in Economic Development of India," *Journal of Madhya Pradesh Economic Association* XXVI (1), (2016): 95-100.

<sup>6</sup>M. Moodie, "Microfinance and the Gender of Risk: The Case of Kiva.Org. Signs," *Journal of Women in Culture and Society* 38 (2) (2013) : 279-302.

<sup>7</sup>R. A. Rahman, A. Al Smady and S. Kazemian, "Sustainability of Islamic Microfinance Institutions through Community Development," *International Business Research* 8 (6), (2015): 196.

<sup>8</sup>A. W. Dusuki and A. Abozaid, "A Critical Appraisal on the Challenges of Realizing *Maqasid al-Shariah* in Islamic Banking and Finance," *IJUM Journal of Economics and Management* 15 (2) (2007): 143-165.

<sup>9</sup>B. Armendáriz and J. Morduch, *The Economics of MicroFinance* (MIT Press, 2010).

Islamic rules also oppose charging high cost/fee/mark up from the poor, as this can get them into more debts and challenges.<sup>10</sup> The Islamic microfinance proposes an asset-based approach instead of a debt-based approach. Moreover, all the micro financing transactions must comply with *Shari'ah* and hence should be free from *Riba*, *gharar*, and *maysir*.

Islamic micro-finance have been divided into three main categories namely charity, micro-equity, and microcredit.<sup>11</sup> Moreover, the idea of profit and loss sharing is to ensure the mitigation of risk and to achieve optimal utilization of resources.<sup>12</sup> In addition, the bank of Negara Malaysia (2012) issued a report on Islamic micro financing including *Mudaraba* for medium scale enterprises, *Ijarah* for micro and small business enterprises and *Salam* for prospects within the agricultural sector.

Numerous studies have highlighted that micro-financing has now become a profit orientated business that follows a debt-based approach.<sup>13</sup> Islamic banks that utilize a PLS based approach encompassing the principles of *Musharakah* and *Mudarabah* instead of saving the poor drag them into more debt.<sup>14</sup>

### 3. The Influence of 'Murabaha' than 'Musharakah' and 'Mudaraba'

Islamic banking is playing no role in reducing poverty and signing agreements on the basis of 'Murabahah' with the investor is the primary reason behind it. *Murabahah* is a short term contract in which the (Islamic) bank discloses the cost and profit of the sold asset to its customer. In 'Musharakah' Islamic bank and its customers are partners in *Shari'ah* compliant investments. *Musharakah* is practiced less in comparison to 'Murabahah.' Islamic banks like other banks demand guarantees from the poor which they fail to provide.<sup>15</sup>

Tunis author, Tahir bin Ashoor who has written *Tafsir-ul-Tehrir-wal-Tanvir* stated that the role of money according to *Maqasid-e-Shari'ah* is to be circulated in a legal way so that a majority of people can benefit from it. Hence Islamic banks should also follow these principles and should play a pivotal role in the circulation of money to all the segments of the society.

<sup>10</sup>M. Obaidullah, *Role of Microfinance in Poverty Alleviation: Lessons from Experiences in Selected IDB Member Countries* (Islamic Development Bank, 2007).

<sup>11</sup>Mahmoud Sami Nabi, "Role of Islamic Finance in Promoting Inclusive Economic Development," *Global Sustainable Finance Conference* (2013): 1-39.

<sup>12</sup>H. Rehman, A. Moazzam and N. Ansari, "Role of Microfinance Institutions in Women Empowerment: A Case Study of *Akhawat*," *South Asian Studies* 30 (1) (2015): 107.

<sup>13</sup>S. Hassan et. al., "Designing Islamic Microfinance Products for Islamic Banks in Malaysia," *Middle East Journal of Scientific Research* 17 (3) (2013): 359-366.

<sup>14</sup>Mehmet Asutay, "Islamic Microfinance: Fulfilling Social and Developmental Expectations," *Islamic Finance: Instruments and Markets*, Q-Finance (London: Bloomsbury, 2010).

<sup>15</sup>Abdul Hafiz, al-Savi, alebank al-Islami wal Faqr Ayyu Dorin Yuntazar? Retrieved Dec 14, 2011 from. <http://kantakji.com/fiqh/Economics.htm>.

#### 4. Suggestion for Partnership on the basis of Microfinance

Some researchers suggest that the government should build an institution that can facilitate microfinance ‘Special Purpose Entity’ (SPE) with the aim of removing poverty. It can also be used to collect money from the investor and invest it on the basis of ‘*Musharakah*’ and ‘*Mudarbah*.’ A separate investment management company or any Islamic bank (SPE) can control the management of this institution. Investing money in smaller proportions decreases the level of risk. For instance, if 10 million is distributed amongst 50 different people, it reduces the level of risk as the money is divided into 50 different investments. If this same money is invested in a single power plant or garment factory, then the level of risk can be higher. Hence microfinance guarantees good profit as the cost on investment is less and is invested in smaller proportions.

