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INSTITUTIONAL DEVELOPMENT TO FACILITATE MUSHĀRAKAH AND MUḌĀRABAH MODE OF FINANCING

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ABSTRACT

This paper is based on the premise that it is not workable for the banks in their existing form, whether as conventional banks or as Islamic banks, to implement the profit and loss sharing mode of financing such as *Mushārakah* and *Muḍārabah*. The purpose of this paper is to make some practical suggestions for facilitating and promoting the use of *Mushārakah* and *Muḍārabah* mode of financing. Rather than focusing on the *Sharīʿah* compliance of existing banking instruments, a detailed research and development work needs to be carried out to develop completely a new form of institution outside the realm of the conventional banking system, which provides more workable and sustainable systems for implementing an alternate mode of financing consistent with the *Sharīʿah* objectives. This paper presents a conceptual framework of the functioning of these institutions and presents an outline of a sample research and development project to set up one such institution. The institutional concept and the sample project presented in this paper will contribute significantly to the existing literature by providing an alternative approach to address the scarcity of *Mushārakah* and *Muḍārabah* financing. It is anticipated that with implementation of the sample project presented in this paper, the pilot operations of the proposed institution can be started within six to eight years.

JEL Classification: G20, Z12

Keywords: Islamic economics, Profit/Loss sharing, *Mushārakah* financing, Institutional development, Research in Islamic finance

1. INTRODUCTION

Sharīʿah compliant financing in the modern era dates back to 1963 when Ahmed ElNaggar, an Egyptian economist established Mit

Ghamar Saving Bank in Egypt. The bank operated quite successfully in the beginning, but because it lacked political support it could not sustain its operations and was abandoned in 1967 (Chachi, 2005).

A parallel initiative was taken up in Malaysia in 1963 when the Malaysian government set up the Pilgrim Fund Board known in Malay as Lembaga Tabung Haji (LTH) to provide interest free savings services for people who wanted to save for performing Hajj. According to the LTH website a relatively small number of 1,281 prospective pilgrims opened their accounts with a total saving of RM46,610 in 1963. Their main objective then was purely to ensure that their savings were secure and free of usury and dividend/ profit was not the objective at that time. LTH has been operational successfully since 1963 and in 2017 it had more than 9 million depositors having more than RM73 billion of deposits earning a net profit of more than RM3 billion in 2017 (Lembaga Tabung Haji, n.d.).

Since these pioneering initiatives in 1963, Islamic finance has made significant progress; financial and *Sharīʿah* experts have developed various *Sharīʿah* compliant products. Numerous Islamic banks now operate in Muslim majority countries and in Muslim minority countries. According to the Dubai Islamic Bank Report (2017), the global Islamic financial services industry, as of December 2016, stood at USD2.293 trillion, with 75% of these assets held by Islamic banks and conventional banks through their Islamic window operations and the remaining 25% in Sukuk and Takaful and so forth (Table 1).

TABLE 1
Sector Wise Islamic Financial Assets

Financing Sectors	Share
Islamic Banking Assets	75%
Sukuk	15%
Funds	4%
Takaful	1%
Micro Finance	1%
Others	4%

Source: Dubai Islamic Bank – Global Islamic Finance Report 2017, 38.

However this growth has also been subjected to various criticism of the financial instruments being used by these institutions. One of the main issues highlighted by many research scholars, as discussed in detail in Section 2, is the Islamic Banking financial assets are predominantly based on *Murābaḥa* and deferred sales contracts and the underlying spirit is still based on charging for the use of money; thus the primary objective of offering an alternative mode of financing is not being fulfilled. The profit/loss sharing (PLS) contracts of *Mushārakah* and *Muḍārabah* combined constitute less than 6%. Table 2 gives the global share of various modes of financing offered by Islamic banks.

TABLE 2
Global Share of Various Modes of Financing by Islamic Banks (2012)

Mode of Financing	Share
Murābaḥa and Deferred Sales Contracts	78.47%
Leasing and Hire Purchase Contracts	10.82%
Mushārakah	4.17%
Muḍārabah	1.67%
Qard Hasan	1.53%
Others	3.34%

Source: World Bank / Islamic Development Bank (IDB) Global Report on Islamic Finance 2016, 69.

