

ISLAMIC COOPERATIVE: AN ALTERNATIVE TO COMMERCIAL ISLAMIC BANKING

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Abstract

The current Islamic banking model which is based on the concept of commercial banking has been criticized as too rigid and not conducive towards achieving the objectives of an Islamic economy. This paper aims to evaluate the suitability of the cooperative model as an alternative to the commercial banking model and to discern whether the values of cooperative would be more compatible to the ideals of Islam. We find that cooperative shares many of the social and economic values found in the teachings of Islam. When the essence of Islamic finance principles such as free from interest, transparency, and application of profit and loss sharing is combined with the values and principles of the cooperative model, what is created is an efficient, fast growing organization with the potential to greatly benefit its members as well as the society in general.

Keywords: Islamic finance, cooperative, *ta'awun*, Islamic banks, *ansar*, *akhuwat*

1. Introduction

When Islamic banking and finance concept was first discussed in the 1950s and 1960s, it was envisioned that Islamic banks would take the form of a publically-owned social service, similar to education and health¹. Islamic banks would offer current accounts that would not earn interest and saving accounts that paid dividends on the basis of partnership. The capital made available from the savings accounts is considered as investment, thus could be mobilised for the utilisation of businessmen through partnership agreements where the profits and losses would be shared between the businessmen (as the entrepreneurs – *mudharib*) and the bank and its account holders (as the owner of capital – *rabbul maal*)². The proposed Islamic banking model was based on profit and loss sharing (*mudharabah*) and participation (*shirkah*), with a general consensus that the Islamic banks would be operating primarily based on equity-based financing³.

Islamic banks are also expected to play a social role of providing inclusive financing to all segments of society, rather than serving selected clients who have collaterals. As such, the products of the Islamic banks should be uniquely designed on the basis of participatory contracts, rather than simply replicating the conventional banks' products and operations -- without the prohibited elements -- namely interest (*riba*), excessive uncertainties (*gharar*) and gambling (*maysir*)⁴. According to Az-Zuhaili⁵, "[t]he primary goal of an Islamic financial institution is not profit-making, but the endorsement of wider socio-economic goals, including economic

¹ Qureshi, *Islam and the Theory of Interest* (Lahore: Shaikh M. Ashraf, 1946): 169. Ahmad, S. *Economics of Islam* (Lahore: Institute of Islamic Culture, 1952): 203.

² Ahmad. S. *Economics of Islam* (Lahore: Institute of Islamic Culture, 1952): 203.

³ Ibid.

Siddiqi, Mohammad Nejatullah, *Islam ka Nazariyah e Milkiyat* (Urdu) (Lahore: Islamic Publications, 1968).

Chapra, M. Umer *Towards a Just Monetary System: A Discussion of Money, Banking, and Monetary Policy in the Light of Islamic Teachings* (Leicester: Islamic Foundation, 1985): 221.

⁴ Chapra.

⁵ Az-Zuhaili, *Fiqh Al-Islami wa-Adillatuh* (Damascus: Dar Al-Fikr, 2003): 350

development, more equitable income distribution, and alleviation of poverty."

The following decades saw the dream of establishing Islamic banking institutions turn to reality with the first Islamic commercial bank: Dubai Islamic Bank started its operation in 1975. Over the years, the Islamic banking industry grew rapidly defying the criticisms of many pessimists regarding the sustainability of the industry. Today, there are more than three hundred Islamic financial institutions worldwide in over seventy different countries with the Islamic banking assets reaching US1.6 trillion in 2014⁶. Islamic banks today offer a wide range of banking products and services that one could find at any conventional commercial bank, including current and saving accounts, personal financing, mortgages, hire-purchase financing, and debit and credit cards.