Equity investment within Islamic banks is based upon the principles of partnership. The client purchases the bank shares, following a series of steps on the market price. Each step decreases the profit ratio of the Islamic bank and hence the client purchases all the units, becoming its sole owner. Third party guarantee can be taken to cover losses or damages and is managed by the micro financing institutions.

#### 5. Partnership on the basis of ‘*Istisna*’

‘*Istisna*’ is not sharing but it is a selling in which products are sold before being manufactured. ‘*Istisna*’ means to demand the manufacturing of goods and the buyer orders the manufacturer to make a specific number of products. If the raw material for the goods are provided by the buyer then it is called ‘*Ijarah*’ (Lease) contract.

In ‘*Istisna*’ contract, it is necessary to specify the requirements pertaining to the products and the price should be pre-determined as well. As ‘*Istisna*’ is not proven by ‘*Qiyas*’ (Analogy), so it is called a non-compulsory contract. According to Imam Abu Hanifa, ‘*Istisna*’ is ‘*Bai*’ (Selling), so the buyer has the right to refuse to the purchase of manufactured goods after examining them. In contrast, Imam Abu Yousuf says that if the goods are manufactured according to the buyer’s specifications then the buyer cannot refuse to buy the goods.<sup>16</sup>

This is the short introduction of ‘*Istisna*’, which is necessary to discuss here. Islamic banks can use ‘*Istisna*’ contract in two ways:

1. Direct ‘*Istisna*’
2. ‘*Istisna*’ on the basis of partnership with microfinance institutions.

We are not discussing the first type (direct ‘*Istisna*’) because it does not fall under the category of sharing contract. However, in the second type of ‘*Istisna*,’ partnership plays an important role and hence we are discussing it in detail. Islamic banks opting for

<sup>16</sup>Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (Karachi: Qur’anic Studies Publishers, 2007), 195,198.

partnership prospects with different microfinance institutions can encounter different issues. One issue is that they will escape from criticism at a certain level due to non-investment at the micro level but the need remains there, until Islamic banks start investing directly at the micro level. The microfinance institutions emphasis on a particular group of people, for example some of these institutions are benefitting people who live below the poverty line and provide them cash ranging from 5 to 30 thousand rupees. Most of these types of institutions are investing on the basis of interest, but in contrast, Islamic institutions work on the basis of '*Qard-e-Hasna*' (benevolent loan). These types of institutions are working only in particular areas, and microfinance institutions are not spread out completely. These limited Islamic microfinance institutions cannot fulfill the needs of Islamic banks, due to which these banks do not participate in the process of micro-financing; such as finding clients, client's investigation, contract on the basis of '*Istisna*,' '*Salam*,' '*Murabaha*,' and '*Diminishing Musharakah*,' getting guaranties, pledge etc., and making profit from them. The microfinance institutions normally receive money on the basis of interest from Pakistan Poverty Alleviation Funds (PPAF), which also receives money from World Bank on interest basis. These financial institutions can get rid of interest if they seek this money from Islamic banks.

### 5.1. Proportion of Profit in '*Istisna*'

One of the leading benefits of '*Istisna*' for Islamic banks is that its profit generation is much greater than the profit generation in '*Murabaha*,' increasing profit proportion for both the shareholders and the Islamic bank. If Islamic bank initiate '*Istisna*' contracts, then the ratio of these profit will be much higher than the ratios offered by microfinance institutions. Although in '*Istisna*', the chances of loss are much higher than '*Murabaha*' contract but that loss can be overcome through the following strategies:

- a) To receive a cheque, pledge or guarantee against the advance payment from the manufacturer.
- b) The chances of loss will be reduced by the division of capital especially in microfinance because the division of capital is more diversified in microfinance industry.
- c) If the manufacturer delays delivering goods, there is a relaxation in '*Istisna*' to reduce the price per day from the fixed price. This is also legal according to the religious scholars and is known as 'an increase in wages due to the urgent delivery of goods and decrease in wages due to delay in delivering the goods.'<sup>17</sup> However this cut in price should be reasonable and should be stopped at a particular stage. It is important to examine the reasons of delay by the manufacturer and if his reason is valid, he should be given some extra time.

<sup>17</sup> تكثير الأجر بالتعجيل في العمل و تنقيص الأجر بالتأخير في العمل



The following example can be helpful in highlighting the differences between the profit ratio of 'Istisna' and 'Murabaha.'