We suggest that the contribution made by various financial and *Sharīʿah* experts over the last 40 - 50 years is commendable and has paved the way for establishing a fast growing Islamic financial industry, although there still is much room for improvement and that will always be the case for any man made system. There is, however, a need to continuously keep working on improving the weak areas. The literature review presented in Section 2 is certainly not aimed at adding to the criticism of various banking instruments; rather it presents the background for this paper.

This paper aims at making some practical suggestions for facilitating and promoting the *Mushārakah* and *Muḍārabah* mode of financing. Its main proposal is that instead of working under the framework of existing banking system, a detailed research and development work should be carried out to develop new form of institutions, outside the realm of the conventional banking system. These new institutions are to be equipped with the necessary tools and systems to facilitate implementation of an alternate mode of financing consistent with *Sharīʿah* objectives. This paper presents a conceptual framework of the working of such institutions and presents an outline of a sample project to develop one such institution.

The institutional framework and the research and development project proposed in this paper are expected to contribute significantly to the existing literature by providing an alternate approach to address the scarcity of *Mushārakah* and *Muḍārabah* financing, and can be implemented easily with the help of a dedicated and committed team as discussed in Section 5.

2. LITERATURE REVIEW

The main focus and objective of the literature review presented below is not to present an evaluation and assessment of the work done in Islamic finance but to present various issues in the operations of Islamic Financial Institutions (IFIs) as highlighted by different research scholars and to identify how future research can resolve these issues. Based on these objectives, the review was restricted to only those research papers which highlighted various issues in Islamic Financial Institution operations. Moreover, the literature review was restricted primarily to the period 2000 onward, on the premise that the issues reported prior to this period will either appear again in the current literature or are not relevant anymore.

2.1 ISSUES IN THE OPERATIONS OF ISLAMIC FINANCIAL INSTITUTIONS

Iqbal, Ahmad, and Khan (1998) highlighted that PLS finance has remained negligible in Islamic bank operations. The choice of the right project to finance requires feasibility studies, technical and financial evaluation, and so forth, so the cost of such effort usually exceeds that of fixed return placements. In addition, profit-sharing arrangements require follow-up and supervision. The Islamic banks can be encouraged to provide more profit-sharing finance by developing appropriate institutional arrangements as well as financial engineering. Another author, Noman (2002) also discussed the lack of PLS based instruments and criticized the heavy reliance on fixed returns modes such as *Murābaḥa* as the actual practice of Islamic banks. He stressed the need for innovation in Islamic banks so that they focus their resources and lead the industry in developing new and unique products and improving the existing ones.

Kahf (2002) noted that the advice of various sharia boards often varies greatly, particularly when it comes to new banking products. Kahf emphasized a strong need for standardization at all levels including sharia codification of banking transactions, standardization balance sheets and other financial statements, as well as manuals and definitions of transactions, and accounting methods. He noted that although Islamic banks have grown at over 10% annually over the past three decades, this growth has not been accompanied by innovations in banking services and public outreach. Ainley et al. (2007) discussed various challenges faced by Islamic banks including diversity of opinion by *Sharīʿah* scholars on *Sharīʿah* compliance of various practices or products. They also raised the issue of shortage of appropriately qualified sharia scholars in the Islamic Financial Institutions (IFIs) which has resulted in individual scholars holding positions on the *Sharīʿah* boards of multiple Islamic banks. The issues related to diversity in *Sharīʿah* opinions are shared by Malik, Malik, and Mustafa (2011) who observed that there is no ultimate authority or a single international organization that governs the IFIs.

