Islamic Banking and Financial Inclusion: Issues and Challenges for Depositing - Taking Commercial Banks
- Prof Dr Salif Azhar Rosly

Institutionalizing Khairat Funds via Takaful
- Mr Ezamshah Ismail

Islamic Banking in a Bind?
- Emeritus Prof. Datuk Dr. Mohamed Ariff

Malaysia’s Halal Inclusion Roundtable & Masterclass
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- Islamic finance and financial inclusion
- Islamic finance and attainments of SDGs
- Inclusive finance and inclusive growth
- Halal economy
- Islamic economy, Islamic finance and digitalisation
- Islamic social finance (Zakat, Awqaf etc.)
- Islamic financial innovations
- Governance and regulatory framework for Islamic finance
- Takaful and wealth management
- Fintech
- Crowdfunding

The paper can be theoretical, empirical or case studies. The paper and presentation can be made in English or Arabic.
In Person

Islamic Banking in a Bind
by Emeritus Prof. Datuk Dr. Mohamed Ariff, INCEIF.

Research Highlights
Islamic Banking and Financial Inclusion: Issues and Challenges for Depositing-Taking Commercial Banks
by Prof Dr Saiful Azhar Rosly, INCEIF.

Social Finance: ‘SuduNest’ a Potential Model for Financial Inclusion
by Asst. Prof Dr Ziyaad Mahomed, Head of Islamic Social Finance, INCEIF
Asmah Nabila Jamaluddin, Project Executive, Islamic Social Finance Unit.

Aspiration: The Start-Up Journey @ INCEIF
by Lim Sze Khai & Nur Izzani, MSc Islamic Finance.
EDITOR’S NOTE

Assalamualaikum wbt,

Alhamdulillah! Praises to Allah, for all the blessings that He has given. The theme of our third issue of IF HUB for the year 2019 is “Financial Inclusion in Islamic Finance”.

In this issue, we are honoured to have Emeritus Prof Datuk Dr Mohamed Ariff, sharing his view in his article, titled “Islamic Banking In a Bind” under “In Person” column. It is an insightful article explaining why Islamic banking is not growing as anticipated, and to explore the possibility of getting out of the maze. Under “Research Highlights” column, we have Prof Dr Saiful Azhar, writing on “Islamic Banking and Financial Inclusion: Issues and Challenges for depositing- taking commercial after banks. We also have Mr Ezamshah, writing on how khairat fund could be institutionalised through Takaful. This article is a continuation from the article published in the previous issue.

INCEIF through its Islamic Social Finance Unit has embarked on a pilot project which aims to improve the standard of living of the Pantai Dalam community in Malaysia. The pilot project is known as SuduNest which is eloquently narrated by Asst. Prof. Dr. Ziyaad. Whilst, under “Aspirations” column, we are proud to have Ms Katherine Lim Sze Khai and Ms Izzani Hafiz, our MSc students, sharing their memorable experiences in bringing their ABL project to the final round of IF Innofest 2019.

Last but not least my gratitude for all the players who have played key roles in making this special issue of IF HUB a reality, both directly and indirectly. We would also like to thank the readers for the feedback provided.

Feedbacks and comments are most welcome.

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Introduction

Without a doubt, Islamic finance has increasingly become an integral part of the global financial system, with Islamic banking playing a lead role in this new trajectory in many parts of the world. Islamic banking assets, deposits and financing have been growing at double-digit pace annually. In recent times, Islamic banking has attracted much international attention, especially in the aftermath of the global financial crisis of 2007-2008 which showed that Islamic banks are generally more stable than their conventional peers, although empirical evidence is admittedly mixed.

A unique feature of Islamic finance is that it is interest-free with many ethical safeguards such as zero space for speculation, ambiguity, uncertainty, short selling, etc. In a sense, Islamic banking is doubly safe, as it is subjected to both Shar’ah screening and conventional oversights. Be that as it may, the fact remains that Islamic banking products are strikingly similar to the conventional ones, the only differentiating factor being the Shari’ah compliance. In other words, Islamic banking products are no more than Islamised versions of conventional banking products. It is not difficult to understand why this is indeed the case.
When Islamic banking made their debut in a big way in the 1980s, there was a need to come up with products that customers could easily recognize, and hence the Islamic substitutes for the conventional products in the market. Apparently, there was nothing wrong with this approach at the initial stage.

While product differentiation through Shari’ah compliance did make considerable sense four decades ago, questions are being raised now about the authenticity of the products marketed by Islamic banks. To be sure, legitimacy of the products is not an issue, because Shari’ah compliance is fully in place, thanks to meticulous Shari’ah screening and auditing. Nonetheless, there are issues relating to the nagging perception that Islamic banking is firmly under the shadow of conventional banking, which is not good for the psyche. What’s more, Shri’ah compliance adds to the costs, which makes Islamic products pricier and less competitive vis-à-vis conventional products.

An attempt is made in this article to explain why Islamic banking is stuck in the initial stage without moving up the ladder to the next level, and to explore the possibility of finding a way out of the maze.

Musharakah does not play an important role, partly because banks tend to be risk avverting.

Legitimacy of products

As mentioned in passing, no one would seriously question the legitimacy or Islamicity of the Islamic banking products. Although these products may appear to be mirror images of conventional products, they are differentiated through Shair’ah compliance, which in turn draws its strength from concepts premised on the Qur’an and Sunnah. Thus, for example, funds are mobilised based on the concepts of qard, waad, wakalah and mudarabah.

In the case of qard, the Bank acts as the borrower, and the Depositor is the lender, where the principal is guaranteed with no return, whereas in the case of waad, the Bank acts as Trustee where the principal is guaranteed, and return, if any, is only discretionary.
Under the wakalah mode, the Bank acts as Investment Agent, where neither capital nor profit is guaranteed, while return of capital is warranted only if the Bank is found to be negligent or in default of its investment obligations, and all profits accrue to the investor after deducting the Bank’s fixed and variable fees. It is important to note that wakalah is neither profit-sharing nor loss-sharing, unlike mudarabah which is profit-sharing but not loss-sharing, with the Bank acting as Fund Manager (mudarib), or musharakah which is both profit- and loss-sharing, with the Bank acting as Partner in a joint venture.

The Bank invests the mobilised funds in financing its clients through such instruments as murabaha (adding profit margin), ijarah (leasing), bai’ibithaman ajil (deferred sale), istisnah (working capital), and bai’salam (product sharing). The Bank also uses the mudarabah instrument for financing, not as mudarib but as the rabbul maal (owner of capital).

To be sure, all these instruments are endorsed by the various Shari’ah boards and committees, even though there are lingering worries in the minds of some that practice may not jive fully with theory. Thus, with respect to murabaha, for instance, the Bank acts as no more than financier for transactions without taking on the responsibilities of the murabaha agent who typically acquires the merchandise and delivers it in good shape, for which a mark-up is added. Likewise, in the case of mudarabah, the Bank shares the profits with the owner of capital after deducting all fixed and variable charges (wages), whereas in theory the mudarib takes no wages because his share of the profit represents wages. Thus, in the event of a loss, the mudarib forgoes all his wages in theory, but in practice the Bank takes its wages in the form of charges. Musharakah does not play an important role, partly because banks tend to be risk averting.

