



# AVAILABLE FINANCING RESOURCES FOR ISLAMIC MICROFINANCE INSTITUTIONS TO ALLEVIATE POVERTY: CASH WAQF APPROACH

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## Abstract

Islamic Microfinance (IM) is considered an important element of economic prosperity and an instrument in reducing poverty rates in the Islamic world. However, the IM industry faces many problems in its efforts to serve the community. One of these problems is the lack of financing resources. This research studies the current Islamic financing channels that are used to finance IM institutions and determine the appropriate mechanisms or models practiced by IM institutions to finance the micro-enterprises and therefore reduce the poverty rate in Muslim communities. This research applied a qualitative approach by reviewing the current literature in the IM industry. This research focused on Cash Waqf as an alternative channel to finance IM institutions as this model has been successfully implemented and experienced by many Islamic countries, to deal with various social problems and poverty alleviation. The desired development can be achieved by investing Cash Waqf funds in micro-enterprises that may help to maximize investment and low-income people's returns also enhance economic development to a direct impact poverty alleviation. It has been found that the Cash Waqf model is considered an appropriate source of funding to finance IM instigations that will utilize the Cash Waqf fund to finance micro-enterprises through several models like Mudarabah, Murabaha, Musharakah Mutanaqisah and Qard Hassan. These models were discussed after merging them with the concept of Cash Waqf through the previous literature, weighing the advantages and disadvantages of each one, and proposing some solutions that could contribute to solving the problems faced by the micro-enterprises.

*Keywords: Islamic Microfinance, Cash Waqf, Alleviate poverty, Miro-enterprise*

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## 1. Introduction

The *Waqf* has played a significant social role throughout the ages while it cared for the poor, the orphans, the widows, and the needy. Many people are willing to give part of their wealth to collaborate in meeting the needs of the poor and needy and provide them suitable employment opportunities. Thus, enabling them to earn a steady income and raising their standard of living and social life. Today, governments in the Islamic world need to revive the *Waqf* foundation to play this crucial role by finding new financing methods that match the rapid economic developments and redistribution of resources. The *Waqf*, through its institutions, projects, and applications based on Islamic covenants, has enabled it to participate in the service of society, the state, and the nation. The *Waqf* is an intermediate financial institution that is interested in financing all areas of the economy through *Cash Waqf* (Arnaout, 2011).

There is an urgent need for policymakers to support society in reducing poverty and preventing its spread since may lead to various social problems. Poverty, if not addressed, will open the door to the unemployed to commit crimes, acts of terrorism, and other anti-social behaviour. Islamic Microfinance through *Cash waqf* is one of the methods used by different countries to alleviate unemployment phenomenon. Eventually, it achieved positive results in contributing to the reduction of unemployment rates. A *Cash Waqf* fund is a legitimate tool and significant for practitioners, as will be shown later. Likewise, the funders and financiers of this fund seek God's satisfaction and obedience in obtaining thawab. However, this fund through its various financing methods can fill the financing gap. This study explains the ultimate need for *Cash waqf* in providing social protection to all Muslims on the basics and concepts of faith and Islamic law. *Cash Waqf* funds in this era can play a vital role, due to the continuing increase of living cost, which weighs heavily on the poor of the society who find it increasingly difficult to make ends meet.

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## 2. Literature Review

The accumulation of wealth and how it is redistributed are closely related. *Waqf*, by definition, is a charity institution and it is one of the most significant institutions to redistribute wealth (Marshall, G. S., 1974). This is based on the historical evidence indicating that “one-third to half of the total state revenue is matched by total revenue of *Waqfs* in the Ottoman Empire during the 18th century” (Yediyıldız, 2003).

Many researchers have indicated how poor people are unable to participate in the development process because they have no access to the financial system. In this regard, providing appropriate microfinance products and services to the needy is a commonly accepted approach taken to alleviate poverty (Obaidullah, 2016).