According to Dusuki and Abozaid (2007), the restricted view of *Sharīʿah* by only focusing on the legal forms of a contract needs to be changed. Instead, the 'substance' of the *Sharīʿah*, that has greater implications for realizing *Maqāṣid al-Sharīʿah*, should be equally looked into in structuring a financial product. Also noted is that almost all Islamic banks across the globe use PLS instruments such as *Mushārakah* in almost negligible proportions. It is suggested that the Islamic banking and finance industry introduce products and services that are *Sharīʿah* compliant in the true sense. In this regard, Uppal and Mangla (2014) stressed that the mission of the IFIs is to provide financial services and products based on equity participation and PLS basis in conformity with Islamic law. However, the actual lending practices are predominantly based on a mark-ups thus implicitly charging interest. They highlighted operational challenges facing the industry in risk management and in offering products and services at competitive prices.

Iqbal (2007) found that Islamic banks are operating with a limited set of short-term traditional instruments, and there is a shortage of products for medium to long-term maturities. The share of equity and other partnership based instruments such as *Mushārakah* and *Muḍārabah* is under 10 percent. The challenge for IFIs is to introduce new *Sharīʿah* compatible products that enhance liquidity, risk management, and portfolio diversification and this suggests that basic research and development may be more cost effective if carried out collectively by various IFIs. Chapra (2008) stressed that the Islamic financial system has only partly fulfilled the Islamic vision as it has been unable to escape the straitjacket of conventional finance. The use of equity and PLS modes has been scant, while that of the debt creating sales and lease based modes have been predominant. Chapra highlighted the absence of institutions needed to reduce the difficulties faced in equity and PLS financing as a result of the principal/agent conflict of interest and the moral hazard. These institutions, if established, would enable banks to obtain reliable information about their clients and to ensure that funds disbursed are employed efficiently according to agreement and that the profit declared reflects the true business reality.

Siddiqi (2008) stressed that research in Islamic finance has lost its initial thrust and neglected the bigger objective of providing an alternative to capitalism and socialism by an economic system that is based on moral purpose and inspired by a spiritual vision. He suggested that Islamic economics is about change from the current institutional structures to new institutions based on Islamic norms. In another related article, Siddiqi (2013) suggested that the Islamic economy should be based on cooperation and not competition. Debts should play a subsidiary rather than the dominant role in financial markets and interest bearing instruments should play no role in money creation and monetary management. Islam's prohibition of interest mandates the designing of financial and monetary arrangements that eschew interest and Islamic financial institutions must develop a viable fairer, poor-friendly and efficient alternative to conventional banking. Al-Salem (2009) commented that Islamic banks failed in products, such as *Mushārakah* that are based on trust, because it is difficult to accomplish it in practice. They need a method for developing investment products and services in the industry.

In terms of innovation in Islamic finance, Laldin and Furqani (2016) highlighted that innovations in this area have so far been to replicate the existing conventional financial structure and replace it with Islamic contracts by modifying the existing (non-halal) conventional products to meet Islamic legal requirements while maintaining the same objectives as the financial capitalist system. The meaning of *Sharīʿah* compliance should be broadened to include spirit of Islamic law and its objectives. Similarly, Aliyu et al. (2017) suggested that fulfilment of *Maqāṣid al-Sharīʿah* should dominate all other objectives of an Islamic banking system. They highlighted the need for conducting studies that will operationalize the Islam, Iman and Ihsan paradigm in all banking transactions coupled with ensuring long term financial and operational sustainability of banking operations. They also stressed the need for unification of Islamic bank financial reporting standards that will capture all the required social and environmental indicators that are currently less disclosed.

2.2 ANALYSIS OF ISSUES AND RECOMMENDATIONS

The common thread among all these research publications consists of two categories, i.e. (a) the scarcity of profit/ loss sharing based instruments such as *Mushārakah* and *Muḍārabah* which has resulted in unsuccessful implementation of interest free economy in the true spirit of Islamic principles and (b) the diversity of *Sharīʿah* opinions related to various banking instruments and services. The issues highlighted and recommendations made under category (a) can be summarized in the following paragraphs.

There is a need to come up with products and services which are *Sharīʿah* compliant in the true sense and cover not only the legal aspect of *Sharīʿah* compliance but also cover the realization of *Maqāṣid al-Sharīʿah*. This requires designing of a viable alternative to the conventional financial and monetary arrangements that is fairer, poor-friendly and financially sustainable.

