Musharaka Financing to Rural-Based small entrepreneurs by Islamic Bank in Bangladesh: An Institutional-Network Approach

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Abstract

Since its inception on March 13, 1983, the Islami Bank Bangladesh Limited (IBBL) has been rendering its financing services based on Islamic Shari’ah as a Joint Venture Public Limited Company in the money market of Bangladesh. One of the main modes of financing of this specialized bank is the Musharaka (Partnership) mode of financing. The present study aims at determining how and to what extent the Musharaka mode of financing works while lending funds to different rural-based small entrepreneurs in the country. Furthermore, the purpose of this study is to explore the success of Islami Bank Bangladesh Limited in extending credit facilities through the Musharakamode of financing to its clienteles. The study also aims at determining how this mode of financing contributes in establishing various network relationships among different economic actors in a society. An ‘Institutional-Network’ theoretical model is used to study this particular phenomenon. The research methodology applied in the study is qualitative in nature. A multiple explanatory case study is adopted as a research strategy in order to focus on contemporary phenomenon within the real life context of rural-based small entrepreneurs and the lending organization.

Keywords: Sharia, Musharaka Financing, Institutions, Network, Rural-based small entrepreneurs, Qualitative Research, Islami Bank Bangladesh Limited, Islamic Bank, Bangladesh
INTRODUCTION

Bangladesh, a nation on the map of the world, attained its independence in 1971. It is one of the world’s most densely populated countries with 150 million people, 26 percent of whom live below the national poverty line of US $2 per day. In addition, a child malnutrition rate of 48 percent is tied to the low socioeconomic status of women in the Bangladeshi society. Since its independence, the nation has increased its real per capita income by more than 130 percent. The country has also reduced its poverty level by more than half by striving to achieve most of its Millennium Development Goals. In spite of such progress, Bangladesh remains a low-income country with substantial poverty, inequality and deprivation. More than one third of the population live below the poverty line, and a significant proportion live in extreme poverty. The poverty rate is highest in rural areas, at 36 percent, compared to 28 percent in urban centres. Many people are unemployed, have an inadequate diet and suffer from periods of food shortage. Most of Bangladesh’s laborers are engaged in informal, low-income jobs with limited productivity. Although agriculture now accounts for less than 20 percent of GDP, the farm sector still employs about 44 percent of the labor force. However, with urbanization, the amount of farmland is shrinking, and most rural households have very little, if any, cultivable land. Rice is the dominant crop, but production increases are limited by farmers’ lack of access to critical production tools such as high-yielding rice seeds. Like other similar nations, rural-based small entrepreneurs play a predominant role in enhancing the economic growth of Bangladesh. However, this sector of economy suffers from the lack of formal credit facilities. Due to this, most people are heavily dependent on rural money lenders who consume the lion’s share of their profit. As a proverb, poor entrepreneurs in Bangladesh say that they ‘are born in debt, live on debt and die in debt’.  

Research problem: rural-based small entrepreneurs and Shari’ah based Islamic banking financing

In less developed countries, and in developing nations in general, rural-based small entrepreneurs (RBSEs) play significant roles in the elimination of the unemployment problem, a serious impediment to a nation’s economic growth. Although large-scale industries are involved in mass-production and invest large amounts of capital, these industries are mostly urban based. Consequently, large-scale industries fail to play a significant role in solving unemployment problems related to those residing in rural areas. This is exactly where SEs succeed better (Anderson, 1982; Macuja, 1981). A number of researchers (Ashe and Cosselett, 1989; Little, 1988; Little et al., 1987) have

highlighted this issue with an emphasis on how and to what extent this sector of the economy contributes to the development of a nation’s economy. The main contribution of this industrial sector is that it creates job facilities for many unemployed people in rural areas. Skilled workers can thus contribute towards the economic growth and development of the nation. However, in spite of its contribution towards economic growth, rural-based small entrepreneurs in almost all developing nations lack institutional credit. In recent years, interest-free banks in different countries have started investing funds towards rural-based small entrepreneur sector.

Bangladesh provides a large consumer market for potential industries. Although it holds one of the lowest wage structures in the world, the comparative advantage of Bangladesh lies primarily in its agro-processing industries. However, besides from agriculture, the rural-based small entrepreneur sector in Bangladesh is a potentially lucrative field of investment (IPPF, 2001). In spite of its major contributions towards economic development, the rural-based small entrepreneurs in Bangladesh suffer from a lack in working capital, institutional credit facilities and poor management. Besides from traditional banking, ‘Shariah’ based financing also plays a predominant role in solving financial problems related to this sector of the economy in Bangladesh. Rural-based small entrepreneurs also receive small loans from different credit institutions. In this regard, Alam (2009) observed that this sort of credit is usually delivered in a scheme of joint-liability use (peer pressure) to enforce loan repayment. This is considered to be a tool for poverty alleviation in developing countries. In Bangladesh, Yunus (1982, 1993) promoted a microcredit program under the name ‘Grameen Bank’, as an effective tool for enhancing the income of the poor through the creation of self-employment in various informal activities. However, it is noted that the interest charged on such loans are very high (Nabi, 1996) but it has nonetheless provided the poor with access to the necessary credit to establish economic enterprises based on their existing skills, in an effort to earn a higher income.