Although Working-age adults who still lack the financial services provided by organized financial institutions are estimated to number 2.5 billion (more than half of the global adult population), the international target of IM financial inclusion is to provide global access to financial services that assist mankind in managing risk and protecting themselves from economic shocks while it saves and invests (Beatriz Armendáriz & Morduch Jonathan, 2010; Demircuc-Kunt, A. & Klapper, 2012).

Another research argued that weak experience and financing conditions hinder those who want to establish micro-enterprises. Perhaps reducing the fees imposed on these projects and creating a specific classification for micro-enterprises are the most prominent demands of the owners of this category of projects. Besides, the competition of the owners of major projects in the Micro-enterprise market favors them as experts with financial capability. However, the small and medium-sized enterprises (SME) owners, their first project is the only source of their livelihood, so falling prey to unequal competition often closes their business, then the market remains the exclusive preserve of the big traders (Al-Zaabi, 2013).

Thus, a group of researchers began a series of studies to identify suitable methods and contemporary financing models that are consistent with the shariah perspective of the *Cash Waqf* and harmonizes its own nature in which they achieve the goals of the *Cash Waqf* and support the owners of micro-enterprises. Many researchers have confirmed that *Cash Waqf* has been used to fund the micro-enterprises. Based on previous researches, the *Cash Waqf* was combined with the concept of *Qard Hassan* (interest-free loan) and used as a source of financing for the poor who were having difficulties accessing financial institutions. Another option was suggested that depended on the concept of *Mudaraba* as a model in which financing assistance is provided to entrepreneurs in which a *Cash Waqf* can be used to meet social goals. Also, *Cash Waqf* is utilized as a microfinance tool for the poor or micro-enterprises (Cizakca, 2004; El-Gari, 2004).

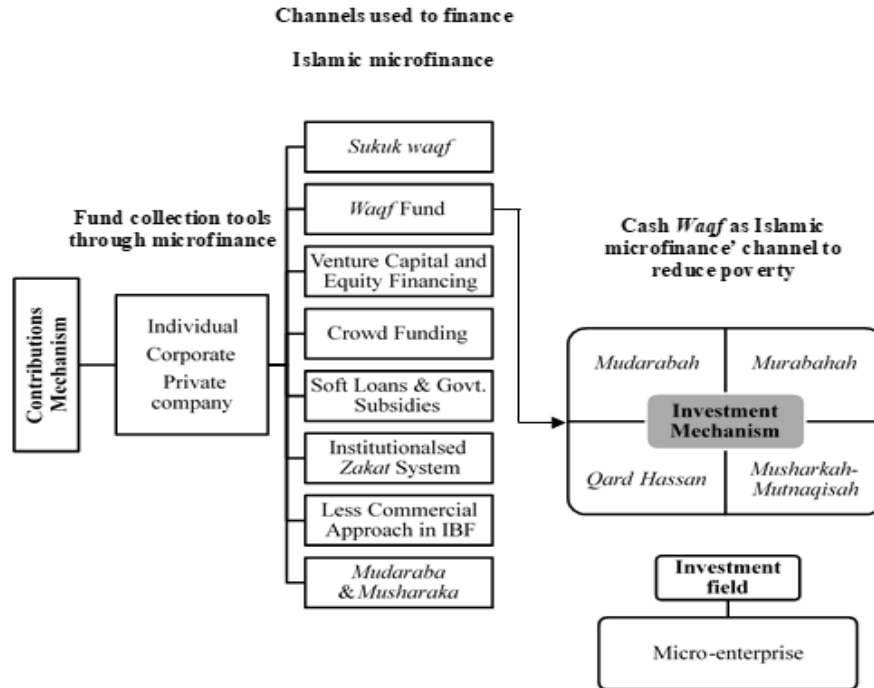
Therefore, to improve the growth of IM and reduce poverty, this study suggests using the *Cash Waqf* models as an alternative and additional source of financing in Islamic countries. These alternative models also are needed to solve the problems of micro-enterprises. The research further provides a practical and accurate perspective of how the modern formula is used for collecting the *Cash Waqf* and the role of the *Waqf* Foundation in gathering contributions to finance the social and Micro-enterprises sectors (Ismail Abdel Mohsin, 2013).

