

# **\*FINANCING HALAL BUSINESS: ISLAMIC SOLUTIONS FOR MUSLIM ENTREPRENEURS IN MALAYSIA**

**Khairul Anuar Ahmad**

Dept. of Syariah, Islamic Academy, SIIUC (KUIS).

## **Abstract**

Entrepreneurship has marked a significant milestone in the development of halal industry particularly in Malaysia over the past few years. Doing halal business without proper concern on the halal status of the entire business process will defeat the purpose of doing so. By embarking on this kind of business, it means entrepreneurs have to fully comply with Shari`ah not just in the halal certification process but also in financing the business. This paper attempts to expose the entrepreneurs to the concept and workings of Islamic financing in comparison to its conventional counterparts. Apart from that, special concern will be given to Islamic financing as a solution for Muslim entrepreneurs.

## **Introduction**

Today, global Halal market estimated to be worth US\$580 billion a year and the Halal food industry pegged to grow at a rate of 7% annually. Halal logo has now become a symbol of quality and religious compliance and this makes it sound as the new green. Then again, some argue it is driven by consumers' urge to follow ritual or their desire for acceptance, while others see it as part and parcel of another rising global trend. Emphasis on Halal is also growing. It is fast becoming a new market force and identifier, and is now moving into the mainstream market, affecting and changing perception on how businesses are being conducted.<sup>1</sup> Conducting halal business without proper concern on the halal status of the entire business process will defeat the purpose of doing so. By embarking on this kind of business, it means Muslim entrepreneurs have to fully comply with Shari`ah not just in the halal certification process but also in financing the business.

## **Why Islamic Financing for Halal Business?**

Halal as opposed to haram means something which is lawful, allowable or free.<sup>2</sup> In the light of Islamic law, it falls under the ambit of permissible things (*mubah*). In the MS 1500:2004, halal is defined as things or actions permitted by *Shari`ah* law without punishment imposed on the doer.<sup>3</sup> This definition however only confines to foods

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<sup>1</sup> Saad Al-Harran & Patrick Low, *Marketing of Halal Products: The Way Forward*, <http://www.halaljournal.com/?page=article&act=show&pid=1386&PHPSESSID=a4bd26cc01d8259f9230c5425704bcb> 4, 9 April 2008.

<sup>2</sup> Lane, E. W., 1968, *An Arabic-English Lexicon (Part 2)*, Lebanon: Librairie Du Liban, pp. 619 & 621

<sup>3</sup> SIRIM, MS1500:2004 Halal Food – Production, Preparation, Handling And Storage – General Guidelines (First Revision), Shah Alam: Dept. of Standards Malaysia, pg. 1.

industry without any special reference to other than foods products. In a broader sense, it may also be applied to cosmetics and pharmaceuticals, hygiene products and nutritional supplements, travel, art, music and books; even marriage and finance. In other words, halal represents all that is lawful and therefore beneficial for humankind, and this is confirmed by the fact that halal products and services are already being used not just by Muslims, but also by people of all religions and cultures.

Islamic financing refers to a system of finance or financing activity that is consistent with Islamic law (Shari`ah) principles.<sup>4</sup> Shari`ah is derived from the root of *shin ra `ayn* which literally means the road to the watering place or the path to be followed.<sup>5</sup> As a technical term, however, it refers to the sum total of Islamic system which were revealed to Prophet Muhammad (PBUH) and which are recorded in the Qur`an as well as deducible from the Prophet's divinely-guided lifestyle called the Sunnah. By Shari`ah principles, the writer meant the Shari`ah texts i.e. the Quran and Sunnah. The relevant juristic opinions are also included since they explain and expound the meaning of the Shari`ah texts in the most reliable manner.