Furthermore, rural-based small entrepreneurs in Bangladesh suffer greatly due to the lack of institutional credit facilities (Ahmad, 1984, Alam, 2009, Alam 2012). There are many formal as well as informal financing organizations that are operational in the money market of Bangladesh. Formal financing institutions like government and privately owned commercial banks normally provide loans to large and medium scale industries. Cooperative banks in the country provide loans to rural-based small and cottage industries. Additionally, moneylenders in rural Bangladesh are an important source of loans to rural-based small entrepreneurs. Due to the shortage of capital, they are compelled to borrow funds from local moneylenders at a high rate of interest. In recent years, different Islamic banks in Bangladesh started lending interest free credit towards different projects run by rural-based small entrepreneurs. Among other modes of financing, this specialized bank gives credit to rural-based small entrepreneurs...
through the ‘Musharaka’ (Partnership) mode of Islamic financing. In comparison to credit by conventional banks and other loan giving agencies like NGOs and village money lenders, the ‘Shariah’ based Islamic banking credit is considered to be a challenging and contributing financing tool which facilitates greatly in creating job opportunities for the rural poor and eliminating rural poverty in the country. The study of ‘Musharaka’ financing by Islamic Bank Bangladesh Limited (IBBL) in this article is based on the socio-cultural context of Bangladesh and its relationship with the Islamic banking system. As mentioned earlier, one of the acute problems of rural-based small entrepreneurs in Bangladesh is the shortage of capital. Interest-free finance initiated by different Islami banks in Bangladesh through their different ‘shariah’ based modes of financing is found effective not only in solving financing problems of rural based small entrepreneurs but also in enhancing the relationship between lenders and borrowers.

Based on the above discussion, the main research questions posed are:

1. How and to what extent does Islami Bank Bangladesh Limited (IBBL) succeeded in implementing the ‘Musharaka’ mode of Islamic banking finance among different rural-based small entrepreneurs in Bangladesh?

2. How does this specific mode of financing contribute in promoting lender-borrower network relationships?

3. To what extent do societal sector institutions like the country culture, religion, family/clan, political systems, legal systems and government influence ‘Musharaka’ financing activities?

**The institutional-network theoretical approach**

The concept of an ‘Institutional-Network’ theoretical frame of reference (Alam, 2002) is used to study this particular phenomenon. The Institutional-Network theoretical concept is developed based on Whitley’s (1992a) ‘Business System’ (BS) institutional approach and Jansson’s (2002) ‘Network Institutional Model’. The Business Systems Approach is an institutional approach used by Whitley (1992b) to study business organizations, inter alia in Asian countries. The author, in his comparative study of Business Systems in East Asian countries, e.g., Chinese family business (CFB) units in Taiwan and Hong Kong, Japanese Kaisha and Korean Chaebol, attempted to determine how firms are constituted as relatively distinct economic actors in different market societies as well as how they organize economic activities in the form of dominant hierarchy-market configurations. The comparative analysis of Business Systems, as Whitley (1992b) observed, is the study of these configurations. In this regard, the author argued that, a key task concerning the comparative study of business systems is to analyze how distinctive patterns of economic organizations become
established and effective in different societies and how they change in relation to their institutional context. In his study, Whitley (1992a) also observed that these patterns concern the nature of economic activities that are coordinated through managerial hierarchies. The author further investigated how these hierarchies organize their cooperative and competitive relations through markets.

Since one of the objectives of the study relates to finding how and to what extent ‘Musharaka’ financing by Islami Bank Bangladesh contributes in promoting rural-based small entrepreneurs and by enhancing the lender-borrower network relationships, apart from Whitley’s (1987, 1990, 1992a, 1992b) institutional concept, the network concepts of Jansson’s (2002) ‘Networks Institutions’ model, is also used in the theoretical framework. The author integrated network with institutions in order to view the network from an institutional perspective. Institutions are also concerned different types of habitual or recognized behavior, such as habits, rules, and procedures, implying that institutions are characterized by a rule-like or governing nature, an ability to facilitate and constrain inter-human and inter-social relations, and by predictive behavior (Jansson, 2002, Hughes, 1939). Veblen (1919, p.239) in this regard observed that, institutions themselves are comprised of settled habits of thought common to the generality of men. In order to study the relationships between Multi-National Corporations (MNCs) and their commercial partners, the author used a network approach and developed a theory to analyze such linkages. Furthermore, to study the network relationships between and within organizations belonging to the two focused institutions, for example, Rural-Based Small Entrepreneurs Systems(RBSES) and Major Financing Systems (MFS) and their relationships with other economic actors in the organizational fields, the concept of Jansson’s (2002) Trans-organizational Network theory is also used in the theory. Since the networks are observed from different angles, the study also used the network concepts defined by different authors like Rasmussen (1988), Kuklinski & Knoke, (1988), Anderson and Carlos (1976), Easton & Araujo (1991), Elg & Johansson (1992), Johanisson&Nowicki (1992, Easton (1992),Håkansson (1993), Aldrich &Whetten (1981), and Emerson & Cook (1984).

To study the impact and influence of ‘Musharaka’ financing on rural-based small entrepreneurs, based on Whitley’s Business System, financial organizations of similar nature in Bangladesh is categorized as Islamic Financing System (IFS) and viewed as particular arrangements of hierarchy-market relations that become institutionalized and relatively successful in a particular context. A similar arrangement is also made to institutionalize different rural-based small enterprises under Rural-Based Small Entrepreneur System (RBSES).