There is much controversy over the instrument of tawarruq for personal loans, where the Client is asked to buy a commodity from Broker A on a spot basis at ‘ask’ price with bank financing, which he immediately spot sells at ‘bid’ price to Broker B, to get hold of the cash he needs. For the Bank, the financing is for the purchase of the commodity, where real sector connectivity is questionable, while it is no more than a personal loan for the Client.
Inclusive approach

Islamic banking is not for Muslims only. It is meant for all everywhere, except China where it is restricted to Muslims only by decree. In Malaysia, non-Muslim participation is substantial, accounting for as much as 40% of the total clientele on the average. In some bank branches, non-Muslims outnumber Muslims as Islamic banking clients. It is unclear what motivates non-Muslims to subscribe to Islamic banking. One plausible explanation may well be that they want to diversify their portfolios to spread their risks thinly. Another motivating factor may be that non-Muslims could see in Islamic banking a more caring or risk-sharing financier, especially in the case of house ownership transactions.

No studies have been done on the clientele profile of Islamic banks, not only because it would be costly and time-consuming, but also because banks do not share information about their clients as these are confidential. Nonetheless, the clients may be broadly classified into three categories. First, there are the Loyalists who subscribe to Islamic banking whole-heartedly with no qualms of any kind, on religious grounds. Second, there are the Sceptics who are unsure if the Islamic banking products are truly Islamic but would nevertheless go for it, believing that sins, if any, would be borne by the owners of these banks. And third, there are the Opportunists who would shift freely from conventional to Islamic banking or vice versa depending on where the price is lower or the return is higher.

On the supply side, too, there is much diversity, with conventional banks playing a pivotal role in Islamic banking. In many countries, conventional banks have Islamic windows offering Shari’ah-compliant finance. In Malaysia, conventional banks have been operating Islamic windows since March 1993. By end-1993, there were 21 conventional banks with Islamic windows. In the face of criticisms that conventional and Islamic funds could get mixed up in the ‘common kitchen’, the central bank invited the conventional banks, both local and foreign, to convert their Islamic windows into full-fledged Islamic subsidiaries in 2002. In Malaysia, there are six wholesome or stand-alone Islamic banks, local and foreign, and 11 Islamic subsidiaries of conventional banks, local and foreign, all of them coexisting with 21 conventional banks, local and foreign.

Tensions within

It is important to underscore the basic differences between conventional banking and Islamic banking. While conventional banks thrive on interest (riba) earnings, Islamic banks by definition are riba-free. Unlike conventional banks where profits are from interest-bearing loans, Islamic banks derive their profits from the contract of trade (al-bai‘), for it is business risk taking, and not financial risk taking, that constitutes the basis for profits in Islam. In Islamic banking, profit is all about risk taking (ghorm), effort (kasb), and responsibility (daman). In addition, the overarching Shari’ah objective (Maqasid-al-Shari’ah) demands that all transactions must have positive impact on general welfare of the concerned party. Thus, there is much more to Islamic banking than the prohibition of riba. Other prohibitions include ambiguity (gharar), gambling (maisir), and bribery (rishwa). There is also an additional accent on transparency in transactions, based on mutual consent with offer and acceptance (ijab and qabul), free from duress (ikroh).

All Islamic banks, be they wholesome or subsidiaries of conventional banks, are indeed different from conventional banks.
However, there are tensions between theory and practice within the Islamic banking fraternity, attributed mainly to the perception that the difference between conventional and Islamic products is merely cosmetic, given the similarity in terms of resemblance and pricing. After all, according to the Law of One Price, two products bearing the same risk profile must assume the same pricing.

The crux of the problem is that Islamic banks are under the shadow of conventional banks in the sense that their products are modelled after their conventional counterparts. Islamic banks have come up with an Islamic substitute for every conventional product, offering ‘differentiated’ products by simply adopting conventional risk and return profile, subject to Shari’ah constraints. One may surmise that the Islamic banking products are in the initial stage of their evolution, namely product differentiation. The expectations are that Islamic banking will evolve into the next phase, moving away from ‘differentiated’ (Shari’ah-compliant) to distinctly ‘different’ (Shari’ah-based) products that will have no bearings on the conventional ones. However, the second phase has remained elusive. Sadly, Islamic banking is still stuck in the first phase even after four decades.

Industry drivers

That Islamic banking has not progressed vertically, despite huge horizontal expansion, may have much to do with the overbearing influence of conventional banks in the industry. For one thing, Islamic banks are outnumbered and outsized by conventional banks. For another, conventional banks have increased their stake substantially in the Islamic banking sector through their Islamic subsidiaries and windows.

In Malaysia, Islamic subsidiaries of conventional banks account for roughly two-thirds of the total. In 2007, Islamic subsidiaries were at par (roughly fifty-fifty) with wholesome banks in terms of asset size, whereas in 2015 their share of total Islamic banking assets grew to 82% of the total. In terms of deposits, the share of Islamic subsidiaries grew from 47% in 2007 to 81% in 2015, while that of wholesome banks shrank from 53% to 18%. In terms of financing, the share of Islamic subsidiaries increased from 51% to 84% between 2007 and 2015, in contrast with wholesome banks’ contraction from 49% to 16% (Ariff, 2017). Clearly, wholesome Islamic banks are overtaken and outshined by the Islamic subsidiaries of conventional banks.

Thus, conventional banks have gained much inroads into the Islamic banking business through their Islamic subsidiaries or Islamic windows. In other words, though ironical as it may sound, conventional banks are in the driver’s seat, with their proxies steering the wheels of the Islamic banking industry.
Who is competing with whom?

Under such ownership structure, competition within the industry tends to look somewhat blurred. It is unlikely that an Islamic subsidiary would compete with its own conventional parent, although it may compete with other conventional banks. Islamic banks in general are no match for conventional banks which are at a huge advantage in terms of economies of scale and scope. Thus, a head-on competition with conventional banks is hardly an option for Islamic banks regardless of whether they are subsidiaries or wholesome. Instead, they would rather be nibbling into the niche market.

Competition is essentially among Islamic banks, and not between Islamic banks and conventional banks. More precisely, competition is really between Islamic subsidiaries and wholesome banks, in which the former have an upper hand for a variety of reasons. For starters, subsidiaries of conventional banks are larger in size than wholesome banks. Second, they have greater outreach in terms of branch networks in comparison with wholesome banks. Third, they can ride on their parents’ coattails and enjoy parental support, while wholesome banks have to fend for themselves. It is no wonder that the Islamic subsidiaries of conventional banks are increasing their market share at the expense of wholesome Islamic banks.

Mirror, mirror, on the wall….

Who is the fairest of them all? There are considerable variations among the three banking models, namely conventional banks, Islamic subsidiaries of conventional parents and wholesome Islamic banks, based on the results of a recent study (Ariff & Shawtari, 2019) which looks at the efficiency, asset quality and stability aspects.

Using data envelopment analysis (DEA) and dynamic panel data ‘generalized methods of moments’ (GMM) estimations, the study reports that there are important differences among different types of banks.
The study finds that wholesome Islamic banks lag behind conventional banks (reference category) and more so against Islamic subsidiaries of conventional parents. In other words, Islamic subsidiaries outshine not only wholesome Islamic banks but also their own conventional parents in terms of efficiency. The study also reveals that Islamic subsidiaries are more stable in terms of their financing income or bank margins compared to the rest, while wholesome Islamic banks have lower quality assets in comparison with both Islamic subsidiaries and their conventional parents.