## 3. Data and Methodology

This study applied qualitative approach to achieve the objective of this research through previous studies located in journals, articles and conducted Studies as well as online Websites to gather and present them. to achieve the objectives of the study and thus determine the Islamic finance channels that use Islamic microfinance to reduce the poverty.

## 4. Conceptual Framework

The framework of this study is proposed to highlight the using of Islamic *Cash Waqf* as a channel to finance Islamic microfinance institutions and their micro-enterprises using qualitative approach based on previous studies to achieve development in society.



**Figure 1:** Proposed Conceptual Framework of the research  
**Source:** Author

As present in Figure 1, to be promoted, micro-enterprise requires financing, which is provided by either individual, private companies or a corporation through Islamic microfinance. There are several sources of Islamic microfinance financing, for example, *Cash Waqf*, *Sukuk Waqf*, Crowd Funding, Venture Capital, and Equity Financing, Donor Grants, Soft Loans and Govt. Subsidies, Institutionalized Zakat System, Less Commercial Approach in IBF, *Mudaraba*, *Musharaka*, and *Waqf*. In this research, the focus is on *Cash Waqf* due to its success in several countries of the Islamic world in dealing with a wide range of social problems and in poverty reduction. The desired development can be achieved by investing the *Cash Waqf* funds in contracts that are Sharia compliant in the field of community development.

Through MFIs the suggested models of *Cash Waqf* can develop human resources and provide the basic needs for survival to the micro-enterprises such as education, technical training, and health care, etc., and achieve a certain level of financial stability and independence in the community (Mohsin, 2013). Thus, will ensure stability and profitability for the projects and parties involved and result in higher income and a better life for all concerned.

## 5. Finding and Discussion

### 5.1 Introduction

This research sought to identify the appropriate Islamic finance channels for funding microfinance institutions through Cash Waqf to support the community and impact through more attention in terms of allocation of funds for micro-enterprises.

### 5.2 Micro-Enterprise

Many ignore the role of micro-entrepreneurs in the economic and social advancement of developing countries. They fail to see how the successes of these micro-entrepreneurs will change the reality of countries and solve various crises. So, they can start developing these projects to accommodate the largest number of individuals and achieve the goal of alleviating unemployment and poverty. It has been proved that it is now possible to exploit and develop the projects of small and medium businesses guided by a vision and complemented by realistic administrative and economic plans aimed at achieving lofty goals that benefit the economy of the countries and the development of society. All these achievements are within reach by embracing entrepreneurial projects and providing the appropriate environment for them to succeed and achieve great economic development for the developing countries.

### **5.3 Issues in Obtaining External Financing**

Some owners of medium and small projects face great difficulties in establishing their presence in the market because especially those new to the market. Many are also impatient and are incapable of matching the competition of established and more experienced competitors. A study issued by the Department of Economic Development in Abu Dhabi confirmed that the weakness of the sources of financing and the high costs of facilities to the segment of SMEs are considered the biggest obstacles to the growth of this sector. In addition, the officials confirmed the reluctance of many banks to finance these projects.

Perhaps reducing the fees imposed on these projects and creating a specific classification for Micro-enterprise are the most prominent demands of the owners of this category of projects. It has been confirmed by one of the SME owners that he faced many obstacles when he decided to establish his project, starting from the bureaucratic red tape when applying for his business license and up to providing housing and health insurance for workers, which puts a strain to the project's already tight budget

Micro-enterprises are still suffering from the reservation of local banks in financing projects which reduces the opportunities for growth and expansion of these companies. As the rate of rejection of short-term debt requests reaches 65 percent according to a specialized study which was attributed by experts and specialists to the banks' fear of taking risks with new projects for reasons related to guarantees that are difficult to provide by the owners of micro-enterprises (Al-Abbas & Ibrahim, 2019).