The Quran and the Sunnah are codes of life of a Muslim which teachings or sanctions must be followed. These rulings encompass three main components i.e. sanctions relating to belief (*ahkam i`tiqadiyyah*), sanctions relating to doings (*ahkam `amaliyyah*) and sanction relating to morality (*ahkam akhlaqiyyah*). Obedience to any one or two of the sanctions does not necessarily mean that one is truly a Muslim. A true Muslim is the one who follow all the teachings of Shari`ah in individual day-to-day aspects of life. In the context of halal business, a Muslim entrepreneur must have belief in God, must do business within the framework of Shari`ah, must perform good morality such as transparency, trustworthy, good relationship with customer etc.

Three major concerns of Islamic financing are it must be free from any elements of interest (*riba*), uncertainties (*gharar*) and gambling (*maysir*). Prohibition of all these elements can be figured out in the text of Shari`ah. In the Quran, the prohibition of *riba* is clearly mentioned in a number of verses (ayat) in which the total prohibition came in the last stage of prohibition that read to the effect:

“...And Allah hath permitted sale (*bay`*) and prohibited usury/interest (*riba*).”<sup>6</sup>

The word *gharar* does not directly originate from the Quran but can be traced from the Prophetic tradition (hadith) narrated by Abu Hurayrah that he said;

“The Messenger of Allah forbade the 'sale of the pebble' [*hasah*] [sale of an object chosen or determined by the throwing of a pebble], and the sale of *gharar*.”<sup>7</sup>

The prohibition of *maysir* is indicated in the Quran which read to the effect:

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<sup>4</sup> [http://en.wikipedia.org/wiki/Islamic\\_banking](http://en.wikipedia.org/wiki/Islamic_banking), 3 April 2008.

<sup>5</sup> Al-Ma`idah (5): 48.

<sup>6</sup> Al-Baqarah (2): 275.

<sup>7</sup> Sahih Muslim.

“O ye who believe! Intoxicants and gambling, (dedication of) stones, and (divination by) arrows, are an abomination— of Satan's handiwork: eschew such (abomination), that ye may prosper.”<sup>8</sup>

Islamic financing is as important as the production process itself to a Muslim entrepreneur. It is due to the fact that Muslims are bound by Islamic law in every aspect of their life. In this context, to gain blessed and halal income, each and every activity of a Muslim must be done in accordance with Shari`ah. In ensuring the validity of a business, Shari`ah has laid down guidelines. According to majority school of Islamic law, there are certain requirements that must be met for a transaction to be valid,<sup>9</sup> i.e.:

1. The contracting business parties (*`aqidan*) must have legal capacity in Islam to do business such as of majority age, sound mind, no court interdiction so on and so forth.
2. There must be a contractual expression (*sighah*) between parties to a contract.
3. The subject matter of a contract (*mahal al-`aqd*) must meet certain criteria such as it must be of value and Shari`ah acceptable (*mutaqawwim*), it must exist during contractual session, deliverable, no uncertainty etc.

As far as halal business is concerned, there is no such issue of not meeting the above mentioned requirements particularly on the halal status of the subject matter. In other expression, Muslims or non-Muslims alike can do halal business so long as the requirement of a valid contract can be satisfied. However, when it comes to funding the halal business, there will be two points that must be observed i.e.

1. The type of property used by Muslim entrepreneurs for funding must be of valuable and Shari`ah acceptable property (*al-mal al-mutaqawwim*) which is halal. Pork and liquor are types of property known as non-valuable and Shari`ah unacceptable properties (*al-mal ghayr al-mutaqawwim*) to Muslims in *fiqh al-mu`amalat*.<sup>10</sup> However, there are two major scholarly views on the legality of these items for non-Muslims. To Hanafi School, pork and liquor are considered as *al-mal al-mutaqawwim* to non-Muslims because the textual prohibition of these items is upon the Muslims. On contrary, the Shafi`i school is of the opinion that these articles are *al-mal ghayr al-mutaqawwim* even to non-Muslims on the ground that they are subject to the law of Islamic state. To simplify, Muslim entrepreneurs cannot use non-halal funding to run their halal business which is the other way around for non-Muslims. By right, non-Muslim entrepreneurs can employ whatsoever facility to finance their halal business, but yet to promote halal industry they are recommended to secure halal or Islamic financing.
2. In Islamic law, there are two types of prohibition namely prohibition due its prohibited nature (*haram li dhatihi*) and prohibition due to external factor or reason (*haram li*

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<sup>8</sup> Al-Ma`idah (5): 90

<sup>9</sup> Muhammad, Abdul Halim, 2005, *Undang-undang Muamalat & Aplikasinya Kepada Produk-produk Perbankan Islam*, Bangi: Fakulti Undang-undang UKM, pp. 40-75.