**Example:**

A microfinance institution receives an order from some other institution to make 400 water bodies on the basis of 'Istisna' and gives the order to the manufacturer on the basis of 'Istisna' as well. The details of expense and profit for microfinance institution are as following:

Money provided by the manufacturer: Rs 116,000

Sale price: Rs. 124,000

Gross profit: Rs. 8000

Financial expenditures: Rs. 890

Transportation expenses of prepared goods: Rs. 500

Net Profit: Rs 6610

When this company invests this amount in 'Murabaha' the following results are achieved:

Ratio of profit: 20%

Number of days: 35

Gross profit: Rs 2224

Financial expenditure: Rs 889

Transportation expenditure to manufactured goods: Rs 500

Net profit: Rs 835

In the given example the profit of 'Istisna' is 7.50 % greater than the profit in 'Murabaha.'

### 6. Partnership on the Basis of 'Salam'

'Salam' can be defined as a sale activity in which the farmer accepts the responsibility of providing the particular crop to the buyer on a fixed date and receives full payment in advance, at the time of contract. Holy Prophet (SAW) has given the permission of 'Salam,' after the prohibition of interest, so that this sale can satisfy the basic necessities of small farmers and traders. Details of 'Salam' are also available in Islamic jurisprudence books.<sup>18</sup>

Islamic banks can make partnerships with microfinance institutions on the basis of 'Salam.' The terms of this partnership can comply these institutes to purchase wheat, rice and cotton etc. from the farmers on the basis of 'Salam' and then sell these items in the market or with a particular buyer on a reasonable price. Moreover, they need to store

<sup>18</sup>Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, 186.

these items for some time which increases a certain degree of risk than the contemporary '*Murabaha*.'

### 6.1. Removing a Doubt

At this point, an obstacle is recognized. Storing of goods by the Islamic banks can create their monopoly, which can be a leading reason for not getting trade permission by the State bank. But this problem can be solved by seeking permission from the State bank for storing goods for a limited period of time after which they cannot sell goods. Moreover, Islamic banks can be fixed to purchase goods from the market at a certain ratio against their portfolio (for example 5% of total portfolio) and similarly their profit can be rounded at a particular point. There is a difference between this situation and the situation in which big investors store goods for maximizing profits, as here a big chunk of profit will go into the pockets of small investors. Capitalists create shortage of goods and then sell these goods at their own prices but banks are restricted and cannot earn profit more than the fixed percentage. An important point to remember here is that the crop which is purchased by the banks from the farmers on the basis of '*Salam*' consist of the common goods of necessity. The items which are purchased by the depositors of Islamic banks from the market should not be creating an impact that they will be increasing their prices. This will incur a heavy loss upon depositors as they will pay a part of their profit (earned by '*Salam*' contract) to purchase the same crop at a higher price from the market. So, this method should be applied after critical thinking.

### 6.2. Another Way for *Salam*

There are other possible methods for '*Salam*' which can be paid to the farmers by adopting the following three steps instead of cash payment.

- a) Net cash.
- b) Fertilizers.
- c) Leasing on land.

These will be offered to the farmers since they have to buy fertilizers for their crop and are also in the need of the land. So these items will be provided either at the same price or on lesser prices in comparison to the market price. The payment for '*Salam*' will be made in the form of net cash, land, and fertilizers. Islamic banks also get the benefit of purchasing these goods at a wholesale rate and also while selling them to the farmers. It is necessary to point out that Islamic bank can provide fertilizers to the farmers after purchasing them from the market but the land will not be in the ownership of the Islamic bank. For this purpose, firstly the bank will get the land on '*Ijarah*' basis from the third party and then hand it over it to the farmer. Islamic bank can increase the profit on '*Ijarah*' when the land is handed down to the client but it is not legal, according to the writer. Therefore, land and fertilizers should be given to the clients either according to the market price or less price by the Islamic bank.



Here, it is also important to note that the grains of the crop that the farmer intends to grow should not be given against the ‘*Salam*’ price. For example, if the farmer intends to grow wheat, then the grain of wheat cannot be given to the farmer on the basis of ‘*Salam*’ because it will be the exchange of wheat with wheat. Prophet Muhammad (SAW) instructed us to acquire an equal quantity in exchange of six particular commodities and wheat is also included in this list. Prophet (SAW) stated that:

‘Sell gold equaling to gold, sell silver equaling to silver, sell wheat equaling to wheat, sell barley equaling to barley, sell dates equaling to dates, sell salt equaling to salt, on the spot, and when differ these commodities then sell as you wish when it is on the spot.’<sup>19</sup>

Islamic banks can make transactions with microfinance institutions on the basis of ‘*Murabaha*’ financing. Islamic bank can sell goods to microfinance institutions on ‘*Murabaha*’ basis and can appoint them as agents, who sell goods to their clients. However, it is necessary to follow the *Shari‘ah* rules in these transactions.

