

# Farmers' Practices in Developing Agricultural Land in Malaysia: Is there an Islamic Micro-finance Solution?

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## Abstract

**Objective** – This paper attempts to highlight the farmers' lives in Malaysia and their problems in developing idle agricultural land.

**Methods** - This paper is using descriptive and exploratory method of study which refer to the situation of agricultural sector in Malaysia.

**Results** - The scheme aPLS (agricultural production and loss sharing) that proposed cannot stand alone in the traditional *fiqh* to be implemented now. Therefore, the combinations of aPLS contract with *ujrah* principle are really needed. This is important to ensure the flexibility of the contract that can offer a fully comprehensive scheme of Islamic agricultural finance.

**Conclusion** – The land together with labour can be considered as a form of capital and therefore has a similarity to the contracts of *mudaraba* and *musharaka*. Hence, it can be said that these principles are “agricultural production and loss sharing (aPLS)” because land will naturally produce an output or a product. *Muzara'a* and *musaqa* therefore can be said to be contracts which are based on sharing output rather than sharing profit.

Keywords: Idle Agricultural Land, Islamic agricultural finance, Malaysia

## Abstrak

**Tujuan** - Tulisan ini mencoba menyoroti kehidupan para petani di Malaysia dan masalah mereka dalam mengembangkan lahan pertanian yang menganggur (tidak terurus).

**Metode** - Tulisan ini menggunakan metode deskriptif dan eksploratif studi yang merujuk pada situasi sektor pertanian di Malaysia.

**Hasil** - Skema aPLS (produksi pertanian dan loss sharing) yang diusulkan tidak dapat berdiri sendiri dalam *fiqh* tradisional untuk diterapkan saat ini. Oleh karena itu, kombinasi dari kontrak aPLS dengan prinsip *ujrah* benar-benar dibutuhkan. Hal ini penting untuk memastikan fleksibilitas kontrak yang dapat menawarkan sepenuhnya skema pembiayaan pertanian Islam yang komprehensif.

**Kesimpulan** - Tanah dan dengan tenaga kerja dapat dianggap sebagai bentuk modal karena memiliki kesamaan dengan kontrak *mudharabah* dan *musyarakah*. Maka, dapat dikatakan dengan prinsip ini " produksi pertanian dan loss sharing aPLS " karena lahan secara alami akan menghasilkan output atau produk. Adapun *Muzara'a* dan *musaqa* dapat dikatakan kontrak yang didasarkan pada berbagi hasil daripada berbagi keuntungan.

Kata Kunci : Idle Agricultural Land, Islamic agricultural finance, Malaysia

## 1. Introduction

Agricultural projects in Malaysia are often in the form of small holdings owned by families and households in rural areas. Private ownership is, by and large, the predominant attribute in the ownership of properties and assets. Most of these small-scale agricultural and non-agricultural enterprises are left to their own devices. Therefore, they have limited capacity to generate revenues beyond the equivalents of the subsistence needs. Thus, it is necessary for financiers to be aware of and to understand the reality of the lives of farmers and the risks they face, in order to effectively finance agricultural land development and eventually to contribute to economic growth. Since Islamic finance is regarded as a flagship of Islamic economics and agricultural development is one of the important aspects in Islamic economic discourse which has still not been emphasized enough by Islamic economists in the current age, there is potential space for the discussion of Islamic micro-finance for agriculture sector and for the enrichment of literature on Islamic economics as well as Islamic banking and finance. Therefore, the outcome of this paper suggests an Islamic micro-finance model to be implemented in agriculture sector.

Generally, four major types of physical assets that form the farm capital are; farm land and buildings, implements and machineries, livestock, and stored crops. Land derives its value from its usefulness in agricultural production and not from its potential as urban estate or in mining (Tostlebe, 1957). The value of land can be raised by the investment of effort and money in cultivating and preserving jobs. In general, labour is the key factor of production while profit is the reward given as motivation for them.

The misunderstanding about where the value of land derives, drag the initiative to activate agricultural land with a structural and technological transformation into the increment in the size of idle agricultural land instead. This is what happened in Malaysia

when a program named as “*pertanian kontrak*” results failure (Amriah & Ratnawati Yuni, 2011).