There is an absence of institutions needed to reduce the difficulties faced in PLS financing. We need to establish institutions which provide reliable information to the financiers about their clients and ensure that the funds lent by them are employed efficiently and the profit declared reflects the true picture of the business. We require standardizing of balance sheets and other financial statements as well as accounting methods. Moreover we need to define reporting standards that will capture all the required social and environmental indicators which reflect the degree of realization of *Maqāṣid al-Sharīʿah*.

Based on these recommendations made by different research scholars, this paper attempts to address the issues related to the scarcity of profit/ loss sharing based instruments. Some of the key issues addressed in this paper are summarized in Table 3 in Section 4 below.

3. NEED FOR A PARADIGM SHIFT

This paper is based on the premise that the existing banking system does not provide the essentially required infrastructure to implement the true spirit of an alternate Islamic economic system. In order to implement the true spirit of the Islamic economic system, it is important to think independent of the existing banking instruments. The sections below give a brief overview of how the existing banking system differ from the requirements of an alternate Islamic economic system and what kind of paradigm shift is needed in our approach in directing the future research and development work in Islamic finance.

3.1 EXISTING BANKING MODEL

One of the fundamental concepts to keep in focus while developing Islamic Financial Institutions (IFIs) is that banks, operating whether as conventional banks or Islamic banks, are designed and developed to act as financial intermediaries. Banks collect money from those who have excess (depositors) by giving an incentive of annual return/ profit on their deposits and lend the collected money to different people or entities who need the money (borrowers) at a certain annual interest or profit.

The banks operate as financial intermediaries and their institutional setup is not designed to invest as shareholders in businesses managed and operated by others and they do not possess any tools and systems designed to ensure that these investments generate enough profit for the bank. Their infrastructure is designed to safeguard their loans, irrespective of whether the borrower is making profit or a loss. Moreover, the banks do not provide many services for individual investors who wish to invest in particular projects on profit/ loss sharing basis.

3.2 HISTORICAL ISLAMIC FINANCING MODEL

In order to implement true spirit of the Islamic economic system, it is important to understand how people were interacting in their business transactions when the Holy Quran was revealed. One thing is clear; at the time there was no concept of financial intermediaries playing the role banks play today i.e. collecting from those who want to save their surplus money at a certain interest rate and giving it to those needing the money at a higher rate and pocketing the difference as profit. All lending transactions were one to one between lender and borrower and the only role played by any intermediary was that of a witness to a transaction and thus indirectly adding to the trustworthiness and credibility of the borrower. The lender had a direct contact with the borrower, and he would lend or invest with the borrower only if he was convinced with the business venture in which he invested and had some kind of guarantee about the borrower's creditworthiness, either through his previous dealings with the borrower or through his family or tribe members. Moreover the transactions were simple and much easier to manage and monitor.

In order to make *Mushārakah* and *Muḍārabah* an effective mode of financing, we need to establish a platform for direct interaction between the investor/lender and the borrower and provide necessary tools and systems, through such a platform, for the two parties to develop mutual trust and credibility and to enable close monitoring of the business operations. This kind of interaction cannot happen through the existing banking institutions which, by their genesis, are financial intermediaries and not investors.

3.3 PARADIGM SHIFT REQUIRED IN RESEARCH IN ISLAMIC FINANCE

The efforts made during the past 30 – 40 years for making the banking operations *Sharīʿah* compliant have shown that it is not workable for the banks in their existing form to implement the profit and loss sharing instruments such as *Mushārakah* and *Muḍārabah*. We need an 'out of the box thinking' i.e. to contemplate outside the realm of the existing banking system and conventional banking instruments. Hence, we need to develop new forms of institutions totally different from banks, which are equipped with the necessary tools and systems to facilitate implementation of *Mushārakah* and *Muḍārabah* mode of financing.

Future research in Islamic banking and finance needs to be redirected from the current focus on making banking products *Sharīʿah* compliant to the new direction of developing new form of institutions, different from banks to provide various kinds of *Sharīʿah* compliant financial arrangements between the investor (lender) and the borrower. Muslims need to provide necessary tools and services to investors to evaluate the proposed business ventures before investing and to provide tools and services to monitor the business performance post-investment.