To put it in a nutshell, wholesome Islamic banks pale in comparison with Islamic subsidiaries of conventional banks and their conventional parents in terms of efficiency, stability and asset quality, while Islamic subsidiaries outperform not only their wholesome counterparts but also their own conventional parents, on all these counts. The superiority of Islamic subsidiaries over wholesome Islamic banks appears to stem largely from their greater outreach and parental support, all which translate to lower costs, thanks to implicit subsidies from the parents in the form of common facilities and logistics.

So what?

One may ask what is wrong with all this. The findings do have some serious implications for the future of Islamic banking. Current trends suggest that Islamic subsidiaries’ share of the niche market will continue to increase while that of the wholesome Islamic banks will continue to fall, with the former sitting more firmly in the driver’s seat, steering the industry in the direction it wants. It is likely that they will be guided by their conventional parents, who lack the passion of wholesome Islamic banks when it comes to taking the industry to the next level.

The chances are that conventional parents will come up with new products, which their Islamic subsidiaries will only Islamise through Shari’ah compliance, while wholesome banks will passively go with the flow.

The above scenario does not auger well for Islamic banking, as it will shake the industry to the first stage of product differentiation and truncate the evolution process. The upshot of all this is that Islamic banking will remain for ever under the shadow of conventional banking, mimicking conventional risk profile and returns. The end result will be that Islamic banks will only offer depositors returns similar to what conventional banks provide, and likewise price their Islamic substitutes to be close to that of conventional originals, resonating the underlying conventional banks’ profit maximisation principle, which is antithetical to Maqasid al-Shari’ah.

The story could have been very different, if Islamic banking was not cast in the mould of commercial banks, and if conventional banks were not allowed to operate Islamic windows and subsidiaries, in which case Islamic banks would have charted a different course of their own, setting their own standards and norms, based on Islamic values and spirits.

A better model to follow?

The preceding analysis does not overlook the fact that Islamic banking, even in its current form, does differ from conventional banking, the differentiating factor being Shari’ah compliance which provides better real sector connectivity, where financing is backed by real assets and where derivatives have limited space.
There is some empirical evidence (e.g. Hassan and Dridi, 2011; Pellagrina, 2012; Sorwar et al., 2016) showing that Islamic banks were more stable (or less unstable) in comparison with conventional banks during the 2007-2008 global financial crisis, which led International Monetary Fund (IMF) and Bank for International Settlement (BIS) to pay more attention to Islamic banking. However, some other studies (e.g. Mobarek and Kalonov, 2014; Alqahtani et al., 2017; Hussain and Al-Ajmi, 2012) have questioned claims that Islamic banks are inherently more stable than conventional banks.

Be that as it may, one may question whether the observed or perceived stability of Islamic banking in its current form falls short of its theoretical equivalent. Based on theoretical constructs, given the centrality of the real sector and the risk-sharing nature of Islamic finance, Islamic banks should have been much more stable than what the empirical evidence suggests. In practice, however, Islamic banking falls short of the ideals, as their risk and return profiles are strikingly similar to that of conventional banks.

Interestingly, there are also studies (e.g. Chiaramonte et al., 2013; Merilainen, 2016; Becchetti et al., 2016) showing that cooperative banks were able to ride out the global financial crisis fairly well, unlike commercial banks. Cooperative banks are said to be adept at accumulating deposits in hard times, thanks to the trust built on serving low-income households, social mandate, best practices and prudence (Allen & Gale, 1997; Ayadi et al., 2010), which enable these banks to adjust their lending rates to customers and smoothen the inter-temporal risks (Groeneveld, 2014). Thus, cooperative banks could maintain their lending growth during the sovereign debt crisis in Western Europe (Merilainen, 2016). Another piece of empirical evidence by Stefancic (2016) shows that cooperative banks in Italy were also less exposed to the shocks of the credit crisis, thanks to their more conservative business strategies and more caring approach towards stakeholders in comparison to their commercial counterparts.

A more recent study by Gulzar, et al. (2019) compares the stability of cooperative banks with that of Islamic banks, based on a sample of 37 Islamic banks and 1,536 cooperative banks during the global financial crisis and post-crisis years, using the two-step GMM methodology. The study concludes that cooperative banks in Europe were consistently and significantly more stable than Islamic banks elsewhere during both crisis and non-crisis times.

It is also of interest to note that several scholars have drawn parallels between Islamic banks and European cooperative banks (e.g. Chapra, 1985; Siddiqi, 2006; El-Gamal, 2006), for there is so much in common between these two, with interest (riba) as the only big differentiating factor. The Islamic banking paradigm is closer to the ideals of cooperative banks than to the principles of commercial banks. Cooperative banking is largely in consonance with *Maqasid al-Shari’ah*, which is not the case with conventional commercial banking.

Under the cooperative banking model, Islamic banks’ depositors will have a better deal, receiving higher returns like shareholders. What’s more, cooperative banks’ emphasis on mutuality, trust, customer wellbeing before profits, moderation, prudence, inclusiveness, outreach, accessibility, reliability, and sustainability does resonate Islamic values.
Conclusion

The narrative of this article is simple to comprehend. Islamic banks, cast in the mould of commercial banks, have been around for over four decades. Despite rapid horizontal expansion, there has been very little vertical movement in Islamic banking in the sense that these banks are warped into Islamisation of conventional products, marketing Shari’ah-compliant products instead of Shari’ah-based products. A plausible explanation for this is that Islamic banks are under the shadow of conventional banks, mimicking the latter in many ways. Moreover, conventional banks have a strong hold on Islamic banking business through their subsidiaries, while wholesome banks pale in comparison, losing their market share to the Islamic subsidiaries of conventional parents. The latter, being more efficient and more stable, with better asset quality, in comparison with wholesome Islamic banks, are in the lead. It is unlikely that the Islamic subsidiaries of conventional banks will be able to take Islamic banking to the next level, as they lack the passion and zeal.

To be provocative, one may say bluntly that Islamic banking is currently under 'siege' or 'occupation'. There are also murmurs that Islamic banking has been 'hijacked' by conventional banks. While such assertions can be easily dismissed as exaggerations or exasperations, one cannot ignore the dominant role conventional banks play in the Islamic banking industry. That said, one must hasten to add that it was conventional banks that promoted Islamic banks more effectively through their Islamic windows, riding on their sprawling branch networks, than wholesome banks could with too fewer branches. It is also important to underline that Islamic subsidiaries of conventional banks are no less Islamic than wholesome Islamic banks, as all of them are subject to the same rigorous Shari’ah oversights. The issue, however, is that Islamic banks tend to behave like a typical commercial bank based on profit maximisation principle which flies in the face of the lofty Islamic values. To reiterate, there is much more to Islamic banking than being simply riba-free.
It is a moot point whether Islamic banks could have behaved differently, had they been modelled after cooperative banking which has much more in common with the spirit of Islamic banking, in comparison with commercial banking. Unlike commercial banks, cooperative banks are less leveraged and hence more stable. Apparently, there is greater space for Islamic values and virtues in cooperative banking than in commercial banking. A *riba*-free cooperative banking model may enable Islamic banks to unshackle themselves from the conventional banking practices and chart an independent course, moving to the middle ground where there is fairness, moderation and inclusiveness, embracing all segments in a plural society.