The Institutional-Network theoretical model, which is developed based on the above discussion, is shown below in Figure 1.
The theoretical model shown in the above figure consists of two major fields: the financial market and other organizational fields. Since the focus of the present study is concentrated on ‘Musharaka’ financing by Islamic banks to rural-based small entrepreneurs under the RBSE Systems and their relationships with the Islami Bank Bangladesh Limited (IBBL) under Islamic Financing System (IFS) within the financial market field, this field is divided into two sub fields: the Rural-Based Small Entrepreneur System and the Islamic Financing System (IFS). Thus, these issues are viewed under the organizational fields in the first rectangle. The Rural Based Small Entrepreneur System and the Islamic Financing System are viewed as two different institutions in the organizational fields. The second box or major field consists of different actors in the other organization fields. These actors are for example, customers, intermediaries (local leaders, seniors), competitors, and suppliers. They are
related to the product and service exchange networks, influencing the major organizational field of the financial market in the first rectangle. The external financial exchange network between the RBSMS and the IFS shown in the framework is meant for studying the exchange network relationships between and within different organizational units belonging to Rural-based small entrepreneurs Systems and the Islamic Financing Systems in the financing market of the major organizational fields.

Since the exchange activities and network relations of different actors in the organization fields are influenced by societal sector institutions like country culture, religion, family/clan, political system, legal system and government, these institutions are placed in the outer rectangle. These macro institutions surround the major institutions in the first and the second organizational fields. They are shown in the outer rectangle in order to study their influences on the exchange functions with regards to ‘Musharaka’ financing to different rural-based small-enterprises under the RBSE Systems by financing organization IBBL under the IFS and also other institutions within and between these organizational fields.

Research methodology

The research methodology applied in the study is of a qualitatively nature (Jick 1979, Merriam 1998, Sherman and Webb 1988, Patton 1985). A qualitative type of research is characterized by collection of data directly from respondents in the field. This is because the entire research program is based on facts acquired from the material world, that is, the practical field of study. The study of lender-borrower network relationships between rural-based SE owners and Islamic banks was conducted through ‘in-depth interviews’ with respondents under review.

While interviewing respondents, based on Merriam’s (1998) ‘Interview Structure Continuum’ idea, I used highly structured, semi structured and unstructured interviews to suit the respective situation that arose. A multiple explanatory case study(Yin 1994) method was adopted as a research strategy in order to focus on contemporary phenomenon within the real life context of different rural-based small entrepreneurs under various RBSE Systems and their relationships with financing organizations within the Islamic Financing Systems.

As a part of the data collection processes, interviews were conducted with senior officials of six Islami Bank Bangladesh Limited (IBBL) branches in greater Chittagong areas. The interview period was about three months. In total, 12 senior IBBL personnel, who are responsible for giving loans to the rural-based small entrepreneurs, were interviewed. A list of different branches interviewed is shown in the following table.
Regarding the collection of data from the field, a direct interview method was used. While conducting interviews the following steps were taken.

- Both formal and informal means of interview methods were used
- Structured and semi-structured questionnaires were prepared and the same were used while interviewing respondents. The questionnaire was used depending on the circumstances and the qualifications of the respondents.
- Audio tape recorders were used to record respondents’ answers. Where the use of a tape recorder was difficult, the answers were recorded in a notebook
- Questionnaires were prepared taking different issues into considerations such as, lending procedures, bank-customer relationships and also other issues related to small-finance to rural-based small entrepreneurs
- Subsequent to the interview, the recorded tape was replayed and the data was recorded in a spreadsheet. A similar procedure was applied to the data that was recorded in the notebook.
- Based on the interviews and respondents information, data was arranged and analyzed from a theoretical perspective.

The definition and Islamic bank and Islamic banks around the globe

An Islamic bank may be defined as a financial intermediary whose objectives and operations as well as principles and practices must conform to the principles of Islamic Law (Shari’ah); and, consequently, is conditioned to operate all its activities without interest. The aim of Islamic economics is not only the elimination of interest-based transactions but also the establishment of a just and balanced social order free from all kinds of exploitation. An Islamic bank is not only a financier but also a partner in business. The system essentially involves sharing of risk between the owner of capital

Table 1: List of branches interviewed

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Branch name</th>
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<tr>
<td>1</td>
<td>Anderkila branch</td>
</tr>
<tr>
<td>2</td>
<td>Borodargarhat ahaddar hat branch</td>
</tr>
<tr>
<td>3</td>
<td>Muradpur branch</td>
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<tr>
<td>4</td>
<td>Patiya branch</td>
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<tr>
<td>5</td>
<td>Shitakunda branch</td>
</tr>
<tr>
<td>6</td>
<td>Station road branch</td>
</tr>
</tbody>
</table>
and the entrepreneurs, as well as sharing the result of the collective efforts. Thus, it differs from an interest-based system in which the risk is mainly borne by the entrepreneur or by the user of capital. In another way, we can call Islamic banking as participatory banking. The bank gives loans in kind rather than cash (Ahmad, 1984, 1981, Molla et.al. 1988; Nassief, 1989). The interest-free housing loans are given through the Islamic Society of North America (ISNA) controlled organization called “Islamic Co-operative Housing Corporation Limited (ICHC). A few Western banks such as, the Kleinwort Benson, Citibank and ANZ Grindlays also started to adopt the pattern of Islamic banking in cost-plus financing, leasing and equity financing for their clients in the Middle East, Southeast Asia and a few international corporations in Europe and Latin America (Ahsan, 1989; Kazarian, 1991; Gathura, 1996; Roula, 1995; Ken, 1994; Parker, 1993; Heffernan, 1999).