Most economists agree that banks' tightening of financing operations is due to the high-risk indicators of Micro-enterprises and substantial paperwork and transactions required in the application process.

Funding sources in Dubai for Micro-enterprises relied 88% on personal funds and borrowing from friends and relatives, while about 9% rely on investors and 3% on bank financing (Al-Abbas & Ibrahim, 2019).

#### **5.3.1 Lack of Collateral**

Collateral is one of the most effective factors in obtaining external finance since it is a safety factor for the Islamic banks in cases where the primary repayment is negatively affected, and the borrowers' default (Haron, Binti Said, Jayaraman, & Ismail, 2013). However, it is obvious that the lack of collateral is one of the biggest problems for micro-enterprises because there are stringent requirements and most of the SMEs do not own legitimate collateral that for a loan (Aris, 2006; Duasa & Thaker, 2016; Meza, 2012).

#### **5.3.2 Insufficient Information and Documents**

The failure to obtain sufficient information and documents about micro-enterprises such as size, age and type of ownership makes it hard for institutions to approve the loan applications and provide financing to them ("Census of Establishments and Enterprises," 2005; Mohd Thas Thaker, Mohammed, Duasa, & Abdullah, 2016).

#### **5.3.3 No Financial Track Record**

Traditionally, one of the important requirements for financial institutions is the track record of the client. However, although the micro-enterprises are usually in an early stage of business, they are unable to provide any financial track record thus lending institutions are reluctant to accept such high risk (Thaker, Mohammed, Duasa, & Abdullah, 2016). Based on the Census of Establishments and Enterprises (2005), around 11 percent of SMEs in Malaysia cannot obtain external finance because of the inability to provide a financial track record.

#### **5.3.4 Nature and Quality of Business**

In Malaysia, the financial institutions consider Micro-enterprises as a risky business, so they believe that the nature and the quality of their business plan do not achieve the minimum standard for receiving a significant amount of financing (Thaker et al., 2016). According to the Census of Establishments and Enterprises (2005), around 5 percent of SMEs in Malaysia cannot access external finance due to the nature and quality of their business.

#### **5.3.5 Characteristics of Micro-enterprises**

Some researchers mentioned that SMEs face difficulty in accessing external financing due to the size and age of the company which are important factors. As a result, lenders prefer not to provide financing facilities for projects owned by

this category because of the small size of the operation as well as the fact that it is new in the market (Lean, J., & Tucker, 2001).

### 5.3.6 Awareness of Financing Facility

According to the study in the Northern States of Malaysia, there is a lack of awareness among entrepreneurs of the loan facilities provided by the government. For example, in Kedah, Perlis, and Penang, 62 percent of the entrepreneurs surveyed did not know that government and banks provide loan facilities and loan related information. Therefore, micro-enterprises have not fully accessed available financial facilities offered by the banks and the government (Idris, 2001).

### 5.3.7 High Cost of External Financing

Most of the financial institutions in the credit market impose high-cost interest in the case of micro-enterprises as this kind of project is highly risky due to the absence of suitable collateral and the high cost of collecting the information. According to some researches, the high cost of external financing is the reason many micro-enterprise operators are reluctant to seek external finance from financial institutions (Saleh, Caputi, & Harvie, 2008). In the case of Malaysia, some commercial banks provide loans at a high-interest rate to micro-enterprises, ranging from 5 to 8 percent. This was proven by a survey in an Annual report that 33 percent of micro-enterprises in Malaysia were facing the issue of obtaining finance due to the expensive cost of external financing (Majlis Pembangunan PKS Kebangsaan, 2013).