Enough basis exists for central banks to seriously study cooperative banking practices in Europe, especially Germany which has a rich experience, with a view to adopting the cooperative model for Islamic banking.

References


Problems

A bank bearing an Islamic label has a lot more to perform than their conventional counterparts. Profitability is paramount. Operational efficiency, liquidity and capital adequacy are equally important. Islamic banks have to further fulfill the expectations of the Islamic values they carry in their business operations. These include compliance to Shariah rules and ethics. The *maqasid shariah*, which is the purpose of the Law is another core element that has put high expectations of Islamic banking. For these reasons, Islamic banks are expected to help small businesses and promote microfinancing and financial inclusion. Carrying the Islamic label in their businesses, warrants Islamic banks to pursue these ethical and social objectives too.
In Shariah, Islam prohibits the payments and receipts of *riba* (al-baqarah 275) which is a fundamental rule in Islamic financing. The intent of prohibiting *riba* serves to protect property (*al-mal*), which is one of the *daruriat*. In the *riba* system, for example, banks borrow from ordinary people as deposits and pay them 3%. Banks use these deposits to make loans at, say, 7% to the big corporations who could earn 30% profit from their investments. In this way, banks take money from the poorer people and lending them to the rich. It is clear that achieving social objectives are not within the scope of modern banking.

Furthermore, depositors who lend their money to banks will see their interest income even less after accounting inflation. Depositors who are making loans to the banks are doing so at low-interest rates and worst still without adequate collaterals put against the deposits.

As banks use cheap deposits to fund big business, it can intensify income disparity and social discontent. Small businesses and start-ups who are not viable to banks are potential losers as they do not have the collaterals to support loans they are looking for. They are potential vehicles for employment creation but unable to do so because bank loans are made for the big corporations who make large business deals and profits.

**Al-Bay and Business Activities**

Islamic banking is challenged by similar issues. They are established as deposit-taking banks and commercial banks as well. The challenge is to conduct business under these two banking models, namely deposit-taking banks and commercial banks, where *al-bay* constitutes the basis of the Islamic banking system.

The Quran says, “Allah has permitted *al-bay* but prohibits *riba*”. As the Quran prohibits *riba*, it also promotes *al-bay* as the alternative to *riba*. *Al-bay* which is the conduct of trading and commerce describes amongst others, the wholesale and retail business but the actual main lesson is the risk-taking in business.

In *al-bay*, the merchant uses his capital fund to purchase goods from a supplier which he intends to sell at a profit in the market place. In good times he makes profit when sales made at the targeted price. However, he could also make some loss when no one buys his goods or selling them below costs. In this way, he faces business risk as he put his capital at risk to adverse market movement.

As shown in Diagram 1, the conception of *al-bay* can be further expanded into its business dimension where capital injection is necessary to initiate a business activity. While one can visibly see the acts of buying and selling in the market place, such activities are not possible without the injection of capital by the merchant in purchasing goods he intends to sell.
In the case of *salam*, a farmer sells the commodities for an advance payment which constitutes his capital. Likewise, in *istikna*, the manufacturer obtains advance payment from the buyer which the latter uses as capital. In *ijarah*, there is a direct injection of capital from the lessor to purchase the asset he intends to rent out.

In essence, all capital injected into the *murabaha, ijarah, salam* and *istikna* is subjected to market forces that can either lead it to appreciate from good earnings or depreciate under a loss event. It is evident from the above, that capital is put at risk when one seeks to make profits. Capital can be raised using *mudaraba* and *musharaka* contracts or arising from merchants’ capital. In this way, capital from the profit-loss sharing contracts (PLS) is linked to the real-production contract, like in any ordinary business where the net worth of the business is obtained when liabilities are subtracted from assets.

On the contrary, the merchant can also use his capital funds to make loans with *riba*. The loan which is usually collateralized is relatively free from risk, as the merchant can recover the loan from the sale of the collateral in a default event. In the Jahili period, defaulters turned into slaves when their loans did not carry any collaterals. In this manner, the payment of *riba* and the principal loan are fully guaranteed, which signifies the gross immorality of the *riba* based debt system.

These two opposites of *al-bay* and *riba* must be properly distinguished to highlight a fundamental rule emerging from the Quranic verse (2:275) that one must take risks to justify the taking of profits, hence the legal maxim “*al-ghurmu bil ghuni*” – profit is accompanied with loss.

*Diagram 1: Al-Bay as a Business Transaction*
Real Sector Contract

It is common knowledge that traditional contracts available to Islamic banks are grouped under sale-based, lease-based and equity-based. As shown in Diagram 1, the equity-based contract is associated with the sale and lease-based contracts as capital to the business entity. These real sector contracts that drive the production sector can also be utilized by big and small businesses alike, hence to the latter financial inclusion should take place in Islamic banks by default.

Islamic Bank as Deposit-Taking Banks

The main challenge is that these real-sector contracts are not made for a deposit-taking bank that most Islamic banks are adopting today. Risks in sales, operating leasing and equities transactions are different from the financial risks that conventional banks normally carry.

Bank risk appetite is set by bank directors who are responsible for formulating policies and strategies to achieve bank corporate objectives. The risk-appetite of deposit-taking bank is constrained by the size of capital it is holding which is defined by the Leverage Ratio. Basel 3 requires a leverage ratio of 3, which means that for 1 dollar of asset, the bank must hold 3 cents to support it. So banking is a highly leverage business, hence control is needed to prevent banks from taking excessive risks as they are mainly using peoples’ money to make loans.

Banks do not use capital funds to make loans but using it as a cushion against unexpected losses. For these reasons, central bank authorities put high risk-weights (RW) on sale, lease and equity-based products up to 400% as they carry high default risks. This will put heavy stress on bank capital if Islamic banks desire to apply the real-sector contracts.

Islamic Banking as a High Leverage Business

Unfortunately, Islamic banks were born into this high leverage business that was originally designed for usury-based western banks. Islamic banking founding fathers and pioneers may have overlooked this important issue which is truly unfortunate. For this reason, Islamic banks too have to take precautions on taking up excessive risks that can threaten the safety of deposits. This will leave no opportunities for Islamic banks to pursue real-sector contracts whose risk profiles may not match risk-appetite of the deposit-taking banks.
Much of the problem is associated with bank deposits which can be withdrawn on call. Bank deposits can both arise from a loan given to a bank by the public as depositors and money credited to one’s bank account from bank loans. Either way, demand deposits are generally callable, thus depositors hold no risks of loss. When depositors make loans to the bank which the bank uses them to make a new loan, risks of the new loan fall on the bank alone.

For this reason, the bank is further required to observe Basel 3 capital adequacy requirement which is set at 10.5%. In this manner, Islamic banks will be stressed-up with high capital holding if they plan to finance the real-sector production activities solely because deposit funds are considered borrowed funds even if they are labeled as say, *mudarabah* investment deposits (MID).

In MID as widely practice in Islamic banks today, the use of profit and loss sharing (PLS) principle is greatly amplified to suggest that assets are funded by PLS deposits, where in actuality they are not. But deposits cannot be submitted to the PLS doctrine, as by Basel Standard these are loans given to banks by depositors.