4. PROPOSED WAY FORWARD

It is proposed that university academia, sharia and financial experts and business community should collaborate to initiate and sponsor various projects to design and develop new institutions which could facilitate and promote contracts such as *Mushārakah* and *Muḍārabah*. These institutions should be designed to address not only the legal *Sharīʿah* issues involved in the related transactions but also attempt to implement the ethical and social spirit embedded in the Islamic economic principles. The proposed institutions will augment the investor's risk management framework by providing additional support for addressing the issues and weaknesses which currently hinder the growth of *Mushārakah* and *Muḍārabah* mode of financing.

Some of the critical issues faced by *Mushārakah* financing are summarized in Table 3 below:

TABLE 3
Issues Hindering Growth of *Mushārakah* Finance

No.	Issues and Weaknesses
1	Lack of appropriate resources to assess and monitor the borrower's creditworthiness.
2	Lack of appropriate mechanism to assess the entrepreneurial skills of the borrower.
3	Lack of mechanism to assess the management team experience and quality of the technical human resources.
4	Lack of appropriate technical expertise to evaluate the feasibility of various investment proposals.
5	Lack of appropriate mechanisms to regularly monitor technical, administrative and financial performance of the projects financed by the investors.
6	Lack of appropriate mechanism for regular monitoring, early identification and reporting of risks related to borrower repayment capacity.
7	Lack of appropriate mechanism to monitor the degree of realization of *Maqāṣid al-Sharīʿah*.

In the following sections we present a sample project to develop one such institution to facilitate *Mushārakah* financing. The main objective of presenting the sample project is to attract interest from academia, *Sharīʿah* experts and the business community and immediately start working in this direction to set up one such pilot institution within the next six to eight years *In shāʾ Allāh*. The the sample project presented can also be used by other researchers as an example in designing their own projects.

4.1 OUTLINE OF A SAMPLE PROJECT

We propose to initiate a comprehensive project as outlined below to design and develop an institution to facilitate the *Mushārakah* mode of financing. The proposed project will be carried out in two distinct phases as follows:

Phase I will be an exploratory phase and will consist of a detailed study to analyze the current working practices of a conventional bank for mid-term and long-term loans and that of an Islamic bank for any *Mushārakah* financing. This will help in understanding the real life practical issues involved from the stage of loan application to evaluation, approval, disbursement and loan recovery. It will also help in identifying the risk management and controls of the existing institutions that can be adopted or adapted in designing the proposed institution. Based on the analysis of two to three such cases for an Islamic bank and another two to three cases for a conventional bank, we will develop a comprehensive list of services to be provided by the proposed institution. The next step will be to develop a high level workflow for providing such services and developing a comprehensive organizational and operational framework for the proposed institution. Phase II will consist of designing and developing a detailed operational and organizational set-up including policies, procedures and detailed workflow of the proposed institution based on the framework developed in Phase I.

4.2. OVERVIEW OF THE INSTITUTIONAL FRAMEWORK DEVELOPED UNDER PHASE I

The organizational and operational framework developed under Phase I will facilitate the interaction between the borrower/investee and the lender/ investor for the pre lending/ pre investment phase as well as post lending/ post investment phase.

For the pre lending/ pre investment phase the proposed institutional framework will include designing a mechanism to facilitate the borrower/ investee by providing various types of standard templates and other related services to present the necessary financial, organizational and operational information about their projects in an analytical form. This will facilitate the potential investors/ lenders in evaluating and appraising the projects presented besides assessing the entrepreneurial skills and management and technical abilities of the borrower/ investee and his or her team.

For the post lending/ post investment phase the proposed institutional framework will include designing a mechanism to regularly monitor technical, administrative and financial performance of the projects financed by the lenders/ investors. This will help in early identification and reporting of risks related to any decline in project profitability. Similarly a mechanism will be developed for reporting on social and environmental indicators to ensure implementation of the ethical and social spirit of Islamic economic principles. The proposed institution will also maintain track record of the creditworthiness of the entities availing financing through these institutions.