<sup>10</sup> Abu Zahrah, Muhammad, 1996, *al-Milkiyyah wa Nazariyyat al-`Aqd fi al-Shari`ah al-Islamiyyah*, Egypt: Dar al-Fikr al-`Arabi, pp. 48-52.

*ghayrihi*).<sup>11</sup> Thus we can say that the former is a direct prohibition and the latter is an indirect prohibition. For an example of the former, Islam prohibits doing business in pork and liquor because there are clear-cut prohibitions of these items in the text of Shari`ah. As for the latter, it's not the item of transaction is *haram* but something else contribute to the illegality of the business under Islamic law. To put it in a simple illustration maybe we can raise this question; can a Muslim person who wants to buy halal foods uses *haram* income in doing so? In a same way to business, can a Muslim entrepreneur secure non Islamic financing to fund a halal business? The answer is definitely negative.

Having discussed, the significance of Islamic financing to halal business shouldn't be denied by Muslim entrepreneurs at the first place for the reason that Muslims are bound by Islamic law and secondly financing is one of the major parts of the entire business.

### **Major Modes of Islamic financing**

To date, there are two major modes of Islamic financing namely debt-based financing and equity based financing offered by financial institutions around the globe. The most common Islamic debt financing instruments are based on contracts of exchange that involve deferred payment on the part of the buyer (customer) such as murabahah, `inah, tawarruq, ijarah and etc. In Murabahah, an intermediary buys the production place with free and clear title to it and then agrees on a sale price with the prospective buyer; which price includes some profit. The purchase may be made lump sum or through a series of deferred installment payments. The latter is a sale of the right to use an object for a specific time period. Another slightly different type of murabahah is `inah where the customer purchases asset from the financier in credit and sell it back to the same party in cash with discount. As for tawarruq, it's almost the same to `inah except the transaction involves three parties. One variation of lease, ijarah thumma al-bay` (AITAB) provides for a lease to be written whereby the lessor agrees to sell the leased object at the end of the lease whereby a portion of every payment goes toward the lease and the balance toward the purchase price of the home.

Equity-based financing instruments come in the form of profit sharing contract (*mudarabah*) or profit-loss sharing contract (*musharakah*). In *mudarabah*, financial institutions act as capital provider cum financier and the customers play the role of entrepreneur. Profit gained will be shared between them and any loss incurred will be borne by the institutions if no negligence is due to entrepreneur. *Musharakah* is a joint venture partnership which purposes are; firstly, to share capital among the partners to establish a company (*sharikat al-`aqd*) with the intention of sharing profit and loss in business or secondly, to co-own properties (*sharikat al-milk*). With regard to the latter, financial institutions has innovated a kind of *musharakah* called diminishing *musharakah* (*musharakah mutanaqisah*) which arrangements are sharing capital to co-own a property at the very beginning and progressively purchase the other co-owner's equity over the property until the title is completely transferred.

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<sup>11</sup> Kamali, Mohammad Hashim, 1998, *Principles of Islamic Jurisprudence*, KL: Ilmiah Publisher Sdn. Bhd., p. 330.

In this regard, Malaysian private financial intermediaries as well as government agencies also offer a wide range of financing products which are based on these two underlying modes and this definitely give more alternatives for Muslim entrepreneurs to opt for what is best for their needs.