As long as assets are funded by deposits, they can only take risks that commensurate with risks of deposits, which is none at all. For this reason, asset risks are only carried by bank shareholders while depositors carry none. Only under a crisis mode, will depositors set to lose when banks become insolvent as no money is available for withdrawal claims.

In this way, real-sector contracts as outlined by *al-bay* stand to face a bleak future when Islamic banks continue to operate under the deposit-taking system. Real-sector contracts promote entrepreneurship, employment, and income creation and all these will be frustrated when Islamic banks remained to be deposit-taking banks.

**Islamic Banks as Commercial Banks**

Islamic banks are also established as commercial banks that require collaterals and guarantees to support finances extended, which will put small and medium scale enterprises (SMEs) out of the competition. SMEs are the ones in need of funding to start-off their projects and sustaining them as well. They also need nurturing and guidance to grow which commercial banks are not made to do. The development role of commercial banks is truly absent as they do not have a mandate to pursue that social objective. They are not made to uphold the social finance agenda when the Islamic label seems to suggest so. The paramount mandate is fulfilling the profit objectives hence return on equities (ROE) is key to these retail banks. The development role of banking is left to governments as they established many development banks run by government agencies.

**The Way Forward: Investment Account for Financial Inclusion**

The way forward is the promotion of investment account (IA) fund which is a significant component of Bank Negara Malaysia’s Value-Based Intermediation (VBI) program. These non-deposit funds allow the investors to carry the risks of the fund users who are, say the small and medium scale business (SMEs), hence enjoying higher returns as well. With a risk-taking mindset common in stocks and mutual fund investment, IA holders can earn relatively much higher than fixed deposits, hence possible improvement of income distribution.
The bank who acts as an agent (wakil) will identify SMEs and structure IA based on the profiles of the projects of SMEs. In this manner, the risk-appetite of IA can be directly linked to the risk profile of the SMEs. This system shall open opportunities for real-sector contracts application available in Islamic traditions, hence help Islamic banks to out-perform mainstream banking in this key area. In the longer run, as the size of IA increases, deposit funds will exist for cash management alone, hence no deposits are taken out to make loans. This should pave the way for a full reserve banking system.

With digital banking coming on board, demand deposits can be managed via the e-wallet system. In this manner, Islamic banks will no longer be leveraging on borrowed funds to extend finances. It will reduce bank capital holding if any it will be used to offset losses arising from operational risk as the bank now is largely driven by fee-based income from its role as wakil or agent to the investment account fund holders.

The funding role will be taken over by an investment account that serves to fund households and businesses using true Islamic financial instruments. For example, in-home financing, the IA fund will buy the house from the developers and sells it to the customer on credit or leasing. This is not happening under a deposit-taking commercial Islamic bank today.

In SME financing, IA holders can act as the rabbulmal while the former as mudarib. Banks as agents will earn fees from financial services associated with SME valuation, listing, and IA structuring and issuances. In this way, blue-ocean in Islamic banking is plenty to benefit from, where financial inclusion can be more viable to banks. But these are not up for grabs as Islamic banks today are still doing business with the money-lender mentality. Most of their businesses are driven by deposit funds and unlikely to move forward to make a difference unless the deposit regime is rationalized along with the conception of al-bay as a risk-taking system.
INSTITUTIONALIZING KHAI RAT FUNDS VIA TAKAFUL

Part 2

Institutionalizing *Khairat* Funds via Takaful (MaTa)

In Part 1 of this article we have recommended that Takaful Operators should be allowed to assist the Masjids to manage their *Khairat* funds in the following ways:

- Firstly, Takaful Operators can help to systematize the administration of the *Khairat* funds. With a standardized benefit and sum covered offered by the company, it would be a good move to easily maintain the fund.
• Besides, Takaful Operators can develop an online platform for the participants to access and check their status, Takaful Operators can provide training for the person in charge of Khairat in the Masjid to ensure the smoothness in the management between Masjid and Takaful Operators.

• Secondly, Takaful Operators are experienced in investment matters. This essential value-added will help to preserve the fund from any major deficiency. If a deficiency still occurs, Takaful Operators can provide an advance (qard). Unlike Masjid management, if a deficiency occurs, the Masjid will be in a quandary. In other words, Takaful Operators are the better solution to maintain solvency of the fund.

• Lastly, Takaful Operators can tackle the problem of marketing faced by Masjid. For example, those people living in high-rise property may be distant from the community and they are unlikely to be reachable by Masjid. Takaful Operators are better marketers and would aid to penetrate the Khairat coverages to a larger market especially the young age groups who are not aware of the existence of this Khairat fund. The institutionalized Khairat via by Takaful Operators would surely bring the community and the Masjid close together.

Despite the divergence of interest, there are overlapping of interest from these two institutions. Both of Masjid and Takaful Operators are bound to organize any Khairat scheme properly as an obligation to social responsibility. As good Muslims, our contributions towards society are considered as “fardhu kifayah”. Moreover, institutionalizing the Khairat fund would certainly bridge the gap between these two different organizations which is a good way of building the community and increase Takaful penetration especially among the Muslims in Malaysia.

### 1.0 Workable Models

Based on the interviews with the Takaful Operators we have formulated the following 2 models that we believe are workable.

**Model 1: Takaful Khairat**

- Takaful Operators will create the coverage plan based on qariah profile. Masjid will collect contributions from each participant and submit to Takaful Operators to get the coverage. It is suitable for new and existing Masjid,

- As the entry age limit is a major underwriting concern, we suggest that Takaful Operators impose a condition on the overall age profile. For instance, 20% of the total participants could exceed 65 years old. Hence, the plan will not exclude those above 65 years old automatically but Masjid needs to attract more young participants in order to cover all their participants above 65 years old.

- Masjid will assess and choose the best coverage based on coverage and contribution trade-off.

**Model 2: Administrative Services Only**

Masjid will submit a lump sum of the initial fund to Takaful Operators to set up a trust fund that provides sustainable coverages of Khairat Fund. It is suitable for existing Masjid that already has an accumulated fund for Khairat purposes and Masjid that uses the general donations for Khairat benefits.
1.1 Model 1: Takaful Khairat

Various coverage for individuals and families should be offered in order to better suit the needs of the participants. Suggested coverage as shown below:

<table>
<thead>
<tr>
<th>Contribution from participants (annual)</th>
<th>Individual Plan</th>
<th>Family Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic</strong></td>
<td><strong>Enhanced</strong></td>
<td><strong>Advanced</strong></td>
</tr>
<tr>
<td>Contribution from participants</td>
<td>RM 10 / person</td>
<td>RM 15 /</td>
</tr>
<tr>
<td></td>
<td></td>
<td>person</td>
</tr>
<tr>
<td><strong>Coverage</strong></td>
<td>Individual</td>
<td>Individual</td>
</tr>
<tr>
<td></td>
<td>Death</td>
<td>Death</td>
</tr>
<tr>
<td><strong>Basic</strong></td>
<td>RM 25 /</td>
<td>RM 25 /</td>
</tr>
<tr>
<td></td>
<td>family</td>
<td>family</td>
</tr>
<tr>
<td><strong>Enhanced</strong></td>
<td>RM 35 /</td>
<td>RM 35 /</td>
</tr>
<tr>
<td></td>
<td>family</td>
<td>family</td>
</tr>
<tr>
<td><strong>Advanced</strong></td>
<td>RM 60 /</td>
<td>RM 60 /</td>
</tr>
<tr>
<td></td>
<td>family</td>
<td>family</td>
</tr>
<tr>
<td><strong>Claim payment upon death</strong></td>
<td>Funeral Expenses :</td>
<td>Funeral Expenses :</td>
</tr>
<tr>
<td></td>
<td>RM 1,500</td>
<td>RM 1,500</td>
</tr>
<tr>
<td></td>
<td>Donation* :</td>
<td>Donation* :</td>
</tr>
<tr>
<td></td>
<td>RM 200</td>
<td>RM 200</td>
</tr>
<tr>
<td><strong>Basic</strong></td>
<td>Funeral Expenses :</td>
<td>Funeral Expenses :</td>
</tr>
<tr>
<td></td>
<td>RM 1,500</td>
<td>RM 1,500</td>
</tr>
<tr>
<td></td>
<td>Donation* :</td>
<td>Donation* :</td>
</tr>
<tr>
<td></td>
<td>RM 200</td>
<td>RM 200</td>
</tr>
<tr>
<td><strong>Enhanced</strong></td>
<td>Family Support :</td>
<td>Family Support :</td>
</tr>
<tr>
<td></td>
<td>RM 800</td>
<td>RM 1,000</td>
</tr>
<tr>
<td><strong>Advanced</strong></td>
<td>Family Support :</td>
<td>Family Support :</td>
</tr>
<tr>
<td></td>
<td>RM 1,000</td>
<td>RM 1,000</td>
</tr>
</tbody>
</table>

Donation*: Waqf to Mosque on the name of deceased

Funeral expenses are not the only claimable amount under the coverage, it also covers the financial support to the deceased family that could help them to go through a difficult time. At the same time, a small part of the claim will be given to the Masjid as waqf on behalf of the deceased for the benefits of the hereafter (continuous reward).

Takaful Operators will assist to set up a trust fund using the contribution collected. Hence, we suggest that Takaful Operators set up the Waqf fund by using the contribution collected to gain trust and ascertain proper governance is in place for the Masjid.

When death happened and claim incurred, Masjid will assist the deceased family to fill up the form and submit documents to Takaful Operators. The documents shall include but not limited to death verification letter, claim form and bank details of the deceased family. Masjid will be responsible to ensure the authenticity of the claim and documents so Takaful Operators would disburse the fund within a short period of time. In order to provide necessary assistance within the stipulated time, we suggest Takaful Operators to disburse the claim within 3 working days now that a proper process in place. The faster claim process will build trust and preference of the community to Takaful Operators.

Masjid will update Takaful Operators on any new registration or withdrawal of the participants on a monthly basis. The digital superiority of Takaful Operators will be a mutual advantage.
Participants are allowed to use the online platform of Takaful Operators to check their plan, coverage, and status.

In short, the Takaful Operator will provide the following services:

i. Administration service: Takaful Operators maintains the member listing for Masjid. Every month’s end, Masjid will notify Takaful Operators on any new registration or withdrawal of the participant during the month. Then, Takaful Operators will update the member listing and collection/refund of the contribution to Masjid.

ii. Training: Takaful Operators provide Masjid the training on registration, withdrawal and claim process to ensure the smooth process.

As a return, there is a Wakalah fee payable to Takaful Operator. Portion of the contribution will be paid to Takaful Operators as the Wakalah fee. The Wakalah fee may differ based on the quotation from different Takaful Operators.

For Model 1, it creates a competitive environment between the Takaful Operators. Each Takaful Operator will have different coverage and contribution package. As a result, it enhances the creativity and service level of the industry. Besides that, it creates potential collaboration between Masjid. Small Masjid could combine their profile to have better bargaining power and get a better package from the Takaful Operators. At the same time, the risk for Takaful Operators is spread better with a larger number of participants.

1.2 Model 2: Administrative Services Only

For Model 2, it is initiated by the Masjid by allocating the lump sum of the initial fund and participants listing to Takaful Operator under the Khairat fund scheme. Takaful Operators will take the fund and set up a Masjid fund which will be invested into Shariah-compliant instruments. Any return from the investment shall be distributed among the Masjid and Takaful Operator (the profit sharing ratio will be discussed later). Any return for the Masjid will be reinvested into the Masjid fund.
When death happened and claims incurred, the deceased family will get the claim from Masjid. Masjid will pay using floating cash flow available in the Masjid. Subsequently, Masjid will get reimbursement from Takaful Operators by submitting the necessary documents such as but not limited to death verification documents and claim form. Takaful Operators will withdraw the money from Masjid Fund and reimburse Masjid within 3 working days from the date of the document receipt. Upon performing the reimbursement, Takaful Operators shall cross-check the death verification document to the member listing. To ensure the continuity and solvency of the account, Takaful Operators will provide Qard Hassan to Masjid Fund in case the balance in the account is insufficient or an Excess of Loss cover to the fund.

As a return, there is a Wakalah fee payable to Takaful Operator. Portion of the contribution will be paid to Takaful Operators as the Wakalah fee.

Masjid shall declare any deletion or addition of members monthly. Subsequently, Takaful Operators will provide the updated member listing and statement of account to Mosque. This is to ensure both parties share the same members listing and Masjid is made known to the transactions and balance of Masjid Fund. With the strong digital capability of the Takaful Operator, participants are allowed to use the online platform of Takaful Operators to check their plan, coverage, and status.

In short, the Takaful Operator will provide the following services:

i. Administration service: Takaful Operators maintains the member listing for Masjid. Each month, Masjid will declare any additional or deletion of members to Takaful Operators via email. Takaful Operators will update the listing and send the latest copy of member listing to Masjid.
The recommendation hopes to bring transformation to the industry and community. Collaboration with Masjid allows Takaful Operators to develop stronger branding with the Muslim community.

ii. Professional fund Management service: Takaful Operators will invest the fund under the account. The fund should invest only in Shariah-compliant vehicles. Any profit for Masjid will be reinvested into the Masjid Fund. Hence, the money in the account shall be growth at a compounded rate.

iii. Fund Solvency: To ensure continuity and solvency, Takaful Operators will provide Qard Hassan in case there is insufficient balance in the account or provide an Excess of Loss cover.

iv. Advisory and training: Takaful Operators provide advice on the initial fund amount and training on risk selection to Masjid. Takaful operators advise Masjid on the amount of initial funds to be allocated using their underwriting and investment expertise. Takaful Operators also provide training to Masjid on the risk selection, management of the account and claim process submission to ensure the smooth process and sustainability of the Khairat Fund.

There are two principles under Model 2, Wakalah and Mudharabah.

i. Wakalah fee: Portion of the initial saving amount will be paid to Takaful Operators as Wakalah fees. (suggestion: 10% from the survey with Masjid).

ii. Mudharabah: Any return from the investment vehicle shall be shared among Takaful Operators (TO) and Masjid (suggestion at 20:80 – TO:Masjid, from the survey with Masjid). The sharing ratio serves as a reward for Takaful Operators that perform well in choosing the investment vehicle. On the other hand, this also reduces the agency problem as Takaful Operators have the incentive to perform well to receive the extra return.