Majority farmer in Malaysia can be classified as small holding farmers, whose normally facing similar situation, which is a financial difficulty. They have gone through cycles of growth and decline in their use of credit. Such cycles take a long time to complete, regularly lasting more than a generation. (Hungen, 1986).

It is a fact that agricultural production is a seasonal process. Farmers have to pay for all production inputs such as seed, fertilizer, land preparation and machinery at the beginning of farming season; but they are only able to produce the output at the end of the season. The lag between the time that they have to pay for their expenses and when they receive output revenues requires them to take a loan to maintain their liquidity.

Therefore, improving the availability of agricultural credit enables farmers to use enough inputs and engage in farm investments in order to produce the optimal level of output and achieve or increase their profits. Thus, agricultural finance helps farmers to expand their production activities and earn their living; in the absence of which both their output supply and their welfare would decline. Consequently, this paper focus is to find solution in term of financing by proposing Islamic micro-finance products in order to help farmer’s sustainability and at the same time resolving the idle agricultural land.

## **2. Methodology**

This paper is using descriptive and exploratory method of study which refers to the situation of agricultural sector in Malaysia. A questionnaire was used for the fieldwork in Malaysia from 13<sup>th</sup> October to 14<sup>th</sup> December 2010. To be more precise, this questionnaire was distributed to 138 farmers in the six selected states in order to gain information regarding their daily lives as well as their financial information during the cultivation process. In addition, interviews were also conducted with the officers of the

Department of Agriculture at the state level concerning the assistance offered to the farmers in each state. Based on the issues of financing in agricultural development in Malaysia, this paper seeks for potential solutions, i.e., Islamic micro-finance which attempts to create a suitable approach to ensure the sustainability production in agriculture.

### **3. Result and Discussion**

#### *3.1. The 'Nature' of Agriculture in Malaysia*

In term of structure, agricultural projects in Malaysia are often in the form of small holdings owned by families and households in rural areas. Private ownership is, by and large, the predominant attribute in the ownership of properties and assets. Most of these small-scale agricultural and non-agricultural enterprises are left to their own devices (Muhammad Hakimi, 2012).

They have limited capacity to generate revenues beyond the equivalents of the subsistence needs of the families. This is a reflection of the production capacity which is small and depends on the immediate needs of the households in the rural sector. Therefore, the asset holdings and products of these agricultural activities are not amenable to market transactions.

Based on the fieldwork done to the farmers of six states in Malaysia (Muhammad Hakimi, 2012), three major issues found. The first issue is about financing. The first and foremost matter that needs to take into consideration among financial institution in Malaysia is about non-cash element in farmers daily live. Cash transactions are necessary in trading sectors, commerce, manufacturing, and construction, but not in agriculture. Farmers do not use money for food, because they eat what they get from their farm. Therefore, incomes from their agricultural products are their net income.

Second thing that require serious attention from financial institutions in Malaysia is lack of support from financial institutions towards farmers in developing their agricultural land. Several factors cause the low involvements of farmers with financial institutions are:

- a) Muslim farmers are not willing to involve in the interest-based (*riba*) financing which is prohibited in Shariah.
- b) Bankers are reluctant to finance small farmers.
- c) The farmers are frustrated with the bureaucracy of the financial institutions.
- d) The small farmers feel that the agricultural government bodies will give them support.
- e) Fear among farmers about paying back a loan or financing from conventional financial institutions.

Third issue on financing is about financial problem that particularly happen during second cultivation cycle. Most of the farmers received full subsidies from Department of Agriculture (DOA) during their first cultivation but have to survive on their own during next cycle of cultivation. Due to financial problem, many of the farmers are not able to cultivate their land and let the land abandoned as how happened to the developed idle agricultural land that again became abandoned.

Fourthly, farmers prefer to make informal financing which is making a loan from relatives, landlords, or unauthorized moneylenders. They are more comfortable to borrow from family members rather than formal institution since it is more flexible if they have problem in repayment. Hence, there are significant numbers of farmers who actively involved in informal financing. This issue can be said as a consequence of all issues that had been mentioned above.