Khan et al. (2008) observed that at present, there about 300 Islamic banking and financial institutions across 75 countries, holding a paid-up capital of over US$13 billion, controlling assets worth US$300-US$500 and investments US$500 billion-US$800 billion, with an average annual growth of 15 percent. It has been estimated that Islamic banking and finance industry will reach US$4 trillion by 2010. It will hold 40 percent to 50 percent of total savings of the Muslim population (estimated as large as 1.5 billion) worldwide within the next eight to ten years.

**The Islami bank Bangladesh limited: first Islamic bank in Bangladesh**

Islami Bank Bangladesh Limited is a Joint Venture Public Limited Company engaged in commercial banking business based on Islamic Shari'ah with 63.09 percent foreign shareholding, having the largest branch network (total 301 branches) among the private sector banks in Bangladesh. It was established on March 13, 1983 as the first Islamic Bank in South East Asia.

IBBL is one of the first interest free banks in South Asian countries. The opening of an Islamic bank in Bangladesh brought a new era in the history of the country's financial market. With the introduction of the country’s first Islamic bank, a long cherished desire of many Muslims in the country was realized. The total number of branches of the bank as of December 1995 stood at 83. The bank had taken steps to spread its activities towards rural areas of Bangladesh.

The responsibility for the management and the formulation policy of the IBBL is vested with the board of directors. The board consists of 14 local and 9 foreign directors. As a rule of the Article of Association, a Bangladeshi director is to be elected as the chairman of the company. A higher power “Executive Committee” is formed to assist the chairman. There are six members in this committee and they are all nominated by the board of directors. In addition, there is a “Management Committee” consisting
of the most senior executives of the bank. There is also a “Shari’ah Council” comprising famous Islamic scholars, economists and bankers. This Council is responsible for supervising various affairs of the IBBL from the perspective of the Islamic Shari’ah. (Huq, 1990, Alam, 2002.)

**Different financing modes used by Islami bank Bangladesh limited**

An Islamic bank renders similar services to their customers as other conventional banks but due to the differences in the principles of Islamic banking systems the modes or techniques of accepting deposits and lending funds to customers differ from conventional banks. The investment modes that an Islamic bank uses while investing funds are discussed below.

**Mudaraba or Capital Financing**

Under the Capital Trust Financing or Mudaraba mode of financing, Islamic banks supplies the entire capital of the business and the customer gives his time and expertise, which forms a relationship between the supplier and user of capital. Thus, the bank and the customer work together and share profits and losses.

**Musharaka or Partnership Financing**

The word ‘Musharaka’ means a profit sharing joint venture, designed to limited production or commercial activities of long duration. In this case, the bank and the customer contribute capital jointly. They also contribute managerial expertise and other essential services at agreed proportions. Profit or losses are shared according to the contract agreed upon. An individual partner does not become liable for the losses caused by others. Due to this joint venture this technique is also known as Equity Participation mode of investment. Profits or losses are distributed according to a predetermined profit and loss sharing agreement. Both the bank and the customer take part in the management and control of the entrepreneurial activities.

**Murabaha (Mark-up or Costs-Plus- Profit based Financing)**

The word ‘Murabaha’ means a cost plus profit based financing. As Khoja & Ghuddah (1997, chap. 1, p.2), states: “The mode of Murabaha sale connected to a promise is used by the Islamic banks which undertake the purchaser of commodities according to the specification requested by the customer and then resells them on Murabaha to the one who promised to buy for its cost price plus a margin of profit agreed upon previously by the two parties”. Under the Murabaha mode of investment the bank agrees to purchase for a client who will then reimburse the bank in a stated time period at an agreed upon profit margin. The mark-up price that the bank and the buyer agree to is mainly based on the market price of the commodity. Thus the bank earns a profit without bearing any risk.
Bai-Muajjal or Cost Plus Sale Under Deferred Payment

The Bai-Muajjal mode of investment is like a Murabaha mode of investment with an exception that the sale under this cost-plus sale mode investment is made on a credit basis rather than cash. The main feature of this technique consists in procurement of goods at the request of the client and selling it to him/her on credit. This mode follows the same conditions as Murabaha mode of investment except the following:

• The bank transfers the possession of goods to the client before payment.
• In order to cover the sale price of the goods, the bank obtains collateral securities from the client.
• The bank normally takes property of Municipal area as mortgage. In case the client fails to repay the sale price, the bank realizes the amount by selling the mortgage property.

Bai-Salam or Advance Purchase

Under Bai-Salam mode of investment the bank purchases industrial and agricultural products in advance from their customers. The main features of this mode are:

• The price is normally paid with the execution of an agreement.
• According to the terms of agreement, the bank receives the goods in due time.

Hire-Purchase Investment under Shirkatul Meelk

Islamic banks in Bangladesh also invest funds under Hire-Purchase mode. Under this investment technique, the bank sells building, transport and other valuable items to the client. The value of hire-purchase amount is payable in installments. When the client pays back the value of the goods including rent, the ownership is transferred to him. The features of hire purchase are:

• Before the purchase of the item the bank determines its accrual price, monthly rent, schedule of payment, cash security, additional security etc.
• The ownership of the item remains with the bank till the client pays the entire amount of installment.
• The rent is received on the basis of accrual income.

Ijara or Leasing

The word ‘Ijara’ indicates leasing. The leasing purchase is another technique followed by Islamic banks in financing customers. This system is almost similar to the leasing activity provided in traditional banking. Leasing is a contract between the bank and the customer to use particular assets. In this case the bank is called the lessor and the
customer is called the lessee who wants to use the assets and pays rent. Zineldin (1990), in this regard argued that the leasing agreement is based on profit sharing in which the bank buys the movable or immovable property and lease it to one of its clients for an agreed sum by installments and for a limited period of time into a savings account held with the same bank. These installments are invested in Mudaraba investment (Venture) for the customer's account. The accumulated profit generated from the payments, and the payments themselves are invested in the bank's investment ventures over the time period of the lease, contributing to eventual purchase of the leased assets.