### 5.4 The Need for an Alternative Model

To obtain credit from commercial banks Micro-enterprise owners must make a greater effort in competing with larger companies. Especially in the case of giving loans to owners of Micro-enterprises, banks impose more stringent evaluation criteria. An alternative model also is needed to solve the problems of micro-enterprises including lack of collateral, have insufficient information and documents, no financial track record, unattractive nature and quality of business, characteristics of micro-enterprises, no awareness of financing facilities and unable to afford the high cost of external financing.

### 5.5 Cash Waqf Micro-Enterprise Investment Model

The *Waqf* in its investment must invest in the most profitable projects, even in small projects, so that it can achieve the highest possible return that guarantees it will continue to provide services to society. This study's selection of the most appropriate models came in terms of micro-enterprises which are contracts of *Musharakah Mutanaqisah*, *Mudarabah*, *Murabahah*, and *Qard Hassan* (Al-Zarqa, 1994).

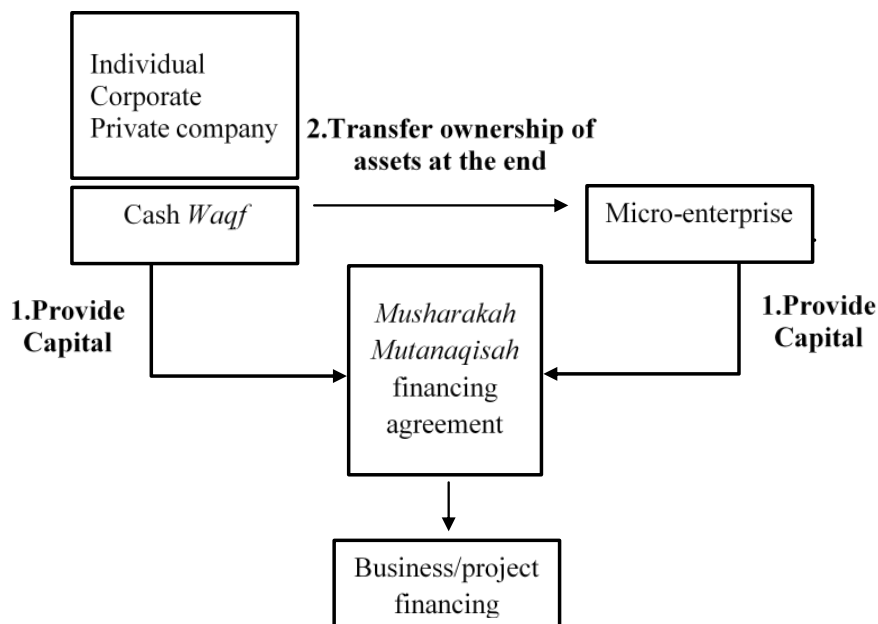


Figure 2 Cash Waqf Micro-enterprise Investment

Source: Author

The above Figure 2 shows an individual, a corporate or a private company donates perpetual *Cash Waqf*. The *Cash Waqf* that provides a portion of the financing through contributions to the capital of a company, a commercial, a real estate, an industrial or a service company as *Mutawali* (Manager) to make the investment decisions of the fund by involving *Musharakah Mutanaqisah* agreement with the Micro-enterprise owner provided that they share in the expected profit or loss according to the agreement and the project ownership is by both parties. *Cash Waqf* promises giving up its rights and to sell its shares to these partners provided that the partners are also committed to buying those shares, either in one payment or in multiple instalments as required by the agreed terms. The ownership becomes the project owners at the end of the agreed period.

*Musharakah Mutanaqisah* is one of the best and most appropriate models in the effective development of society in financing micro-enterprises. One of the important benefits is providing reassurance in the hearts of funding-seekers because they realize that owners of *Cash Waqf* participate in the loss which is out of their control and the share of the *Cash Waqf* will go back again to them at the end. In addition, it is considered less costly for micro-enterprise owners than the costs of other financing models. It also helps in moving minds and discovering energies, which leads to developing the production and increase of the wealth, especially since the relationship between the *Cash Waqf* and the owners of micro-enterprises here is not a creditor and debtor relationship, but rather an ongoing counseling relationship and joint evaluation to ensure the achievement of common interests. In addition to that, the *Cash Waqf's* risk score decreases the more part of the capital is recovered, thus increasing the rate of return.