The second main issue arise is the farmers themselves. Farmers face few tribulations in developing their idle agricultural land. Most of the farmers in the interview only use traditional method in activating their land. They are unorganized and

do not have proper transaction records of their agricultural input and output. Because of this, farmers fail to accurately calculate their income or profit and drag them to the unpredicted problems and put them in trouble for the next cultivation.

Another issue from farmers arises reflected in government's policy which is about the change from cash crops to permanent crops. Farmers who cultivate cash crops during the first harvesting cycle consider changing into permanent crops such as palm oil and rubber as farmers want to increase their income. Indirectly, this changing affects the government mission of food security.

Lack of cooperation among farmers and problems in marketing their agricultural products are other issues that occurred among farmers in Malaysia. The influences of middleman who control the market lead to marketing problem where farmers do not get the fair price for their output.

Thirdly, land issues are also crucial to take attention. It can be stated that the size of farm significantly affects the farmer's income. Based on the fieldwork, farmers who involved in small scale farms of one to five hectares got an income of RM 1000 – RM 2000 while farmers who dealt with large area of land from 11 to 15 hectares got a monthly income of RM 3001- RM 4000 and above. Majority of respondents who are dealing with more than 20 hectares got RM 4001-RM 5000 income. It can be determined that farmers with large scale farming get a higher income. However, it is hard to find those who own and cultivate their land at the same time. Therefore, the only way for agricultural entrepreneur to get a better income is deal with the landowners who own a large scale farm or several landowners that have small scale farm each.

Another issue of land that occurred is about scattered land ownership and uneconomic sized holdings. Generally, much of land in Malaysia has been alienated on permanent titles. The land is normally held under a single ownership, but over the years,

Islamic and customary law of inheritance, as well as the sale of land, have gradually given rise to the multiple ownerships and the fragmentation of land.

The change on the status of land from agriculture to another profit orientation such as industry and commercial housing is a serious matter to ponder. The status change will disturb the ecology and of course the food security. Basically, the issues discussed are the reality picture of farming. All parties including farmers, landowners, financial institutions, and government are chasing to meet their goals, but without right understanding and the feel of responsibility among each other, nobody can sustain in achieving their missions.

Accordingly, in Malaysia, even though agricultural markets are free arenas, there are certain inflexible elements such as government subsidies and support programs in which we find direct intervention from the government in the market mechanism, prices and resource allocations. This can be seen through the direct participation of the Department of Agriculture (DOA) in Malaysia to support farmers in developing agricultural land as well as activating idle land.

However, high dependence to the subsidies and programs from government results to the cycle of idle land which had been discussed before. As mentioned earlier, shortage in capital happen in second cultivation as they only get subsidies at start. In this situation, farmers need financial aid, but financier reluctant to give financing due to the risks in agriculture. Farmers, at this moment strive to sustain with borrowing money from relatives, or landlords. However, this traditional method will not long last and at the end will result unsustainable in cultivation. Therefore, Islamic micro-finance is suggested as a way to overcome the capital shortage that farmers faced.

### *3.2. micro-finance and Islamic micro-finance*

Based on this fieldwork which has revealed the real scenarios of farmers' lives, there are some alternative solutions from an Islamic perspective and in particular related

to Islamic micro-finance that can be proposed here. Theoretically, special element in micro-finance lies in “joint liability” concept which lender does not take a secured interest like common credit disbursement mechanism (Braschler, 2006). It is different from conventional loan especially in terms of participants. micro-finance is usually in small size loan, easy and flexible terms and conditions, short term financing, weekly repayment basis, fast and easy procedures of loan disbursement (A.Rahim, 2007) and un-collateralized (Amit & Bhagwan, 2010).

Micro-finance main features consist of groups of individuals who are interested, several groups from the center, have weekly meetings between representative from the center and the participants, and an official meeting from the micro-finance institution (MFI) for the transaction matters. There are also forced in saving and insurance programs besides several social development programs.