Ijara-wa-iqtina (Leasing Purchase)

According to the Western leasing system the lessee pays specific rentals and a fixed rate of interest over a given period for the use of specific assets. But in the Islamic banking system of leasing, the risk related to leasing has to be shared between the bank and the lessee, in case of any damage to the leased assets. The contract is called ‘ijara-wa-iqtina’ i.e., leasing purchase, when the ownership of the assets is transferred to the clients after the completion of the leasing contract.

Quard E Hasan

Quard E Hasan means an interest-free loan given by the Islamic bank to the needy people in a society. The practice of dealing with this sort of investment differs from bank to bank. Quard E Hasan is normally given to needy students, small producers, farmers, entrepreneurs and economically weaker sections of the society, who are not in a position to obtain loan or any financial assistance from any other institutional sources. The main aim of this loan is to help needy people in a society in order to make them self-sufficient and to raise their income and standards of living (Alam, 2009).

Musharaka financing by the Islami bank Bangladesh limited (IBBL): an empirical review

This section represents a summary of information gathered through interviews from senior IBBL personnel in different rural branches in the greater Chittagong area. It includes a description of different issues like, the ‘Musharaka’ financing procedures that the IBBL uses while lending funds to its clientele, bank-clientele network relationships, formalities that borrowers must observe to be eligible for obtaining loans, mode of the repayment of loans, securities required to obtain loans and other related aspects regarding financing to rural-based small entrepreneurs.

The Nature of Rural-based small entrepreneurs to whom Loans are Given

Rural-based small entrepreneurs who form the clientele of the IBBL to whom the bank gives loans through a ‘Mushaka’ mode of financing, as reported by the respondents of
the bank, are of an average age of 25 to 35 years. Among the customers, more than 50 percent and more than 30 percent finished their college level education and undergraduate education, respectively. Almost all customers have prior business experience. The amount of loan given to customers ranges from BDT 50,000 to BDT 200,000 depending on the type and the nature of the business. The nature of the business consists of local and foreign trade, dairy farm, agro-based business etc.

The Loan Procedures Followed in ‘Musharaka’ Financing

The clientele of ‘Mushraka’ financing of the IBBL belongs to two different groups mainly manufacturing and trading. Prior to the initiation of loans, the bank advises the clientele to prepare a business plan and to submit a formal application for loans. The bank, upon the receipt of the application and business proposal, discusses the projects prospective and the social needs of the same in the project approval committee. Once the project is favorably considered, the bank then proceeds with other necessary formalities.

One of the bank staff pays a visit to its customer’s business site and makes a feasibility study about the business and its environment. The officer also interviews the particular customer about his or her expertise in the intended business. Once the bank staff is satisfied with his needed inquiry, he reports to the manager who later starts processing the loans. The bank prepares the necessary ‘Musharaka’ document and requests the customer to open accounts with the bank.

Pre-requisite for Obtaining Loans: Collaterals and Guarantor

The ‘Musharaka’ mode of Islamic banking financing is like a joint venture type of business. The bank and the customer contribute capital jointly. The customer is responsible for administrative and management activities of the entire business. The profits or losses are shared according to the contributed capital ratio. The customer keeps accounts of all expenses and income and periodically submits an income statement to the bank. Based on the statement, the profits or losses are determined. The customer needs to give collateral securities for the money borrowed from the bank. Apart from the collateral securities, the customers are required to submit two letters of recommendation from two influential persons in the locality who also act as guarantors for the customers.

Bank gives Loans in Kind

Once the loan application is considered favorably, the customers are asked to submit a list of goods or materials that they intend to buy. The bank later arranges the purchase

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3. 1 US $ = Bangladesh Taka (BDT) 78.0300
Mid-market rates: 2015-11-13 18:53 UTC
of the required goods for the customer. In the case of agriculture and manufacturing businesses, the bank buys necessary equipment and raw materials for the customers. Before processing loans, the bank ensures that the clientele have sufficient working capital to run the day to day business.

The Branch Wise ‘Musharaka’ Financed Customers

Many of the branches interviewed initially had no ‘Musharaka’ financed base customers, while in some branches the number of such customers reduced from previous years. A list of customers as reported by respondents in different branches is shown in the following table:

Table 2: ‘Musharaka’ clientele in different branches interviewed

<table>
<thead>
<tr>
<th>Branch name</th>
<th>Total</th>
<th>Trading</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anderkila branch</td>
<td>5</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Borodargarhat ahaddar hat branch</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Muradpur branch</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Patiya branch</td>
<td>17</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Shitakunda branch</td>
<td>5</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Station road branch</td>
<td>6</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>27</td>
<td>9</td>
</tr>
</tbody>
</table>

It is apparent from the above table that in the Muradpur branch there are no ‘Musharaka’ customers. However, it was reported by the respondents in this branch that the bank is negotiating with some customers who submitted their business proposals and their matter is under consideration. It is also known from the above information that about 80 percent of the rural-based small entrepreneurs borrowed funds for trading concerns while 25 percent are for manufacturing businesses.