As for *Qard Hassan*, within the framework of the *Cash Waqf*, the loan is derived from the validity of the temporary *Waqf*. In practice, the *Waqf* foundation establishes a temporary *Cash Waqf* fund for the loan. The fund collects *Waqf* funds temporarily from the lenders by issuing *Qard Hassan* certificates. In a second phase, the *Waqf* foundation will use this money in the form of short- and medium-term loans for those in need especially small entrepreneurs who need financing at no cost. It can be said that *Qard Al-Hassan* in the framework of the *Cash Waqf* can contribute to Islamic microfinance to provide for the needs of the poor. The *Waqf* Foundation can also use a percentage of the income generated from the temporary investment to grant interest-free loans to those in need using the *Qard Hassan* contract (Khalid, 2014). In the final stage, the borrower will pay the loan to the *Waqf* Foundation, which in turn will return it to those who issued the *Waqf* (*waqif*). In this regard, some problems arise concerning the liquidity of the *Qard Hassan* fund and the repayment guarantees of the loan from (*Mawqoof Alihi*) (Hichem, 2017). However, the *Qard Al-Hassan* is characterized as permanent if it is merged with the endowment. Therefore, there is no guarantee that the poor will pay off the loan, but there is no information on how this money is going to be used by this category (El-Gari, 2004).

In this context, the fund's management must take the necessary measures to confront this risk by taking guarantees and verifying the economic feasibility of their projects. The fund can also work to find a third party in the case of non-payment of debt or weak liquidity to donate and redress the loss if any. The *Waqf* foundation can play the role that Islamic banks have not played in the field of *Qard Hassan*. This role will enable *Waqf* institutions to meet the needs of important segments of society, especially entrepreneurs, which will create a competitive environment with Islamic financial institutions. The *Waqf* foundation should also benefit from the experience of Islamic banks in the management of liquidity risk in order to avoid a decrease in the value of the *Waqf*.

However, in terms of *Murabahah*, with Islamic micro-enterprises in many Muslim countries, the process tends to be high-priced because it is a common practice or the cost of the administration is equivalent to *riba* (Ismail, Hassan, Ismail, & Shahimi, 2010; Muhammad, 2012). *Murabaha* is not appropriate in financing all areas of micro-enterprise. The *Murabaha* formula is based on the rapid turnover of capital and a low degree of risk, which is not appropriate for some characteristics of financing small projects. Accordingly, the *Murabaha* model can fit the small project only in financing raw materials for small productive projects, without being appropriate for financing other fields for small projects for which the cost of financing in the *Murabaha* model is relatively high, which is not consistent with the nature of the income of the micro-enterprise.

Besides, the *Mudarabah* model is considered as a high-risk investment and it depends on the experience of the *Mudarib* (the micro-enterprise), so back to the definition of the micro-enterprise which is "companies having less than 5 employees". Usually, most of the employees are from one family, their businesses depend on their savings, and they do not have experience in *Mudarabah* (Hassan, Tee, Jian, & Mohd, 2010; Sayyed, Ebrahimi, & Zaman, 2014). Besides that, many of the models such as *Murabahah* and *Mudarabah* focus on SMEs in general rather than micro-enterprises as there is a need for a tested model for the micro-enterprises.