Many elements of micro-finance are consistent with the broader goals of Islamic finance. Both advocate entrepreneurship and risk sharing to help the poor, the financial inclusion, focus on developmental and social goals, and involve the participation by the poor (Obaidullah, 2008). Hence, there is no doubt about benefits to join them together while modifying the products and services to produce it as Islamic micro-finance. Instead of just retain the best practices of micro-finance, Islamic micro-finance would consider to religious and cultural sensitivities of the Muslim clients.

However, there are few important aspects in micro-finance need to be modified to make it *shariah compliant*. Prohibition of *riba'* is the main fundamental of Islamic finance existence. Regardless reason, the intentions are *riba'* is prohibited. At least two main types of *riba'* can be classified which is namely as credit *riba'* (*riba' al-nasi'ah*) and surplus *riba'* (*riba' al-fadl*) (al-Zuhayli, 2006). *Riba' al-nasi'ah* can be defined as postponement interest where happen in the delay of settlement of a due debt whether in term of loan or goods sold. While surplus *riba'* (*riba' al-fadl*) can be described as an

unlawful excess in the exchange of two counter-values in the six canonically-forbidden categories of goods; gold, silver, wheat, barley, salt and dry dates. *Riba'* also exists if there is either inequality or delay in delivery of the goods offered.

As an alternative to *riba'*, profit and loss sharing arrangement are held as an ideal mode of financing in Islamic finance (A.Rahim, 2007). Fairness of sharing the profits and losses can be seen in two dimensions: the supplier of capital possesses a right to reward, but this reward should be commensurate with the risk and effort involved and thus governed by the return on the individual project for which funds are supplied. What makes profit-sharing permissible in Islam while interest not is the profit-sharing ratio, not the rate of return itself that is predetermined.

In early literature on IBF studies, it was envisaged that a partnership contract or PLS rooted in the principles of *al-mudaraba* and *al-musharaka* was to be the core characteristic of Islamic banking financing operations. This was proved through the proposal to apply the PLS scheme from (Qureshi, 1945), (Uzair, 1955) and (Siddiqi M. , 1983a) in order to eliminate *riba* in banking transactions (Saeed, 1999).

Additionally, the Islamic principles of *al-mushraka* and *al-mudaraba* can be adopted for all types of business. Capital can be invested alike in commercial, industrial and agricultural business on the principle of *al-mudaraba* and each enterprise can be carried on by a few capitalists jointly in partnership. Therefore, the discussion of banking without interest should make this stand as a cornerstone or the basis for the system of banking without interest (Siddiqi M. , 1985, pp. 104-105).

### *3.3. Theoretical Proposal of “Agricultural Product and Loss Sharing” (aPLS) as an Islamic micro-finance for Agriculture*

The “joint liability” concept in micro-finance is actually similar to *mudarabah* and *musyarakah* contracts where have widely applied in Islamic finance. In terminology,

*al-mudarabah* was define as a contract between two contracting parties whereby one party (*rabb al-mal*) provides capital (money) to the second party (*mudharib*) to employ that money in trade while the profit will be divided based on initial agreement (Hailani & Sanep, 2009). The point behind this kind of partnership is collaboration of parties who have money but not skilled with the parties who have good skills and experience but do not have money.

Meanwhile, *al-musharakah* was define as joint enterprise in which all the partners share the profit or loss in the joint venture in the context of business and trade. It comes from the word *shirkat ul-amwal* which refers to partnership between two or more persons with contribution some of their capital (Usmani, 1999). Hence, *al-mudarabah* can simply define as a profit sharing agreement and *al-musharakah* is about joint venture, which involve a profit and loss sharing agreement.

In structuring an Islamic micro-finance for agricultural sector specifically, Islam provides another contract which similar to *al-mudarabah* and *al-musharakah* but exclusive for agriculture; namely *al-muzara'a* and *al-musaqa*. In general, *al-muzara'a* and *al-musaqa* contracts can be defined as an agreement between the owner of a piece of land and the farmer. They would share the produce in proportions which are agreed and depend on the contribution that each has made.(Hailani & Sanep, 2009). In practice, one of the partners is working on the agricultural project and other is providing capital (land). The relationship between the partners is based on trust, with the landlord having relied heavily on the farmer's ability to manage and his honesty when it comes to harvest.