## Islamic Financing for Entrepreneurs in Malaysia

In Malaysia, sources of fund for entrepreneur could be secured either from public sector or private sector. The Government of Malaysia has initiated programs to spearhead the development of SMEs which are broadly categorized into financial assistance and business support services. Towards addressing financial constraints, the government has put forward some assistance in the form of soft loans,<sup>12</sup> grants,<sup>13</sup> equity financing,<sup>14</sup> venture capital,<sup>15</sup> guarantee scheme<sup>16</sup> and tax incentives<sup>17</sup> through its ministries and agencies.<sup>18</sup> Out of these supports, it is the financing type of assistance that is the concern of this paper. The following part of this subsection will discuss briefly the facilities offered by the government ministries and its agencies.

MeCD and MOSTI are two of the ministries that directly give support to entrepreneurs. MeCD plays the role of a manager for some of the government funds which twelve of them are channeled through its agencies<sup>19</sup> where some of the sources of fund are Islamic such the one offered by Majlis Amanah Rakyat (MARA),<sup>20</sup> Amanah Ikhtiar Malaysia (AIM)<sup>21</sup> and Tekun Nasional.<sup>22</sup> On the other hand, grants for innovation in science and technology are offered by MOSTI alone. Specifically, there is no Islamic grant under any of the MOSTI programs. Though, all the grants are deemed to be Islamic as there is no indication of Shari'ah contravention i.e. interest bearing, and it can be treated as *hibah* which is lawful in Islamic commercial law.

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<sup>12</sup>For the list of soft loans offered by these institutions, pls visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=finspec](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=finspec), 4 April 2008

<sup>13</sup> Visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=grant](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=grant) for the list of grant offered by ministries and agencies, 4 April 2008.

<sup>14</sup> Visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=equity](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=equity) for the list; 4 April 2008.

<sup>15</sup> Visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=ventcap](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=ventcap) for the list, 4 April 2008.

<sup>16</sup> Visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=guarantee](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=guarantee) for the list, 4 April 2008.

<sup>17</sup> Visit [http://www.smeinfo.com.my/index.php?tpl\\_id=12&ch=2&pass=scheme&fundtype=taxincentive](http://www.smeinfo.com.my/index.php?tpl_id=12&ch=2&pass=scheme&fundtype=taxincentive) for the list, 4 April 2008.

<sup>18</sup> List of Ministries and Agencies offering financial assistance can be found on <http://www.smeinfo.com.my/index.php?ch=2&pg=3&ac=62#fa>

<sup>19</sup> Log on to [http://www.mecd.gov.my/index.php?option=com\\_content&task=section&id=14&Itemid=37](http://www.mecd.gov.my/index.php?option=com_content&task=section&id=14&Itemid=37) for list of MECD agencies, 5 April 2008.

<sup>20</sup> <http://www.mara.gov.my/bpn/perkhidmatan.htm>, 4 April 2008.

<sup>21</sup> <http://www.aim.gov.my/~cms/index.php?categoryid=11>, 4 April 2008.

<sup>22</sup> <http://www.tekun.gov.my/>, 5 April 2008.

Bank Negara Malaysia (BNM) offers a list of financial assistance in the form of special funds,<sup>23</sup> which are channeled through participating Islamic and conventional financial institutions, and guarantee schemes.<sup>24</sup> Out of these guarantee schemes, only two of them are compliant with Shari`ah i.e. Islamic Banking Scheme and Flexi Guarantee Scheme.<sup>25</sup>

In respect to other government-related banks,<sup>26</sup> almost all these banking institutions offer Islamic financing under corporate or business segment. Types of financing available at these banks are debt-based financing and no equity-based financing is offered. The thinkable reason for not offering musharakah or mudarabah type of financing perhaps owing to the fact that equity-based financing is a very risky business. Contracts of which underlying-principle are sale dominate the product offerings and only a few of them apply Islamic contract of lease (*ijarah*). In addition, only one bank i.e. SME Bank that have come up with special funding for halal business namely Halal Hub Program.<sup>27</sup> As a matter of fact, this bank was selected by Government of Malaysia to be a funding agent for halal-related business under the Ninth Malaysia Plan (RMK9).