### 7. Partnership on the basis of ‘*Muzara‘ah*’

Agriculture is the backbone of the Pakistani economy. State Bank of Pakistan (SBP) offers suggestions to Islamic banks related to operating in the agricultural sector. Islamic banks can work very well in this field through ‘*Salam*,’ just like some micro finance institutions that are operating successfully. As ‘*Muzara‘ah*’ is based on sharing, Islamic banks should invest on the basis of partnership, which is not possible without a struggle. It is easier to work on the basis of ‘*Muzara‘ah*’ for banks, because the crop acts as a guarantee for them. Islamic banks can visit them regularly and can get their share when they ripe.

Though this type of partnership is not workable for the poultry, livestock, or the fish farming sectors. The state bank should modify their trade restriction policy for Islamic banks, allowing them to trade for a particular limit. This restriction is also one of the reasons of Islamic banks not working on the basis of ‘*Shirkah*’ and ‘*Mudarabah*’.

#### 7.1. Definition of ‘*Muzara‘ah*’

Maliki’s define ‘*Muzara‘ah*’ as follows: “Sharing of land”<sup>20</sup> ‘الشركة في الارض’

This definition explains ‘*Muzara‘ah*’ because there are numerous commandments related to within ‘*Muzara‘ah*.’

<sup>19</sup>Muslim bin Hajjaj, *Sahih Muslim*, “The Book of Transactions,” Chapter: Conversion of Currency and Selling of Gold for Silver on The Spot,” *Hadith* 3854, <http://www.sahihmuslim.com/sps/smm/sahihmuslim.cfm?scn=dspchaptersfull&BookID=10&ChapterID=629>.

<sup>20</sup>Wahbah al Zuhaili, *Al-fiqhul Islami Wa Adillatuhu*, chapter “Uqudu Istismaaril Arz,” 316/5, Damascus: Darul Fikr, 1985).

## 7.2. Stimulation of 'Muzara'ah'

Imam Abu Hanifa and Imam Zufur are against 'Muzara'ah. Imam Shafi is also against it, but if it is under the condition of 'musaqāat' it can be obtained. Imam Abu Hanifa, Imam Zaufur and Imam Shafi discuss the non-permissibility of its credibility by referring to the saying of the Holy Prophet (SAW) who forbids the 'Mukhabarah' (مخابره) (also called 'Muzara'ah'). It is also unfair because a 'Muzara'ah' worker receives an income from the crop and there is no crop during the agreement or is unknown, because sometimes nothing is acquired from the land. So, this contract will be void because of uncertainty or non-existence of the contract. The dealings of the Holy Prophet (SAW) with the people of 'Khayber' was on the basis of 'Kharaaj-e-Muqasamah' (Getting the crop on the basis of ratio of total crop from the land, i.e., one third or one fourth etc. and it is legal).

Imam Abu Yousuf, Imam Muhammad, Imam Malik, Imam Ahmad, Dawood Zahiri and many other are in favour of 'Muzara'ah.' The argument is that the Holy Prophet (SAW) allowed the people of 'Khayber' to work on a particular piece of land for a particular portion of crop and fruits.

One of the reasons given for its justification states that it is an agreement of partnership between work and money. It is permissible like 'Mudarabah' because sometimes the owner of the land cannot grow the crop in a productive manner and hence can produce a good crop through mutual collaboration. According to the 'Hanafi' School of thought, the decree can be issued, grounding them upon the sayings of 'Sāhibain' (صاحبين) because of the need and common practices of the people. They state that initially they start as 'Ijarah' and end as partnership. Offer and acceptance are not necessary in this agreement.<sup>21</sup>

Bukhāri narrates that the Holy Prophet (SAW) states about (Mukhabarah) that if anyone amongst you shows mercy towards his brother by giving him a land voluntarily than it is a better, rather than taking a particular share (one third or one fourth etc.). Furthermore, Imam Bukhāri defined the concept of 'Mukhabara' from this *Hadith* as "the seed provided by the worker" which than facilitates an agreement related to a specific part or portion of the crop.<sup>22</sup> Imam Muslim also commented on this concept similarly.<sup>23</sup>

<sup>21</sup>Ibid, 615/5; Abdullah bin Ahmad Almuqadsi Ibn e Qudamah, *Umdatul Fiqh* (Al-taif: Maktaabtul Tarfain, n.d.) Ibn e Nujaim, *Albahr ul Rāaiq*, "Kitabul Muzaarah," 181/8 (Dar-ul-Marifah, Bairut, n.d.).

<sup>22</sup>Muhammad b Ismail Bukhaari, *Jamiul Sahi al-Bukhrai*, "Kitaabul Muzaarah, 2205), 821/2, (Beirut: Dar Ibn e Kaseer, 1987).