2.0 Conclusion
Khairat Funds and schemes objectives can go beyond just profit. The aim and purpose of institutionalizing the Khairat Funds is not just to maximize the fund’s returns and improve the financial position for both Masjids and Takaful Operators. Khairat coverages are the stepping stone for Takaful Operators to do more. As the adage “the more you give the more you receive”. It is the bridge that will connect Takaful Operators to the Masjid and the Muslim community in particular. The cooperation of the operators, Masjids and community is mutually beneficial; they grow with the support from one another (alignment to ta’awun).
The recommendation hopes to bring transformation to the industry and community. Collaboration with Masjid allows Takaful Operators to develop stronger branding with the Muslim community. Similar to bancatakaful Takaful Operators can widen their network and serve the community better and provide greater convenience to the society. It is a new way for Takaful Operators to penetrate every corner of Malaysia. Muslims may have access to Takaful products and coverages via their familiar Masjid environment, where they would attend every week. All this could be done via "Masjid-Takaful" (or MaTa in short). Institutionalize Khairat Fund would be the first step for the expansion. The community will be brought together to help one another via Khairat funds and other Takaful schemes.

We hope there will be a Takaful Operator that would dare to take the first step in implementing such a model to become the market leader. A market leader that poses a good corporate image, take good care of the community, and not only their profit. A market leader that provides value-added services needed by society.

Jc Project MaTa is in line with our country direction and Bank Negara Malaysia’s (BNM) value-based intermediation (VBI) initiative, namely sustainability of takaful and coverage for everyone. The government has urged Takaful Operators to expand their reach to more people, just as the mySalam scheme is increasing the penetration rate for Takaful among the B40, to raise the quality of life of the community. We believe that Khairat funds will be one of the ways to impact and create value for society as a whole. In line with the digital revolution, MaTa apps should be developed to facilitate all the processes of registration, documentation, reporting and communication amongst the stakeholders. Hence, by annexing itself to the Masjids via Khairat funds, Takaful Operators could contribute to society and strive together towards a prosperous and respectful nation and their financial sustainability.
Islamic social finance (ISF) tools have been instrumental in alleviating poverty as they promote fairness in the distribution of wealth in society. For Malaysia, when effectively mobilised, such instruments are expected to create a significant positive impact on both socio-economic situation and Malaysia’s economic growth in general. As an impact-focused technique, community investment through cash Waqf for example, has potential to support those that are less advantaged and provide entrepreneurial assistance through asset purchases and working capital needs. To this end, we present a model of Islamic social finance based on the ‘Central Halal Kitchen’ concept, using e-hailing delivery solutions for distribution.

Islamic financial institutions have long had challenges providing finance to start-ups and micro enterprises due to the higher levels of risk and limited or no security cover.
It has thus been difficult to establish these types of start-ups with adequate capital. In fact, Malaysia has experienced robust economic growth for the past few decades, with urbanisation expanding from 34.2 percent in 1980 to 71 percent by 2010 (Siwar, Ahmed, Bashawir, & Mia, 2016). The acceleration of urbanisation resulted in rising social issues, high cost of living, unemployment and poverty. Urban poverty has been a visible phenomenon, and with the lack of access to funding, micro entrepreneurs have been left to find finance solutions of which they have little knowledge or experience in. As such, INCEIF’s Islamic Social Finance Unit is currently developing the concept of a ‘Halal Central Kitchen’ called “SuduNest”, to bring together like-minded entrepreneurs in food and beverages that would be managed with strong quality controls and halal certification whilst they use their talents in preparing succulent meals for the community. Sudu

As a social enterprise, SuduNest aims to help and strengthen the living standards of the underprivileged community and to achieve zero poverty in the urban areas, specifically the city of Kuala Lumpur by the year 2030. SuduNest selected Pantai Dalam as their first location to launch the pilot project. After a market study based on the interviews and surveys, it was found that a proportion of the Pantai Dalam community have financial challenges. In order to earn a living some have established micro food and beverage businesses, although the ability for these home industries to progress is severely restricted due to obvious factors, for example:

a. They have no halal certification as it is difficult to acquire certification without an official kitchen that can be vetted

b. They have limited training and skills in providing their services and learn very much on the job

c. The ingredients and quality of the products have been purchased based purely on cost rather than quality

d. They have limited to no expertise in marketing, packaging, promotion and distribution of their products to market.

1 Sudu means spoon in Bahasa

To this end, we present a model of Islamic social finance based on the ‘Central Halal Kitchen’ concept, using e-hailing delivery solutions for distribution.
With these challenges in mind, the team established a strategic approach to assist the community with the objective of improving their plight as best as possible. SuduNest is therefore expected to be a catalyst for them to improve their standard of living and soon move to the next income group. The strategic objectives of the initiative are outlined below:

SuduNest: Strategic Objectives

1. **Halal Certification**
   - To assist micro-SMEs in the community to acquire Halal certification for their products

2. **Digital Platform**
   - To increase their market penetration and distribution using available online platforms

3. **Trainings**
   - To enhance the community skill-set and improve the livelihood of the urban poor

Sources: INCEIF (2019)
The Business Model

Based on the diagram above, SuduNest is a supportive self-sustaining initiative that provides a venue, equipment, quality assurance and assists in obtaining Halal certification for the entrepreneurs working out of SuduNest’s central kitchen. Based on a management company (MANCO) structure, the MANCO covers all costs including rental, kitchen equipment, utilities and the supply chain together with organising for delivery. From here, SuduNest provides for the livelihood of all the chefs working in the central kitchen where they are assigned specific areas to produce foods and beverages that they have been doing for so many years. To increase the value proposition, SuduNest supports the training and supervision of these entrepreneurs to drastically improve the standards of production, thereby increasing the price that may demanded for the newly packaged product.

How does SuduNest intend to find fund for this project? SuduNest intends to establish a cash waqf to fund the overall operation of the central kitchen. With the cash Waqf, SuduNest can actually purchase the equipment and the chefs could utilise all of these facilities at SuduNest for a share in the profits. The MANCO ensures that the facilities and the entrepreneurs adhere to the Halal standards set by The Malaysian Islamic Development Department (JAKIM). Once tested and enhanced, the SuduNest business model is may be replicated to other underserved communities in Kuala Lumpur and broader Malaysia.

The premise of SuduNest is not new. Central kitchens exist. However, applying the cash waqf support fund and the continuous training and supervision whilst maintaining halal standards has little precedent.
There are significant efforts to improve the condition of the urban poor, through training and skills-building for widows, single mothers and others in need.

However, it is also true that many of these entrepreneurs have the talent and passion to break out of the cycle of poverty and contribute to the communities they are part of.

The 3-Tiers Approach in SuduNest

The first level of support and skills training may thus be recognised as the basic skilling level. Generous donors including financial institutions and individuals have been contributing to the purchase of basic equipment for these entrepreneurs. However, there is limited effort in taking them to the next level. At the first level, we propose a 3-tier approach to launching these entrepreneurs into a more sustainable and supportive ecosystem for development that is limited only in their own effort.
However, it is also true that many of these entrepreneurs have the talent and passion to break out of the cycle of poverty and contribute to the communities they are part of.
By progressing through these tiers, even those without any substantial educational background may be catapulted into becoming small-business owners and can graduate from the central kitchen into their own enterprise. Whilst it is expected that not everyone will be able to progress from one tier to another, the ecosystem will exist as a supportive mechanism that will enable those that intend to move up a tier.