Islamic banks have grown to be efficient and profitable organizations, they were even in a better position compared to the conventional banks during the global financial crisis in 2007/2008. There have been accumulating evidences that the Islamic financial system, in general, fared better than its conventional counterpart in weathering the economic and financial shocks due to the global financial crisis (see, for example, Abdulle and Kassim⁷; Kassim and Kamil⁸). The stronger position of the Islamic financial institutions is largely attributed to the inherent stability of the Islamic financial system which is free from the prohibited elements of *riba*, *gharar* and *maysir*, as well as the nature of the Islamic financial transactions which is related to the real economic activities.

The thriving Islamic banking and finance industry has attracted the participation of not only Muslim countries, but also Western financial institutions and many non-Muslim countries. Yet, despite

⁶ Ernst and Young. *World Islamic Banking Competitive Report 2012-2013*. Ernst and Young Ltd. (2013)

⁷ M. Y. Abdulle and Kassim, S. H., "Impact of global financial crisis on the performance of Islamic and conventional banks: empirical evidence from Malaysia," *International Journal of Islamic Economics, Banking and Finance*. 8(4) (2012): 9-20.

⁸ S. H. Kassim and S. Kamil, "Performance of the Islamic unit trusts during the 2007 global financial crisis: evidence from Malaysia," *Asian Academy of Management Journal* 17(2) (2012): 59-78.

all these achievements, there remains a central unresolved issue: do the Islamic banks promote and achieve the objectives of Islamic economics as originally envisioned by Muslim scholars?

A review of Islamic economics literature reveals that the objectives of Islamic banks should involve the provision of basic human needs, promotion of justice and brotherhood, equitable distribution and circulation of wealth, and alleviation of poverty⁹. Unfortunately, there is a lack of literature regarding the social and economic impacts of Islamic banks to really answer whether Islamic banks are fulfilling these objectives, but a cursory review of most Islamic banks would reveal a lack of financial products aimed at improving financial inclusion, particularly to the poor in the rural areas in the form of Islamic micro-financing. The Islamic commercial banks today tend to involve themselves in head-on competition with the conventional commercial banks, targeting similar customers and mainly focusing on sectors that would be giving the highest possible return. The Islamic banks are also confined to the same risk-averse attitude as the conventional commercial banks, and consequently have failed to internalize and implement the ideals of the profit and loss sharing concept. These observations do not seem to suggest a focus on poverty alleviation or the promotion of an equitable distribution of wealth within a Muslim society.

Looking at the present conventional banking industry in the developed world, one would find a diverse mix of commercial, savings and cooperative banks. This, however, was not always the case. Before the 19th century, there only existed the commercial banks. These banks were aimed at providing the rich members of society with financial instruments to help utilize and grow their wealth. The poor working classes, however, were not considered profitable for these banks, and they were, therefore, neglected, especially in rural areas. These were the conditions that prompted the establishment of the first cooperative and savings banks, aiming for the inclusion of the rural poor. In this respect, Islamic banking is still

⁹ Chapra.
Siddiqui.

Chaudury, M. *Fundamentals of Islamic Economic System*, Lahore: Burhan Education and Welfare Trust (1999).

in the pre-19th century stage, since Islamic commercial banks tend to dominate the Islamic banking and finance industry greatly, with very few alternative types of banks available to Muslims, resulting in an obvious lacuna in serving the financial needs of the poor.

There is some literature to be found documenting the different characteristics of these different banking models (commercial, saving, and cooperative) and their effects on an economy, which will be discussed in greater detail later; yet there are no such studies for Islamic banks. This paper therefore seeks to provide a deeper understanding of this issue. Is there a need for the creation of Islamic cooperatives as there was within the conventional banking industry in the 19th century? Would the unique characteristics of the cooperative model make a better platform to achieve the objectives of socio-economic justice as envisioned by Islamic economics?

2. The Islamic Perspective of Cooperation

The concept of cooperation is expressed by the Arabic word *ta'awun* originating from the root word *awn* which means assistance, aid, or support¹⁰. Allah (s.w.t) says in the Quran: “And assist one another in righteousness and piety, but do not assist one another in sin and aggression” (Ma'idah: 2). In this verse, Allah orders mankind to cooperate and assist one another in those things that are good and benefit society. Indeed, the concepts of cooperation, aid, and assistance are all central to the concept of brotherhood and are repeated often in the Quran and sunnah.