In particular, *al-muzara'a* is closely related to the cultivation of general agricultural products and *al-musaqa* is for orchard preservation. The approach crosses over into a form of partnership or product and loss sharing in agriculture. These principles have transformed the use of land and labour into commodities which both give them a value and expose them to loss and damage. Hence, it can be said that land together with

labour can be considered as a form of capital and therefore has a resemblance to the contracts of *al-mudarabah* and *al-musharakah*,

Many researchers consider *al-muzara'a* and *al-musaqa* to be a partnership in profit just like *al-mudarabah*. In nature, capital of *al-mudarabah* will create profit as it cause the term profit and loss sharing (PLS) known by many Islamic economists. Nevertheless, *al-muzara'a* and *al-musaqa* have their own origins in classical custom. It was participation in output like sharecropping or output sharing. This is because the land as capital will produce the product or agricultural output. In the meantime, (Sarker, 1999) stated that output sharing contracts are mainly categorized into two types of principles which are *al-muzara'a* and *al-musaqa*. This is supported by (Khan, 1995) which agreed the difference between these contracts with *al-mudarabah* is the output shared and not the profit earned.

#### *3.4. The Proposed Scheme of Islamic "Agricultural Product and Loss Sharing" (aPLS) for the Islamic micro-finance for Agriculture*

*Al-muzara'a* and *al-musaqa* contract of financing which can be named as aPLS contract, can be initiated subject to joint partnership in the mobilization of land, other physical inputs and labour. As a basis, a contract based on these principles can specify that land and other physical factors of production for the partnership could come from one party while labour could be supplied by the other party. On the other hand, only land can originate from one party while other factors, including labour, could come from the other party. Yet, another alternative of *al-muzara'a* is that land and labour could come from one of the contracting parties, while other factors of production may be provided by the other party in the contract. In contemporary agriculture, there is also a three-party *al-muzara'a* partnership, where the first party provides land, the second provides the physical inputs, and the third provides labour.

- a. The Traditional Schemes of *al-Muzara'a* and *al-Musaqa* (M&M) between Landlord and Farmers.