<sup>23</sup>*Sahih Muslim*, Chapter. "The Prohibition of Muhaqalah and Muzabanah and Mukhabarah: and Selling Produce before its Goodness Appears, and Mu'awamah: Which is Selling Years in Advance," *Hadith* 1536b, 1536c, 1536d. <https://sunnah.com/muslim/21>.

### 7.3. Conditions for the Validity of 'Muzara'ah'

According to Imam Abu Yousuf, there are eight conditions for the validity of 'Muzara'ah':

1. Credibility of both parties.
2. Specific time limit.
3. Fertility of land.
4. Handing over the land to the worker.
5. Production should be distributed between both parties, while sharing.
6. Clearly mention the person who will be providing the seed, to avoid any inconvenience.
7. Share of each individual should be clearly defined.
8. The type of seed should be clearly mentioned for achieving clarity pertaining to wages. Also some seeds take much effort for a good quality yield and hence the type of seed should be clearly mentioned.<sup>24</sup>

### 7.4. Ways for the Applicability of 'Muzara'ah'

There are four ways for the applicability of 'Muzara'ah' according to 'Saahibāin.' One of them is void and remaining are valid.

1. If one individual owns the land and the seed and the other makes provision for the tractor and labor etc. than the 'Muzara'ah' is fair. This can be done in a way that the owner of the land and the seed hires the worker on the basis of 'Ijarah' and tractor etc. is given to the worker to perform their duties.
2. If the owner only owns the land while seed, tractor, and other works belong to the other individual then the 'Muzara'ah' is also fair. This can be done by signing a lease agreement with the landlord against a specific amount of crop production.
3. If land, tractor and seed belong to one person and services belong to the second person, then the 'Muzara'ah' is also fair. It can be understood as an agreement of 'Ijarah' signed by the owner of the land with the worker for some part or portion of the crop.
4. If land and tractor belong to the one person and the seed and services belong to the other person then this contract is void according to 'Zahir ur Riwayah'.<sup>25</sup>

Islamic banks sharing in agricultural sector are fulfilling the purpose of *Shari'ah*. According to Maulana Manazir Ahsan Gilani agriculture and gardening have been explained in detail in the Holy *Qur'an*. Details pertaining to monsoon waves and their relationship with farmers, threats as well as happiness associated with these waves, lush

<sup>24</sup>Zuhailli, *Al-fiqhul Islami Wa Adillatuhu*, chapter "Uqudu Istismaaril Arz," 618-619/5; Ibne Nujaim, *Albahrul Raiq*, "Kitabul Muzaarah," 181-182/8.

<sup>25</sup>Zuhailli, *Al-fiqhul Islami Wa Adillatuhu*, Chapter "Uqudu Istismaaril Arz," 621-622/5; Maulana Akbar Shah Hashmi, *Almataul Zaruri* (Karachi: Islami Kutub Khana, 2003), 170.

green fields, full meadows, green gardens are much discussed in the Holy *Qur'ān*. It seems that this topic has been mentioned in the Holy *Qur'ān* to familiarize people with this aspect of the human economy and their natural needs.<sup>26</sup>

However Maulana Manazir Ahsan Gilani has some reservations regarding '*Muzara'ah*.' According to him experience indicates that the farmer does not work wholeheartedly in sharing, as he has doubts regarding the amount he is getting in exchange for this troublesome task. A major portion of the income goes to the landowner and hence the farmer may not work hard.<sup>27</sup> Maulana Manazir Ahsan Gilani also quotes the sayings of the Holy Prophet (SAW) and mentions that he did not like this form of contract either and only the following three forms were sanctioned by the Holy Prophet (SAW).

1. If someone owns the land than he has to harvest the land himself.
2. If he cannot harvest it by himself, he should give this land to his brother to harvest it freely.
3. If he wishes he can collect the rent of this land in the form of gold or silver (i.e., in the form of money).<sup>28</sup>

Maulana Hifz–ur-Rehman Seoharvi states that Islam does not support the existing system of landlordism and did not approved the landlordism between *Ansār* (helpers; the Muslim residents of Medina who were called Ansār) and *Muhajireen* (migrants to Medina) in the form of '*Ijarah*' and '*Muzara'ah*.'<sup>29</sup> He states that from the age of the Holy Prophet (SAW) to the age of rightly guided caliphs ,this system was imposed, but the Holy Prophet (SAW) thoroughly explains that he did not like the simple method of landlordism.<sup>30</sup>

Dr. Noor Muhammad Ghafari states that when the Holy Prophet (SAW) migrated to Madinah the system was based upon feudalism and capitalism. Farmers were mostly poor people and the feudal lords exploited them by imposing different sanctions upon them and also received tenant from them.<sup>31</sup> Three exploitation methods were in practice there,

1. The landlord specified the area that was near the canal or river and the farmer received dry land in share.

<sup>26</sup>Manazir Ahsan Gilani, *Islami Muashi'āt* [Islamic Economics] (Karachi: Daarul Ishaat, n.d.)