Apart from the entities mentioned, other government agencies that offer Islamic financing is ERF that offer debt-based financing for rehabilitation purposes. Malaysian Debt Ventures (MDV) is about to launch its Islamic scheme of financing, while Malaysian Venture Capital Management Berhad (MAVCAP) offers venture capital financing with no Islamic label but still considered Islamic on the basis of *musharakah*.

A number of government corporations also extend some financial help in the form of grants and funds which have no Shari`ah compliant label yet still acceptable under the Shari`ah principle of *hibah*. These corporations are Malaysian Biotechnology Corporation Berhad (MBC), Malaysia External Trade Development Corporation (MATRADE), Malaysian Technology Development Corporation (MTDC), and Small and Medium Industries Development Corporation (SMIDEC). Interestingly, Perbadanan Usahawan Nasional Berhad (PUNB) is the only corporation that offers Islamic equity-based financing namely *musharakah mutanaqisah* and benevolent loan (*qard al-hasan*). Another kind of corporation i.e. Credit Guarantee Corporation Malaysia Berhad (CGC) offers Islamic credit guarantee schemes to protect financing amount from any event of default.<sup>28</sup> In other word, these kinds of facility are not financing per se, but only a mean to safeguard the interest of creditor.

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<sup>23</sup> The funds are New Entrepreneurs Fund 2 (NEF2), Fund for Small and Medium Industries 2 (FSMI2), Fund for Food (3F), Bumiputera Entrepreneurs Project Fund (BEPF) and Small Debt Resolution Mechanism. Please visit <http://www.smidec.gov.my/detailpage.jsp?page=banknegara>, 4 April 2008.

<sup>24</sup> The schemes are Islamic Banking Scheme, Franchise Financing Scheme, Direct Access Guarantee Scheme, New Principal Guarantee Scheme, Flexi Guarantee Scheme, and Small Entrepreneur Guarantee Scheme, see *ibid*.

<sup>25</sup> *Ibid*.

<sup>26</sup> These banks are Bank Kerjasama Rakyat Malaysia, Bank Pembangunan Malaysia Berhad, Agrobank, SME Bank, EXIM Bank and Bank Simpanan Nasional. To the best of writer's knowledge, EXIM Bank offer no Islamic financing as at present and Bank Simpanan Nasional offer Islamic financing but rather for individual financing purposes.

<sup>27</sup> Visit <http://www.smebank.com.my/rmk9.asp>, 5 April 2008.

<sup>28</sup> <https://www.iguarantee.com.my/iguarantee/index.htm>, 5 April 2008.

Under private sector financing, funds are available from local and foreign commercial financial institutions as well. Almost all these financial institutions are banking institutions and only some are finance companies. With regard to banking institutions, it can be classified into full-fledged Islamic banks and conventional banks with Islamic window.

As far as full-fledged Islamic banks are concerned, local firms dominates the offering of funds as compared to foreign firm since the number of the latter is still relatively small. In general, financing is offered through corporate business of the bank where two major categories of financing namely business financing and trade financing are made available. Islamic business financing is designed for financing any type of halal business whereas Islamic trade financing is to cater for the need of entrepreneurs who do exim (export and import) business. Between these two types of financing, the number of Islamic products in business financing is more than in that of trade financing. Out of these financing products, debt-based financing is in dominance. As at present, very few local and foreign Islamic banks offer equity-based financing. The same goes to local and foreign conventional financial institutions with Islamic window, whereby equity-based financing is hard to be found at these institutions.<sup>29</sup>

## **Conclusion**

In summary, halal business is not just about halal certified product but must also take all the Shari`ah aspects into account. Halal concept must be viewed in a broader spectrum and not only confined to a particular segment of business in order to ensure the end-to-end process of halal business is totally in accordance with Islamic law. On that ground, an attempt to give some ideas about the importance of Islamic financing for Muslim entrepreneur is laid down in this paper.