Nevertheless, the idea of *Musharakah Mutanaqisah* and its suitability for financing Micro-enterprises is examined by semi-structured interviews conducted with experts from various backgrounds and it has proved effective in Malaysian practices. Accordingly, financing Micro-enterprises through microfinance by using *Cash Waqf* as a source of funds, whether through *Musharakah Mutanaqisah*, *Mudarabah*, *Murabahah*, and *Qard Hassan*, is one of the most important sources of financing appropriate for the nature and characteristics of those projects. Additionally, in the eyes of the researcher, the *Cash Waqf*, as a source of financing has the advantage of financing various fields for micro-enterprise. In addition, it will contribute to developing society, reducing poverty, and raising productivity by expanding opportunities available to owners

of micro-enterprises, especially in light of the obstacles they face in terms of the complexity of documents or the difficulty in obtaining financing or for other reasons as mentioned earlier in the issues of obtaining external financing. *Cash Waqf* aims to provide services to the community and raise the level of the individual socially by meeting his/her essential needs (Mohd Thas Thaker et al., 2016).

As discussed, the *Musharakah Mutanaqisah* model is effective since it provides reassurance in the hearts of finance-seekers due to the low-risk ratio and the increased rate of return. Also, the sharing of *Cash Waqf* in any loss that is beyond their control. Besides, returning the shares of the *Cash Waqf* to micro-enterprises at the end is considered less expensive for owners of small projects compared to the costs of other financing models.

As for the *Qard Hassan* model, some mentioned fears of not being able to repay the money as required in this category. Requiring of financing, such people have to face a high-risk ratio due to the lack of guarantee. Therefore, the *Waqf* fund needs to apply more stringent procedures and greater effort by checking on the economic feasibility of their projects and finding a third party in case of non-payment. As for *Murabahah*, it was found that it might not be appropriate to finance all forms of small projects, as it is limited to financing raw materials for productive projects, the cost of finance for micro-enterprises may be relatively high and this is not acceptable to people with limited income. As for the *Mudarabah* model, it is considered a high-risk investment and depends on the *Mudarib's* experience. Therefore, the owners of small projects find that they do not have experience in *Mudarabah* which adds more risks to them.

## 6. Conclusion

The Islamic microfinance industry faces many problems to serve the community. There is an urgent need to introduce and develop an alternative source of financing for Islamic microfinance institutions to ensure the prosperity of this sector. The author specifically selected the *Cash Waqf* as a new financing source for the microfinance institution for micro-enterprises, as they are a significant element in the community, to bridge the economic gap and enable this impoverished sector of the community to be financially independent through their micro-enterprises and to have a better life and in this process, contribute significantly to the eradication of at least the extremely poor in society.

## 7. Recommendations for Future Study and Implications

In order to succeed in reducing poverty, the following are recommended:

- I. It is necessary to support and give more attention to financing micro-enterprise owners, as they are among the most important elements that can support society and develop the economy by providing them with the appropriate financing.
- II. It is proposed that that *Cash Waqf* is a suitable source of Islamic microfinance financing especially for micro-enterprises.
- III. Reducing the percentage of difficulties that stand in the way of owners of small enterprises in entering the market by financing them through integrating the *Cash Waqf* into appropriate contracts for each case (*Mudarabah*, *Murabahah*, *Qard-Hassan*, or *Musharkah Mutnaqisah*).
- IV. Placing facilities for micro-enterprise owners and reducing the risk ratio of their projects by employing consultants to support their investment decisions and ensure the success of their projects.
- V. Finding a third party that supports the *Cash Waqf* fund as collateral in case of default in payment or establish a reserve *Cash Waqf* fund.
- VI. Establishing public awareness of the importance of contributing to the *Cash Waqf* fund for social participation.
- VII. Using the media to clarify the official procedures and facilities provided by the government and Islamic banks for a *Cash Waqf* due to the lack of knowledge among those in need and providing easy access for them to these facilities.
- VIII. Establishing an educational training course on how to complete the required official documents to facilitate access to finance and to ensure the success of the small project.
- IX. Encouraging businessmen and donors to donate to *Cash Waqf* funds by offering incentives or exempting their contributions from tax, as Malaysia is currently doing, for exempt, 7 percent to donors to *Waqf* funds.

As a result, the GDP will increase, thus combating poverty and generating social and economic growth in the Islamic world.

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