<sup>27</sup>Manazir Ahsan Gilani, *Islami Muashi'āt*, 373.

<sup>28</sup>Ibid., 373-375.

<sup>29</sup>Hifzul Rehman Suharwi, *Islaam ka Iqtasadi Nizaam* [The Economic System of Islam] (Karachi: Idarah Islamiat, 1984), 230.

<sup>30</sup>Ibid., 235-236.

<sup>31</sup>Dr. Noor Muhammad Ghaffari, *Nabi Karīm ki Mua'ashi Zindagi* [The Economic Life of Prophet SAW] (Lahore: Diyal Singh Library, 1999), 138.

2. The farmer used to acquire a part of the land and harvested it for himself (e.g., Part A) and then also harvested (e.g., Part B) for the landlord, against their own land.
3. The poor farmer was obligated by the owner to pay crop taxes like ‘lagān’ for harvesting against the land of the landowner.

When Holy Prophet (SAW) migrated to Madinah he announced a just method for lease and eradicated methods that lead to the exploitation of the poor farmers.<sup>32</sup>

Allama Yousuf Qarzawi states that renting out land is legal and many other jurists also permit it. Allamah Ibn-e-Hazm rejected renting out the land and approved the sharing of land. The jurist and successor, Taaūs rejected renting out the land in gold or silver but approved the sharing of a quarter or a third part of the production. Taaūs says that Hazrat Muaaz (R.A) was sent by the Holy Prophet (SAW) to Yemen. He rented out the land with the condition of taking one third or one fourth of the crop as tenant. So, according to Tāūs, gold and silver is not allowed but a share of the crop can be taken. Because the Holy Prophet (SAW) has forbidden to give a specific part of the land to cover the cost of production, a given percentage of the crop can be shared. So, if the yield is good both parties can draw benefits from it. Also in case of any harm to the crop, both parties have to share the loss.

He also states that likewise, if a person, rents any of his asset he has the right to take rent through it and use it. Land is not depreciated like a building or any other commodity. When a person rents out a house the tenant directly gets the benefits by taking residence in it. This is also applicable on machines but in the case of land, direct benefits are rare. Empty land which is neither served by the seed nor is softened, is not permitted to rent. Actually, ‘Muzara‘ah’ takes place when two individuals enjoy an equal amount of share within the benefits or harm. Prophet (SAW) imposed a condition on the people of Khyber to share half of their production, which remained intact until the period of Hazrat Umer (RA) till the time they were deported. The people of Khyber provided seed and spent money on harvesting.<sup>33</sup>

## 8. Analysis and Preference

Author further states that sharing is the ideal form of ‘Muzara‘ah’ in comparison to renting out the land because this form of ‘Muzara‘ah’ follows the principles of *Shari‘ah* in a better way. Author also has some reservations following Allama Yousuf Qarzawi, in relation to the forbidding of leasing out the land and present the following arguments in its favor:

<sup>32</sup>Ibid., 45-46, With reference of *Sahih Al Bukhari*, “Kitabul Muzaarah”

<sup>33</sup>Yusuf al Qarzawi, *Alhalal wal Haram fil Islam* [Halal and Haram in Islam] chapter “Ijaratul arz bil Nuqūd,” (Beirut: Almaktab al Islami, 1980), 276-278.

- a. It is not unfair to rent out the land if both the parties are not equally sharing in the profit or loss, because this type of sharing in profit or loss is present in contracts based upon partnership and is absent in contracts based upon '*Ijarah*.'
- b. Usually, when something is rented out it loses its value. If an asset loses its value it doesn't mean that it cannot be rented out and hence this land can be used to grow crops, keep animals on it and can be used for many other purposes. Although these are sub-benefits but the lessee could get all of them.
- c. Normally the land produces crops and we reap benefits from them. So it is legal to rent out the land. This is also a reason due to which underwater land cannot be rented out, as it does not yield profits.
- d. The farmer should have a specific share, half or more than half and the owner should not receive all the profits from the land. The rule imposed here is that both the worker and the investor should get their shares in a right proportion.

Following are the sayings of the Holy Prophet (SAW) that proves the absolute permissibility of '*Muzara'ah*' and the various conditions that imply.