The Visit of Bank Officials to Customers’ Business

Once the loan is sanctioned and the clientele start their business, the bank staff pays regular visit to them. Even though the supervision and control of the business is in the hands of customers, from time to time, the bank gives advice and look after the business progress. The Musharaka manager from every branch retains a close contact with their clientele and also helps in maintaining proper business records. In case the customers face any difficult situations, the bank experts in the related field advise and guide them accordingly. Apart from that, the bank assists indirectly in promoting their business by informing other potential customers of the bank.
Direct Contact with Customers by Bank Officials

As reported by the respondents in the bank, ‘Musharaka’ based customers are free to visit banks at any time and may discuss different business issues directly with the bank manager and other responsible officials. In every branch, there is a liaison officer who organizes the interview between bank officials responsible in ‘Musharaka’ financing and the customers. A ‘Musharaka’ based client is not required to pre-book an appointment to see the officers or the branch manager. They are always welcome by the bank officials to discuss any business related issues during office hours.

Influence of the Country culture and Religion in Musharaka Financing

It is reported by bank officials that the country culture and religion do not have any direct influence on the ‘Musharaka’ based financing to rural-based small entrepreneurs. However, it is observed by bank officials that many customers sometimes become victims of their cultural influence and bound to spend a lion’s share of their income in different functions and cultural occasions like marriage, religious ceremonies etc. Due to that, many clients face problems in procuring working capital for their day to day business. However, the bank officials often arrange meetings and gather to discuss different issues regarding spending from the perspective of Shari’ah. The bank’s officials voluntarily assist their customers in using their borrowed funds in proper and portable ways. It is reported by all respondents that the bank lends funds on a Musharaka basis to not only Muslim customers but also non-Muslim customers. Furthermore, many of the branches have non-Muslim customers who borrowed funds from them.

Legal and Political System in the Country

As informed by the respondents interviewed, the IBBL did not experience any difficulties from the viewpoint of legal and political system of the country. They have every option to lend funds in a business that complies with Shari’ah laws and regulations. However, the bank officials reported that they have many complaints from their customers about the local legal system in the country. Many of their clients who intend to initiate a new business become victims of a group of local political leaders who demand a high amount as donations. If they do not fulfill their demand, it becomes very challenging and almost impossible for them to start a business. In such cases, rural-based small entrepreneurs seldom get any help from local law regulating authority.

The Repayment Process of Loans

The repayment of loans is done through different installments which are mutually agreed upon by the bank and the customers at the time of signing the ‘Musharaka’ agreement. The agreement is renewed periodically and once the joint venture agree
ment periods ends, before signing the next agreement, the customer presents the statement of profits and losses to the bank. Upon proper examination of the records, the profits or losses of the project are determined. If there is any loss, the customer is to bear the losses as previously agreed upon. Once the profit margin is determined, a certain percentage of the customers’ profit is also used to pay the installment of the loans.

**Direct Supervision of Borrowed Funds**

The Islamic banks under review allow their customers free access to their entire amount of borrowed funds, with an important stipulation; before one is able to get unlimited access, one must prove to the bank that the amount being lent will only be spent on buying goods, raw materials or other accessories for the development of the business. In order to do this, the customer must produce new invoices from the vendors of the goods or raw materials each time he/she visits the bank. They may then utilize the amount of money they borrowed from the bank on a ‘Musharaka’ based financing. This is allowed to take place only after the loan has been sanctioned and credited to the individual’s Profit and Loss Savings Account.

All IBBL branches follow the same system while giving loans to rural-based small entrepreneurs. However, direct contact with customers and supervision of the borrowed funds sometimes differ from branch to branch. Since the credit is given in kind rather than cash, the supervision of loans is done according to the plan and program developed by each individual bank.

**Analysis of empirical findings**

Direct contact with ‘Musharaka’ customers to develop personal network

It is known from the study that, due to the nature of the business under the ‘Musharaka’ mode of financing, the bank personnel mostly contacts their customers directly. Apart from physical visits, some of the the clientele in rural areas are also contacted through telephone and faxes.
Communications with customers are shown as percentages. It is known from the above table that all branches of the IBBL under review contact their customers directly and avoid any contact through agents or third parties. This in turn develops personal network between the lenders and the borrowers.

**Table 3: Means of contact with customers in percentage**

<table>
<thead>
<tr>
<th>Branch name</th>
<th>Personal Contact</th>
<th>Through Agents or Middleman</th>
<th>Telephone &amp; fax</th>
<th>Through Mail</th>
<th>Through Other media</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anderkila branch</td>
<td>75 to 100 %</td>
<td>Nil</td>
<td>10 to 20 %</td>
<td>20 to 30 %</td>
<td>01 to 10 %</td>
</tr>
<tr>
<td>Borodargarhat ahadder hat branch</td>
<td>80 to 100 %</td>
<td>Nil</td>
<td>10 to 30 %</td>
<td>20 to 30 %</td>
<td>01 to 10 %</td>
</tr>
<tr>
<td>Muradpur branch</td>
<td>90 to 100 % 1/</td>
<td>Nil</td>
<td>01 to 10 %</td>
<td>10 to 20 %</td>
<td>01 to 10 %</td>
</tr>
<tr>
<td>Patiya branch</td>
<td>750 to 100 %</td>
<td>Nil</td>
<td>5 to 10 %</td>
<td>20 to 30 %</td>
<td>01 to 10 %</td>
</tr>
<tr>
<td>Shitakunda branch</td>
<td>85 to 100 %</td>
<td>Nil</td>
<td>10 to 15 %</td>
<td>20 to 30 %</td>
<td>01 to 10 %</td>
</tr>
<tr>
<td>Station road branch</td>
<td>70 to 100 % 1/</td>
<td>Nil</td>
<td>01 to 10 %</td>
<td>10 to 20 %</td>
<td>01 to 10 %</td>
</tr>
</tbody>
</table>

Communications with customers are shown as percentages. It is known from the above table that all branches of the IBBL under review contact their customers directly and avoid any contact through agents or third parties. This in turn develops personal network between the lenders and the borrowers.