The proposed institutional framework will also give a high level design for maintaining a database of various entities (individuals or organizations) seeking support in terms of borrowing or investment. Similarly it will give a high level design of a database of various entities (individuals or organizations) interested in investing in different projects.

Phase I will also identify different types of *Sharīʿah* compliant contracts which need to be developed and implemented for different types of financing models under profit / loss sharing arrangements.

4.3 METHODOLOGY – PHASE I

The following Table 4 gives an outline of the proposed methodology to be used during Phase I. However a more detailed and specific methodology will be developed after the project team has been constituted as discussed in Section 5 below.

TABLE 4
Proposed Methodology

No.	Tasks	Methodology
1	Study the workflow of an Islamic bank for the award of financing under *Mushārakah* mode – review two to three cases.	Document and analyze the complete workflow including all the paperwork prepared and submitted by the borrower, analyze various evaluation and approval stages up to the stage when loan is credited to the borrower's bank account. Similarly analyze the workflow for repayments and loan clearing. Identify issues faced by the Islamic banks under various previous cases of *Mushārakah* financing.
2	Study the workflow of a conventional non Islamic bank for the award of long term loans – review two to three cases.	Document the complete workflow including all the paperwork prepared and submitted by the borrower, analyze various evaluation and approval stages up to the stage when loan is credited to the client's bank account. Similarly analyze the workflow for repayments and loan clearing. Identify the risk management and related controls that can be adapted for the new proposed institution.

TABLE 4 (*continued)*

No.	Tasks	Methodology
3	Simulate the above two to three cases of non-Islamic banks as these are to be financed under *Mushārakah* mode of finance by an Islamic bank and identify the additional controls and monitoring required.	Desktop work using the documentation prepared in item (1) and (2) above along with extensive consultations with various Islamic bank officials and *Sharīʿah* experts and internal discussions with the project team.
4	Based on the analysis of items (1) – (3) above, identify the services which need to be provided by the proposed institution to facilitate *Mushārakah* based financing in line with the institutional framework outlined in Section 4.1-4.2 above.	Desktop work based on the output of items (1) – (3) above, supported by internal discussions with the project team. Hold a seminar to be attended by bankers, businessmen, *Sharīʿah* scholars and academicians to get their opinions and suggestions and improve the work accordingly.
5	Develop a high level workflow of the services identified above.	Desktop work based on output of items (1) – (4) above and adaptation of international best practices for similar processes, supported by internal discussions with project team. Hold a seminar to be attended by bankers, businessmen, *Sharīʿah* scholars and academia (stakeholders) to get their opinions and suggestions and improve the work accordingly.
6	Develop high level requirements of the web based electronic portal to provide the above services.	Desktop work based on the output of items (1) – (5) above, supported by internal discussions with the project team. Hold a seminar to be attended by the stakeholders to get their opinions and suggestions for improvement.

TABLE 4 (*continued)*

No.	Tasks	Methodology
7	Identification of various *Sharīʿah* based contracts for different profit / loss sharing based transactions between the lender/ investor and the borrower/ investee.	Desktop work based on the output of items (1) – (5) above, supported by discussions with the project team. Hold discussions with *Sharīʿah* experts in different countries and hold a seminar to be attended by bankers, businessmen, *Sharīʿah* scholars and academia to get their opinions and suggestions and improve the work accordingly.
8	Develop an institutional framework for providing the above services to facilitate *Mushārakah* mode of financing.	Desktop work based on the output of items (1) – (5) above, supported by internal discussions with the project team. Hold a seminar to be attended by the stakeholders to get their opinions and suggestions for improvement.
9	Discuss the proposed framework with the selected businessmen, Islamic banks, and *Sharīʿah* scholars from different countries.	Develop questionnaires – separate questionnaires for different types of stakeholders like bankers, *Sharīʿah* experts, businessmen and others. Test the questionnaires with a small sample and improve the questionnaires accordingly. Conduct face to face interviews and document and analyze the interview findings.
10	Finalize the institutional framework for the proposed institution to facilitate *Mushārakah* financing.	Desktop work based on the analysis and consolidation of output of items (5) – (9) above supported by internal discussions with the project team to finalize the institutional framework of the proposed institution. Present the institutional framework in conferences and international journals.