- Rafay bin Khudaij narrated that the Holy Prophet (SAW) prohibited renting out the land. Hanzalah asked Rafi Bin Khudaij that if it is also forbidden in exchange for gold and silver? Rafi replied that such an exchange can take place.<sup>34</sup>
- Abu Huraira (RA) narrated the saying of the Holy Prophet (SAW) that, "the man who owns the land should either harvest it himself or should give it to his brother for no cost. If he can't do so, he should keep the land."<sup>35</sup>

Rafay narrated that Ibn-e-Umer (RA) gave his land to the farmers on '*lagān*' (Rent) during the time period of the Holy Prophet (SAW) and continued this exchange till the reign of caliph, Usman (RA). At the end of the caliphate of Muaviyah (RA) he was informed by Rafay bin Khudaij that the Holy Prophet (SAW) prohibited renting out the land. Hence Ibn Umer gave up this practice of renting out the land and later stated that this was the opinion of Rafay that the Holy Prophet (SAW) stated so.<sup>36</sup>

Hanzala bin Qais Ansari narrated that I asked Rafay bin Khudaij for renting out the land and taking gold or silver in exchange. He allowed me this practice because during the time of the Holy Prophet (SAW) people rented the land through small or big channels, which led to the destruction of some part of the crop while other parts were saved due to which Prophet (SAW) prohibited this practice. If this exchange is specified and rented against a guaranteed thing, then this practice of renting out is permissible.<sup>37</sup> The results of above mentioned *Hadith* are:

<sup>34</sup>Abu Abdullah Malik b Anas, *Muwatta Imam Malik* (Wit narration of Yahya Laisi), "Chapter on Leasing of Land," (Cairo: Dar Ihya wa Turth al-Arabi, 1390), 2/11.

<sup>35</sup>*Sahih Bukhari*, "Kitaab ul Muzaarah," 2216, 2/825.

<sup>36</sup>*Sahih Muslim*, "Chapter on Leasing of Land," 109, 3/1179.

<sup>37</sup>*Ibid*.



1. Holy Prophet (SAW) prohibited this practice for a limited time period because it led to quarrels and clashes amongst individuals, but was not declared unlawful on a permanent basis.
2. Specifying a particular part of the rented land creates ambiguity and can harm the cultivator, hence it is forbidden.
3. Ibn-e-Umer (R.A) was stern in acting upon the 'Sunnah' and hence stopped this practice as a precautionary method. This is the reason due to which he stated that "Rafay thinks like that," but when he heard it from Rafay as a *Hadith*, he was alarmed and deduced that perhaps the Holy Prophet (SAW) decided about this matter during his last days.
4. When the Holy Prophet (SAW) advised to give land and take no rent, it was on the basis of equality and brotherhood. The narration of Ibn-e-Abbas also expresses similar meaning.

The purpose of *Shari'ah* is not to create hindrances in work but to avoid mishaps. A system should be employed to discontinue the exploitation of the farmer on the hands of the owner, otherwise renting out the land is not a bad practice as the companions of the Holy Prophet (SAW) also carried this practice. The main purpose is to avoid exploitation of both the parties and not to stop a specific type of sharing, which is just in itself. The bank does not own the land, of course, the landowner owns it and the bank or the farmer takes it. So, the rules of the feudal system does not apply here. Hence banks cannot give these lands free of cost to the farmers, as it can lead to the exploitation of the shareholders. So, the writer concludes that there is a difference between the method which is suggested to the banks by the writer and the method mentioned by Manazir Ahsan Gilani. For example,

1. The bank works on the basis of 'Muzara'ah' where the bank does not own it.
2. 'Adjusted weightage system' can be used in such a situation; i.e., the farmer who works hard can be granted his share according to the ratio of his work.
3. The Islamic bank should announce bonuses to farmers when they reach the target, in order to persuade them.
4. The bank receives more crop yield because of the hard work of the farmer whereas the farmer does not receive a better payment.
5. The bank can open a warehouse, so the farmer can purchase or take commodities from that warehouse on the basis of 'Murabaha' or 'Musawamah.' Islamic bank can also perform under the umbrella of this warehouse.

#### 8.1. Results of the Discussion

1. It is imperative for Islamic banks to invest on poor people, as the reason given by them is not defensible.
2. 'Istisna' is better than 'Murabaha.'
3. Islamic banks can share with microfinance institutions through 'Salam' and 'Istisna,' as the ratio of profit are better if compared to 'Murabaha.'

4. The state bank should permit trade activities to the Islamic banks in specific sectors, so that can they participate in economic activities and cannot not create a monopoly. Islamic banks should operate on a limited profit policy.
5. 'Muzara'ah' is permitted in the *Shari'ah*, as it facilitates sharing in the crop yield, fulfilling the *Shari'ah* goals.
6. Islamic bank should initiate sharing on the basis of 'Muzara'ah,' as it according to the *Shari'ah* principles.
7. In 'Muzara'ah' profit should be distributed according to 'adjusted weightage system' so that both parties can get an equal share in profit.