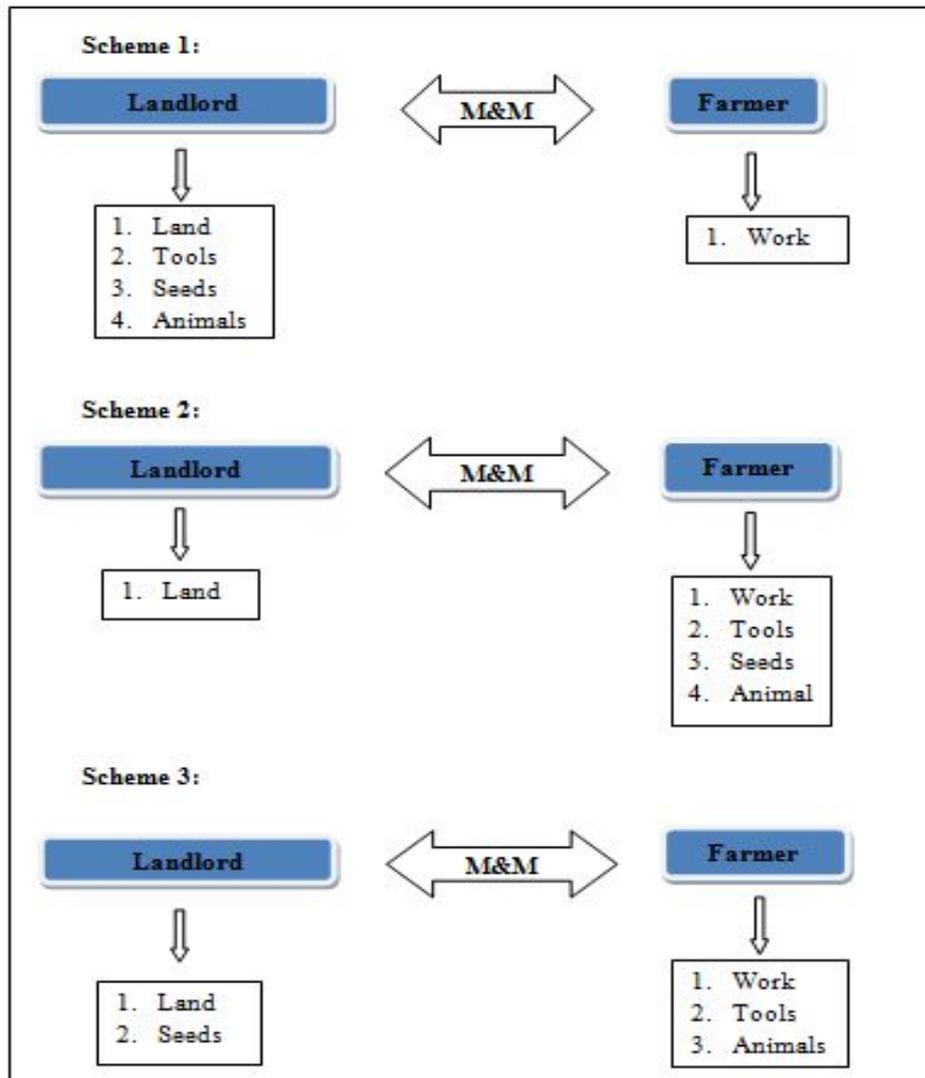


Figure 1. The Traditional Schemes of *al-Muzara'a* and *al-Musaqa* (M&M) between Landlord and Farmer

The figure above shows the traditional schemes of *al-Muzara'a* and *al-Musaqa* (M&M) between landlord and farmer. Land, seeds, work, tools, and animals are the elements needed to be counted as contribution between both parties. Based on traditional schemes, landlord must provide land, while farmer must give contribution in term of

work. The rest of the elements can be contributed by any parties as long as both of them agree.

b. A Combination of aPLS and *al-Ujra* for Developing Agricultural Land  
*aPLS and al-Ujra (fee or commission) Labour*

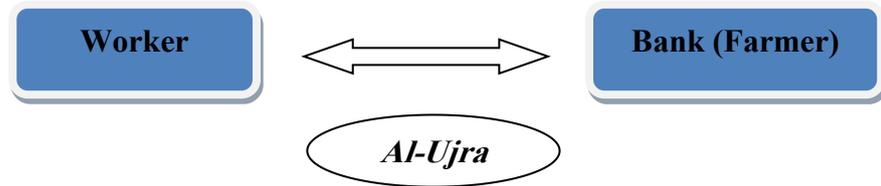


Figure 2 : An Example of *al-Ujra* Structure

Procedures:

1. The bank acts as a farmer in this transaction and hires agricultural workers based on an *al-ujra* contract.
2. *Al-ujra* can be defined as wages or service fees against work done for others.
3. The workers will supply their labour skills and be paid by the bank as agreed in the contract.

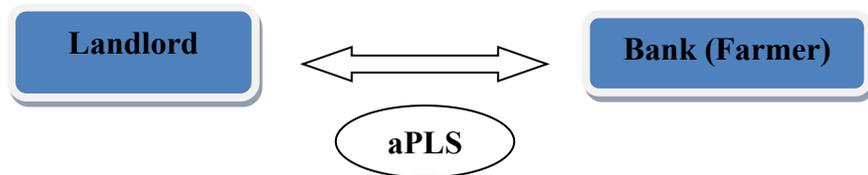


Figure 3. A Proposed Scheme of aPLS between Farmer and Landlord

Procedures:

1. The contract based on this principle can stipulate that land and other physical factors of production such as tools, seeds and animals could come from landlord while labour could be supplied by the farmer.
2. Instead, only land can initiate from the landlord while other factors, including labour, could come from the farmer.