With the expansion of halal business, the number of financial institutions offering Islamic funding for Halal business is getting bigger which offerings ranging from debt to equity-based financing. Even if debt is discouraged and sharing of risk is encouraged in Islam, the market trend is in favor of the former. This is perhaps due to the risk sharing level on the part of the commercial institutions is still low, yet sharing capital is the thing that is highly needed by entrepreneurs especially those with small capital or to certain extent without capital at all. Going forward, this is the aspect that must be improved by commercial institutions so that more equity-based financing can be made available for entrepreneurs. In the same way, the government through its departments and agencies has put forward a lot of financial assistance in the form of equity-based financing such as venture capital or even provision of special fund and grant of which some are Islamic. It's now up to the Muslim entrepreneur to choose what is best that suit their needs.

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<sup>29</sup> See Appendix.

## Shari`ah Principles Used for Business Financing at Financial Institutions.

| <i>Institutions</i>   | <i>Debt-based financing</i>  | <i>Equity-based financing</i>                 |
|---|--|---|
| Affin Islamic Bank Berhad                                   | Bay` bithaman Ajil, Murabahah, Bay` al-Dayn  |   |
| Al Rajhi Banking & Investment Corporation (Malaysia) Berhad | Murabahah  |   |
| Alliance Islamic Bank Berhad                                | Bay` bithaman Ajil, al-Ijarah Thumma al-Bay`, Murabahah, Bay` al-Dayn,                       |   |
| AmIslamic Bank Berhad                                       | Bay` al-`Inah, Bay` bithaman Ajil, al-Ijarah Thumma al-Bay`, Murabahah, Bay` al-Dayn         | Musharakah, Mudarabah                         |
| Asian Finance Bank Berhad                                   | Murabahah, Tawarruq, Ijarah, Ijarah Muntahiyah bi al-Tamlik, Istisna`                        | Musharakah, Musharakah Mutanaqisah            |
| Bank Islam Malaysia Berhad                                  | Murabahah, Bay` al-Dayn, Ijarah, al-Ijarah Thumma al-Bay`, Istisna`, Bay` bithaman Ajil      |   |
| Bank Muamalat Malaysia Berhad                               | Istisna`, Bay` bithaman Ajil, Murabahah, al-Ijarah Thumma al-Bay`,                           |   |
| CIMB Islamic Bank Berhad                                    | Bay` al-`Inah, Bay` bithaman Ajil, al-Ijarah Thumma al-Bay`, Murabahah, Bay` al-Dayn         |   |
| EONCAP Islamic Bank Berhad                                  | Bay` al-`Inah, Murabahah, Bay` al-Dayn   |   |
| Hong Leong Islamic Bank Berhad                              | Bay` bithaman Ajil, Murabahah, Bay` al-Dayn  |   |
| Kuwait Finance House (Malaysia) Berhad                      | Murabahah, Ijarah, Ijarah Muntahiyah bi al-Tamlik, Istisna`, Ijarah Mawsufah bi-Dhimmah      | Musharakah, Mudarabah, Musharakah Mutanaqisah |
| Maybank Islamic Berhad                                      | Bay` bithaman Ajil, Murabahah, Bay` al-Dayn  |   |
| RHB Islamic Bank Berhad                                     | al-Ijarah Thumma al-Bay`, Murabahah, Istisna`, Ijarah, Murabahah, Bay` al-Dayn,              | Mudarabah                                     |
| Public Bank Berhad  | Bay` bithaman Ajil, Bay` al-`Inah, al-Ijarah Thumma al-Bay`                                  |   |
| HSBC Bank Malaysia Berhad                                   | Bay` bithaman Ajil, Ijarah, al-Ijarah Thumma al-Bay`, Murabahah, Bay` al-Dayn, Bay` al-`Inah |   |
| OCBC Bank (Malaysia) Berhad                                 | Bay` bithaman Ajil, Ijarah, al-Ijarah Thumma al-Bay`, Murabahah                              |   |
| Standard Chartered Bank Malaysia Berhad                     | Bay` bithaman Ajil, Bay` al-`Inah, al-Ijarah Thumma al-Bay`, Murabahah, Bay` al-Dayn         |   |