### Bibliography

- Armendáriz, B. and J. Morduch. *The Economics of MicroFinance*. MIT Press, 2010.
- Asutay, Mehmet. "Islamic Microfinance: Fulfilling Social and Developmental Expectations." In *Islamic Finance: Instruments and Markets*. Q-Finance. London: Bloomsbury, 2010.
- Bukhari, Muhammad b Ismail. *Jami Sahi al-Bukhrai*. Beirut: Dar Ibn e Kaseer, 1987.
- Chapra, Muhammad Umer. *The Global Financial Crisis*. Kyoto: Centre for Islamic Area Studies at Kyoto University, Japan, 2009.
- Dusuki, A. W. Dusuki., A. Abozaid. "A Critical Appraisal on the Challenges of Realizing *Maqasid al-Shariah* in Islamic Banking and Finance." *IIUM Journal of Economics and Management* 15 (2) (2007): 143-165.
- Ghaffari, Dr. Noor Muhammad. *Nabi Karim ki Muaashi Zindagi* [The Economic Life of Prophet SAW]. Lahore: Diyal Singh Library, 1999.
- Gilani, Manazir Ahsan. *Islami Muashi'āt* [Islamic Economics]. Karachi: Daarul Ishaat, n.d.
- Hassan, S. et.al., "Designing Islamic Microfinance Products for Islamic Banks in Malaysia." *Middle East Journal of Scientific Research* 17(3) (2013): 359-366.
- Ibn e Nujaim, *Albahr ul Raaiq*. Dar-ul-Marifah, Bairut, n.d.
- (al-) Muqdasī, ibn-e-Qudamah Abdullah bin Ahmad. *Umdatul Fiqh*. Al-taif: Maktaba-tul Tarfain, n.d.
- Moodie, M. "Microfinance and the Gender of Risk: The Case of Kiva.Org. Signs." *Journal of Women in Culture and Society* 38 (2) (2013): 279-302.
- Nabi, Mahmoud Sami. "Role of Islamic Finance in Promoting Inclusive Economic Development." *Global Sustainable Finance Conference* (2013): 1-39.
- Nader, Y. F. "Microcredit and the Socio- Economic Wellbeing of Women and their Families in Cairo." *The Journal of Socio-Economics* 37 (2) (2008): 644-656.

- Obaidullah, M. *Role of Microfinance in Poverty Alleviation: Lessons from Experiences in Selected IDB Member Countries*. Islamic Development Bank, 2007.
- (al-) Qarzawi, Yusuf. *Alhalāl wal Harām fil Islam* [Halāl and Harām in Islam]. Beirut: Almaktab al Islami, 1980.
- Rahman, R. A., A. Al Smady and S. Kazemian. "Sustainability of Islamic Microfinance Institutions through Community Development." *International Business Research* 8 (6), (2015).
- Rehman, H., A. Moazzam and N. Ansari. "Role of Microfinance Institutions in Women Empowerment: A Case Study of Akhuwat." *South Asian Studies* 30 (1) (2015).
- Seoharwi, Hifzul Rehman. *Islaam Ka Iqtasadi Nizaam* [The Economic System of Islam]. Karachi: Idarah Islamiyat, 1984.
- Shrivastawa, D. and R. Singh. "Microfinance and its Role in Economic Development of India." *Journal of Madhya Pradesh Economic Association* XXVI (1) (2016): 95-100.
- Usmani, Muhammad Taqi. *An Introduction to Islamic Finance*. Karachi: Qur'ānic Studies Publishers, 2007.
- Zuhaili, Wahbah. *Al-fiqhul Islami Wa Adillatuhu*. Damascus: Darul Fikr, 1985.

### Glossary of Islamic Economics and Finance

1. *Mudharabah*:  
A profit and loss sharing contract in which one party provides capital and the other party manages the enterprise. In case of loss the provider of the capital bears the financial loss while the worker loses his labor.
2. *Musharakah*:  
It is an agreement under which the Islamic bank issues funds which are associated with the funds of the business enterprise and others. The profit is distributed among the partners in pre-determined ratios, in case of loss each partner will bear it according to the ratio of his investment.
3. *Murabaha*:  
Sale on profit; Cost plus profit, sale at stated cost price and mark-up.
4. *Musaqāt*:  
Contract for watering trees between the owner of the land and a worker on a condition that the produce will be shared; leasing fruit garden on fruit sharing basis.
5. *'Muzara'ah'*:  
Economic transaction; sharecropping contract. Technically, contract for the cultivation of land between the owner of the land and the worker with the condition of sharing the product.
6. *Bai Salam*:  
Advance payment for goods (usually crop) which are to be delivered later. Normally, existence of the goods is necessary for the validity of sale at the time of the bargain. But this type of sale forms an exception in the general rule, provided that goods are defined and the date of delivery is fixed.
7. *Ijarah*:  
Letting on lease. Technically, sale of a definite usufruct in exchange for a definite reward. Commonly used for wages but also refers to a contract of land lease at a fixed rent.