**Bank-Customer Relationships: A Unique Means of Promoting Clientele Business**

It is revealed from the study that almost all branches allow their customers to visit senior officials or managers in charge of the department directly when needed. Formalities to meet senior officials are very simple and customers of all levels can avail the opportunity to discuss their business issue and gain advice regarding their business. Since the ‘Musharaka’ manager pay a regular visit to their customers in rural as well as in urban areas and consult various issues regarding business outside the bank premises, this promotes the customers’ business and encourages them to conduct their business successfully.
It is apparent from the above information that almost all branches maintain a strong relationship with their ‘Musharaka’ customers and also assist them by providing necessary advice and marketing of their products.

**Moral Teachings to Customers Enhances ‘Musharaka’ Financing**

It is also known from the study that senior bank staff in every branch is trained in such a way that they may motivate customers regarding their ‘Musharaka’ mode of financing. Since this mode of financing is mainly based on trust between the bank and the customers, the bank advises its customers from a religious point of view with regards to being honest and truthful in conducting business and in maintaining proper business records.

**Delay in the Repayment of Loans by a Customer**

The study also reveals that, once a ‘Musharaka’ customer fails to repay the loan in due time, or does not comply with the contract, the bank takes legal actions. Before taking a legal action, in case of default, the bank contacts customers personally. Apart from that, the following steps are also taken by the bank.

- Inform through correspondences
- Influence through people related to the customers
- Influence through local leaders
- Influence through guarantors

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**Table 4: The Extent of the Bank-Customer Relationships**

<table>
<thead>
<tr>
<th>Ibbl branches</th>
<th>Extent of the bank’s relationship with its customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch name</td>
<td>Access to bank’s senior staffs</td>
</tr>
<tr>
<td>Anderkila branch</td>
<td>1</td>
</tr>
<tr>
<td>Borodargarhat ahaddar hat branch</td>
<td>3</td>
</tr>
<tr>
<td>Muradpur branch</td>
<td>2</td>
</tr>
<tr>
<td>Patiya branch</td>
<td>1</td>
</tr>
<tr>
<td>Shitakunda branch</td>
<td>2</td>
</tr>
<tr>
<td>Station road branch</td>
<td>1</td>
</tr>
</tbody>
</table>

*Note: 1. Always; 2. Very often; 3. Often; 4. Sometimes; 5. Not at all*
Contact through organizations with whom the customer is related

There is a provision with the IBBL that, if any ‘Musharaka’ borrower becomes bankrupt or fail to repay the loan or comply with the terms and conditions, due to unavoidable circumstances, such as, natural disaster, or political unrest etc., the customer is given a further loan to develop his business position. Customers in some cases are given partial relief from their loan when it is discovered that they are truly unable to repay the entire amount of their loan.

Problems Due to the Cultural Influences on ‘Musharaka’ Financing Activities

The IBBL is based on Islamic principles, which aims at making the maximum utilization of savings and proper distribution of wealth. Sometimes social customs, the country culture, norms, and habits of people hinder the realization of these objectives. In rural Bangladesh, rural-based small entrepreneurs are not highly educated. The religious beliefs and faith of the people are influenced by the culture of the society. Although, every religion teaches all well to mankind, when it mingles with culture, it loses its strength and fails to bring any changes to human life. Islamic bank experienced many problems that arose from cultural influence, habits and norms of people. Although family ties play a great role in promoting business or production activities, such relations are also influenced by certain cultural factors. It is observed that the IBBL find it difficult to educate people and to make them understand that expenditure in an unproductive way does not bring any benefit to the individual or to society.

The Role of the Government

Almost all senior personnel of the IBBL interviewed in different branches under review opine that the ‘Musharaka’ mode of financing system is encouraged by the Government of Bangladesh. The government often issue circulars regarding the credit policy, which the bank finds very helpful when dealing with their clientele. Most rules and regulations of the government are helpful for the bank, especially to administer their loan activities. In some cases, the government discriminate their policy which Islamic banks find unfavorable for them.

Promote Institutional Credit Facilities for Rural-based small entrepreneurs

It is observed from the study that a majority of rural-based small entrepreneurs in Bangladesh not only suffer from a shortage of capital but also from a lack of institutional credit facilities. The empirical result shows that the ‘Musharaka’ mode of financing as an institutional credit facility saves needy rural-based small entrepreneurs from the paws of the money lenders who normally charge a higher rate of interest. It is also noted from the study that most conventional banks in the country are urban based.
They invest a very negligible amount of their deposits for rural-based small entrepreneurs. Moreover, due to the lengthy and complicated loan procedures, rural-based small entrepreneurs fail to obtain loans on time. This in turn gives opportunities to informal money lenders to promote their money lending business among rural-based small entrepreneurs at a higher rate of interest. Thus, it may be concluded from the study that the ‘Musharaka’ mode of IBBL financing to rural-based small entrepreneurs enhances the institutional credit facilities. This is a positive contribution towards the economic enhancement and alleviation of poverty in a poverty-stricken nation like Bangladesh.