3. Another alternative of aPLS is that land and seeds could come from landlord, while all other factors of production such as tools and animals may be provided by the farmer

Procedures

1. In the first contract, the bank acts as a farmer and has a transaction with the landlord in developing agricultural land based on the aPLS principle as suggested earlier. It should be clear that it is not possible for the bank to be a farmer in real terms.
2. Therefore, in the second transaction, the bank will hire an agricultural worker for managing and harvesting the agricultural land based on the *al-ujra* contract. The bank will pay wages to the workers for their labour.
3. In this scheme, if the farmer doesn't have the capability to harvest the land by himself, he can create another relationship with other workers which are based on the *al-ujra* contract.

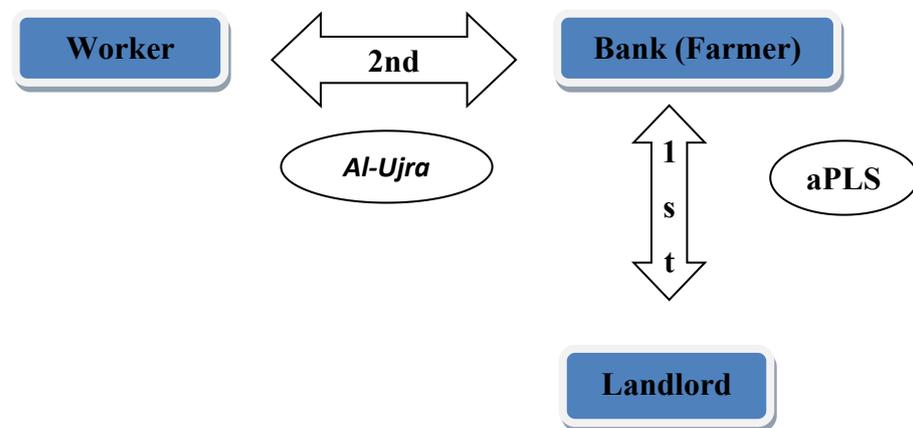


Figure 4. A Combination of aPLS and *al-Ujra* for Developing Agricultural Land

**4. Conclusion**

Based on the issues discussed above, the nature of farmers does not actually need a big amount of money to sustain in their cultivation. But, they also need support in term

of financial, and motivation to secure their life. This support can be earned when they do partnership in agriculture based on aPLS micro-finance scheme.

In reality, the Islamic banks should distribute a pragmatic part of their funds to social priority sectors like agriculture and create a sound Islamic agricultural financing system to facilitate agricultural land development. Islamic banks can use “production and loss sharing” rooted in *muzara'a* and *musaqa* contracts to finance the fixed and working capital needs of small and medium farmers who cannot provide sufficient collateral to qualify for financing through conventional institutions. Moreover, agricultural partnerships’ financing, when supervised and guided, could give much higher returns on investment than most of the other methods of finance.

As a conclusion, it can be understood that the scheme aPLS that proposed cannot stand alone in the traditional *fiqh* to be implemented now. Therefore, the combinations of aPLS contract with *ujrah* principle are really needed. This is important to ensure the flexibility of the contract that can be offer a fully comprehensive scheme of Islamic agricultural finance.

Furthermore, these principles have changed the use of land and labour into commodities which both give them a value and expose them to loss and damage. Hence, it can be said that land together with labour can be considered as a form of capital and therefore has a similarity to the contracts of *mudaraba* and *musharaka*. Hence, it can be said that these principles are “agricultural production and loss sharing (aPLS)” because land will naturally produce an output or a product. *Muzara'a* and *musaqa* therefore can be said to be contracts which are based on sharing output rather than sharing profit.

In brief, it should be noted that any Islamic financial products approved, should not only prioritize profit maximization as their main motivation. They must have soul in considering their social responsibility specifically for the farmer’s development and generally for the worldwide food security. To sum up, it is necessary to make more

empirical studies to further clarify the above mentioned issues, defining particular steps by bringing together input from many parties, and eventually building a framework for a partnership between the landlord and the farmer from the perspective of Islamic economics.

Therefore, it is relevant to use the principles of *muzara'a* and *musaqa* or aPLS with proper adjustments from financial experts to make them practical transactions in Islamic banking and financial institutions as a form of Islamic micro-finance for agriculture.

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