The contribution of GDP by SMEs in Malaysia, increased to 38.3 percent in 2018 from 37.8 percent 2017\(^2\). The growth momentum according to sectors was accelerated by food and beverages (F&B) industry which grew to 8.6 percent in 2018. SuduNest is expected to benefit from this growing sector as it eases access to halal certification inclusion, making it more marketable and acceptable for the majority of Malaysians. Its financial benefits align with the UN SDGs, Value-Based Intermediation (VBI) and the Universal Financial Access 2020 (UFA2020), assisting families and micro-enterprises with socio-economic empowerment.

The premise that SuduNest is built upon, is that of supporting others in other to reach personal fulfilment. Finally, a parable of the ‘Sudu’ was related by the Head of Social Finance at INCEIF, Assist Prof Ziyaad Mahomed, in a recent speech he gave:

“I leave you with an anecdote that I used to listen to growing up, about the ‘Sudu’ and what we were meant to do.

 growing up, we’ve heard about a conversation between the inhabitants of heaven and the inhabitants of hell. One day they get to meet and the people of heaven asked the people of hell, with concern and worry, what it felt like to be in hell.

And the people of hell replied, “It’s terrible! It’s horrible! It’s beyond the imagination. The people of heaven asked, “please explain...” the people of hell replied, “Do you know how they

torture us? They give us the most delicious food laid out on vast tables.

Then, they give us these long spoons and no matter how hard we try, we can’t feed ourselves and we starve. It’s HELL!

The people of heaven scratch their heads in confusion and say, “that’s very strange...We also get long spoons. But we figured those spoons were to feed each other!”

References
Action based learning (ABL) had contributed such excitement throughout our student life at INCEIF. Action based learning is a method of learning by essentially working on real projects, issues and challenges in association with selected partner companies, using models taught in the classroom with the support of mentors, faculty experts and industry leaders. Throughout ABL, we were assigned to a project with Malaysian Takaful Association (MTA) to institutionalise the Khairat fund as part of the core subjects for MSc students.
In the project, we had a chance to interview almost all Takaful operators in Malaysia which allow and enable us to understand the underlying issues faced by the industry. As we learnt, we started to develop the business model which not only able to solve the problems for the Takaful operators but also help the society as a whole in getting takaful coverage.

The Malaysia Takaful penetration was reported to be at 14.8%\(^1\) in 2017 due to lack of affordable and accessible product\(^2\). As such, these two elements have been our main focus in our new proposed business model for our ABL project, targeting the B40 segment.

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1 Lim, Justin. "Malaysia’s 2019 Takaful Growth to Stay Moderate." The Edge Financial Daily
2 Hui Lin, Chiew. "Expanding Insurance and Takaful Solutions for the Underserved Segment." BNM Box Article
Throughout the project, we also had interviewed several Masjids which further helped us in enhancing our proposed model. In our feasibility study, we conducted a market survey that allowed us to gather primary data which was used to analyse the needs and wants of our target market. We were truly cherished to know that our model is widely accepted by our target market based on our findings. Moving forward, we would continue to engage with Masjids to ensure our model meets the expectations of the prospective takaful subscribers.

However, achievement on paper was not our only goal as we believe our ideas could go beyond that and help the B40 community. As such, we decided to bring the ideas to another level as a start-up idea. To be able to compete with other established start-up ideas, we had enhanced our model by having a wider scope in social and financial inclusion, to tackle more social issues and to manage the needs of the B40 community.

The learning curve was steep, but we were eager to bring the changes. We actively participated in different start-up programs in order to familiarise ourselves in the start-up environment. We had successfully made it into top 20 of the BNM’s Alpha Pre-Accelerator Start-up during MyFintech Week 2019, which was held on 17-21 June 2019, at Sasana Kijang Bank Negara Malaysia. Our commitment paid awesome rewards when we obtained new knowledge which was impossible to obtain through books and notes. Start-up is a long process, nothing comes by luck and we must equip ourselves in both aspects of technical and mental. We must have the right knowledge and skills to operate, at the same time be mentally prepared, to be persevering on what we were working on. We appreciate this experience very much which we could utilise in our lifetime.
By qualifying ourselves in IF Innofest 2019 competition which was held August 2019 at Sasana Kijang, Bank Negara Malaysia, we had an opportunity to present our ideas to regulators, government agencies, industry players, investors, potential partners and academicians. The valuable feedback and comments we gathered during IF Innofest 2019 were extremely useful in deepening and widening our thought process and focus areas. Pitching an idea that aimed for social and financial inclusion using takaful products had allowed us to win the judges’ attention. We were announced as second runner up during IF Innofest 2019. This has become a token for us to affirm that our idea is valid and able to be commercialized.

We gained great and unforgettable experiences from IF Innofest 2019. We hope to see more participation from students in similar events in the future. This is an opportunity for students to showcase their ideas and innovations for the betterment of the industry as well as the community. The involvement in such event is rewarding while winning the prize is an extra bonus. No doubt the experience is life changing as we build our connection with the industry and create indelible memory. Below is a brief details on MaTa, our team ABL project:
MaTa (2nd Runner-Up during IF INNOFEST 2019)

MaTa aims to help the community during difficult time, to get community protected from adverse situation. Many Malaysian have neither insurance nor takaful coverage and many are underinsured. Hence, we need to create a model that ables to provide an accessible and meaningful coverage. We see Masjid as the most suitable and potential channel as it is the most reliable institution for the community. Bridging Masjid and Takaful operators enables Masjid to provide more systematic and wider range of services to the community. Furthermore, no matter how rarely Muslims present themselves to Masjid, nobody can refrain from it in the event of death. Hence, Khairat would be the first focus area that we would like to address.

We are developing the symbiotic relationship where the collaboration will benefit all involved parties, namely Masjid, Takaful operators and local community. In our model, we are creating the mutual benefits in:

- access to fund for the takaful operators;
- administration assistance and investment opportunity for the Masjid; and
- convenience and protection for the community.

The community would feel more connected and have a better sense of belonging to the Masjid. We believe our model would improve the takaful penetration rate and subsequently enhance the quality of life, especially the B40 segments as the protection is now easily accessible and handled by trusted party.

Our vision is to bring MaTa beyond Malaysia. We hope to introduce the mutual assistance principle in Takaful to the world. Takaful could be alternative for financial assistance during adverse situation but it should be clearly differentiated from insurance because Takaful focus in “ta’awun”, mutual assistance and shared responsibility among members in providing financial aid and assistance to those who had incurred misfortunes, mishaps or faced difficulties.
To conclude, the formation of MaTa doesn’t belong to only two of us. We are blessed to have guidance and assistances from different parties. We would like to take this opportunity to express our highest appreciation to our mentor – Mr. Ezamshah who led us to the clear path. A special thanks to ABL project teams and INCEIF for bringing us the opportunity. We are grateful to have Mr. Syahid and Mr. Asmawi by our side in guiding us throughout the process. It is impossible to have MaTa without anyone of them.

Last but not least, the whole experience is an eye-opening and we believe this is just the beginning of our journey to create substantial positive impact to the society. Although a lot of efforts needed to push this further, we will hold our faith to create the success story and most importantly, to provide the needed protection for the society.
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