**An Easy Lending Procedure Makes Rural-based small entrepreneurs More Organized**

It is found from the study that under the ‘Musharaka’ mode of financing, the bank officials assist their customers to be organized and provide them with guidance regarding their business as well as personal and social life. The simple loan giving procedure under the ‘Musharaka’ system not only educates clients about interest free loans but also organizes their activities by close supervisions so that they may contribute to society. Apart from that, the entire lending activities of the banks are organized in such a way that borrowers are benefited from the beginning to the final stage of their projects. Thus, it may be concluded that, the loan giving procedures from the beginning to the end makes the activities of the rural-based small entrepreneurs more organized.

**Proves Credit Worthiness and Adds Security**

The study reveals that as a rule, in order to obtain funds under the ‘Musharaka’ financing mode, every small entrepreneur needs to show a minimum amount of working in capital in order to initiate the business and to run the day to day expenses until the business generates profit. This stipulation not only ensures savings but also allows the IBBL personnel to judge the credit worthiness of rural-based small entrepreneurs. As a pre-requisite of the loan, the bank also asks a customer for collateral and two recommendation letters from two local influential people. The letter must contain that they will act as a guarantor for the customers. By this procedure, the bank ultimately ensures that borrowers are really worthy of giving credit.

**‘Musharaka’ Financing Eliminate the Exploitation of Middlemen**

It is also revealed from the study that, the bank officials under the ‘Musharaka’ mode of financing deal directly with rural-based small entrepreneurs and follow simple formalities in advancing loans. This in turn eliminates any interference from middlemen in their lending activities. Thus, the ‘Musharaka’ financing procedures of the IBBL saves their clientele from third parties. Hence, rural-based small
entrepreneurs can save a lion’s share of their borrowed funds and are able to use the same for productive purposes.

**Loans in Kind and Not in Cash Makes the Productive Use of Borrowed Funds**

It is found from the study that the “in kind” financing system under the ‘Musharaka’ financing mode of the IBBL ensures that borrowed funds are used in a productive way. It is mentioned in the previous section that the bank does not extend credit to their clients in cash but pays in kind. By doing so, the bank receives surety of the customers’ use of funds for the purpose they borrowed for. The application of the “in-kind” (for example, loan in material or goods rather than cash) lending principle under ‘Musharaka’ financing depicts that the loan recovery rate is higher in almost all of the branches under review.

**Creates Mutual Obligations between the Parties**

The lending of funds by the IBBL under the ‘Musharaka’ mode of financing may be termed as a ‘giving and taking policy’. This term indicates that both the customer and the bank contribute capital in certain projects and share the profits and losses according to the agreed proportions. Thus, it creates a mutual obligation between lenders and borrowers. The rural-based small entrepreneurs are bound to fulfill their obligation by discharging the responsibility of managing the business. This system makes the customers conscious of making proper use of their borrowed funds. Furthermore, this system develops initiative among rural-based small entrepreneurs to work hard and to be sincere in dealing with bank loans. It also encourages them to save more as they need to repay the loans after a certain period of time. Thus, it is concluded that the ‘Musharaka’ lending policy of the IBBL assists in developing saving habits and creates mutual obligations between lenders and borrowers.

**Conclusion**

In conclusion, to answer the two research questions addressed in the earlier sections, it may be said that the IBBL is yet to succeed in promoting the ‘Musharaka’ mode of financing among the rural-based small entrepreneurs in Bangladesh. From the study it seems that the number of ‘Musharaka’ customers is not up to a satisfactory level compared to the rural-based small entrepreneur customers belonging to other modes of financing. It is reported by the senior officials interviewed that, the customers must be more morally conscious. The ‘Musharaka’ mode of financing is based on faith and honesty of the customer. It is also reported by respondents that many of their customers belonging to the ‘Musharaka’ financing fail to disclose all business transactions properly. Since the responsibility of the entire business rests upon the rural-based small entrepreneurs, the bank usually depends on its financial records and expects a financial statement that records all facts properly in order to determine the true profit.
or loss of the business. It is reported that in many cases, the bank experienced dishonesty among customers while determining profit or losses of the business. This discourages bank officials and as a result, the bank loses their interest in investing funds under the ‘Musharaka’ mode of financing. It is also noted that societal sector institutions have an indirect impact on this specific financing mode. Even though the government encourages the system, the law-regulating bodies stand as a barrier in promoting this mode of financing. As mentioned in the earlier sections, the country culture combined with religious faith compels many rural-based small entrepreneurs to spend their borrowed funds on unproductive activities. This ultimately causes a great loss in their business. It is also concluded from the study that rural-based small entrepreneurs in many cases become victims of local political leaders. In order to start a new venture, they need to give donations to leaders of different political groups. If they do not comply with the illegitimate demands, they cannot commence their business. Those who are responsible for regulating law in the society do not help these needy rural-based small entrepreneurs when they suffer. Rather, the law minting officials take parts in favor of the influential local leaders. This ultimately results in losses for many rural-based small entrepreneurs and the bank eventually faces problems in realizing their objective of earning profit from the ‘Musharaka’ mode of financing. Thus, it may be concluded that, although the ‘Musharaka’ mode of financing has many positive aspects and advantages, rural-based small entrepreneurs need to be more honest with their attitude and the law regulating body needs to come forward in assisting rural based small entrepreneurs running business under ‘Musharaka’ mode of financing. By doing so, this specific mode of financing would work magnificently in promoting rural-based small entrepreneurs in society, particularly, by creating job opportunities for many unemployed youth in Bangladesh.

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