4.4 OUTLINE OF PHASE II

Phase II of the project will consist of preparing a detailed design of the proposed institution based on the framework developed under Phase I. It will consist of three to four sub projects, some running in parallel covering various organizational and operational aspects of the proposed institution.

This phase will include preparing a detailed workflow, policies, operating procedures and related templates to provide the services identified in Phase I. It will also develop the organizational structure of the proposed institution including job descriptions, hiring policies and procedures, performance indicators and so forth. A comprehensive electronic portal will be developed under Phase II to support the working of the proposed institution.

Phase II will also include development of *Sharīʿah* based contracts for different services to be provided by the proposed institution as well as for the financial transactions between the lender (investor) and the borrower (investee).

A more detailed methodology and work plan for Phase II will be prepared toward the end of Phase I, after detailed and in depth discussions on Phase I output with all the stakeholders in the university academia, *Sharīʿah* experts, financial experts and business community.

5. PROJECT TEAM AND PROJECT EXECUTION

The proposed sample project can be launched by an Islamic bank or a large business group by hiring services of professional consultants. Alternatively, it can be a research and development project by a university. We suggest that such projects need to be led by independent bodies such as universities and not by commercial entities as it carries a risk of introducing their own commercial bias into the design of such institutions. Moreover, the knowledge developed through these projects should be made available in the public domain for implementation, testing, improvement and further development and should not be the intellectual property of any commercial organization. For these reasons we propose that the project be led by a university research team, but with input from *Sharīʿah* experts, business community and reputable financial and management consultants.

We propose a Project Team to be headed by a Project Leader and the team to consist of two components, the Project Core Team and

Project Advisory Team. The Project Core Team will comprise of the 1-2 persons doing detailed fieldwork to study and collect data from conventional and Islamic banks and carry out the necessary analysis and design and development work on the project as described in Section 4.3 above. The Project Advisory Team will consist of various subject matter experts who will provide technical expertise to improve the quality of the Project Core Team deliverables. The Project Advisory Team will consist of *Sharīʿah* experts, banking professionals, financial and management consulting professionals and experienced businessmen.

The Project Core Team will work in close interaction with the Project Advisory Team. All outputs generated by the Project Core Team at various intermediate stages of the project will be discussed and debated extensively with the Project Advisory Team before moving on to the next stage of the project.

It is anticipated that with the help of a committed and dedicated project team as described above, one such institution to facilitate *Mushārakah* mode of financing can be put in place for pilot operations within a period of six to eight years *In shāʾ Allāh*.

6. CONCLUSION

Islamic finance has made significant progress over the last quarter of a century and numerous Islamic banks are now operating in Muslim majority countries as well as in Muslim minority countries. However this growth has also been subjected to various criticism of the financial instruments used by these institutions. Islamic banking is still predominantly based on *Murābaḥa* and deferred sales contracts as highlighted in Table 2. The underlying spirit of Islamic banking is still based on charging for the use of money; thus the primary objective of offering an alternative mode of financing has not been fulfilled

Despite various research scholars identifying these shortcomings over the last quarter of a century, no sustainable effort has been made to design and develop an alternative mode of financing based on Islamic principles of profit/ loss sharing. Primary focus over the last 20 – 30 years has been to introduce *Sharīʿah* compliance in the existing banking products rather than developing an altogether different solution outside the existing banking system.

This paper argues that instead of introducing *Sharīʿah* compliance in the existing banking instruments, research in Islamic finance should be re-directed toward setting up new institutions outside the operational framework of existing banks; these new institutions will genuinely promote as well as effectively facilitate the profit/ loss sharing mode of financing.

In order to move forward in this direction, this paper has presented an outline of a sample project along with a proposed methodology to act as a template for designing other similar projects. It is anticipated that the sample project outlined in this paper can be initiated and implemented successfully with support from a dedicated team and cooperation from *Sharīʿah* experts and the business community and that the pilot operations of the proposed institution can proceed within six to eight years, *In shāʾ Allāh*.

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