Ibn Umar reported, the Prophet, may Allah bless him and grant him peace, said, “A Muslim is the brother of a Muslim; he does him no injustice nor does he leave him alone (to be the victim of another's injustice), and whoever does the needful for his brother, Allah does the needful for him, and whoever removes the distress of a Muslim, Allah removes from him a distress out of the distresses of the day of resurrection, and whoever covers (the fault of) a Muslim, Allah will cover his sins on the

¹⁰ Ibn Manthur, *Lisan Al-Arab* (Beirut: Dar Sadir, ed. 2014): 159.

day of resurrection”.

(Reported by Al-Bukhari and Muslim).

Abu Musa said, “The Prophet, may Allah bless him and grant him peace, said, “One believer in relation to another is like a building whose parts reinforce each other,” and he intertwined his fingers.”

(Reported by Al-Bukhari and Muslim).

Abu Hurairah said, “The Messenger of Allah, may Allah bless him and grant him peace, said, ‘Allah aids the slave for as long as the slave is aiding or assisting his brother (in faith).’”

(Reported by Muslim).

The Prophet, may Allah bless him and grant him peace, said, “The masjid (mosque) has pegs (men that spend so much time in the masjid it is as if they are a part of its construct), their companions are angels, so if they are absent, ask about them; if they are sick, visit them, and if they are in need assist them.”

(Reported by Ahmad).

The Prophet, may Allah bless him and grant him peace, said, “Every Muslim must give charity.” They asked, “And if he does not have anything?” He said, “Then he should work with his hands, help himself and give charity.” They said, “And if he cannot or does not work?” He said, “Then he should assist the needy oppressed person who needs aid.”

(Al-Bukhari, and Muslim).

Ibn Khaldun¹¹ said in *Al-Muqaddima* regarding the importance of cooperation: “Human congregation or cooperation is necessary, and wisemen express this with their saying: mankind is civil by nature, i.e., he needs to congregate. The clarification of this fact is that Allah,

¹¹ Ibn Khaldun, *Al-Muqaddima* (Beirut: Dar Al-Kutb Al-Ilmiyah, 2004): 324.

the Glorified, created mankind and assembled them upon a form that cannot truly live or remain without nourishment and He (Allah) guided him (man) to seek it (nourishment) by way of his natural inclinations and the abilities that He built within him to achieve that. Except that an individual's ability is deficient to attain all his nourishment, needs and it is not sufficient to sustain the materiality of his existence. Even if we only prescribed the least amount that is possible to prescribe, which is a day's basic sustenance of grain, for example, the benefit is not obtained except after a lot of milling, kneading, and cooking and each of these processes require assistance from certain tools, which are not complete without various methods of manufacturing by the blacksmith, carpenter, potter, etc. Even supposing that he eats it as a grain without any treatment, then it will require even more than this, such as cultivation, ploughing, and the process of removing of the grain from its husk. Each of these stages requires even more tools and manufacturing than the first (example). It is impossible for one person to meet all or some of this, so it is necessary to group the many abilities of the human race to obtain one's basic sustenance. So through cooperation needs are met by a much greater degree."

3. The Cooperative Model

A cooperative is an autonomous association of persons who voluntarily cooperate for their mutual, social, economic, and cultural benefit¹². Cooperatives have been around since the beginning of man's history, but was first recorded in Scotland in 1761 by the Fenwick Weavers' Society¹³. The society began with the goal of maintaining high standards of craftsmanship within the weaving community and to use their collective influence to set the prices of yarn and cloth. Gradually, the gambit of the society expanded: members of the society would contribute money to a central fund to lend back to the members for expensive items, and to make charitable

¹² "Cooperative Identity, Values and Principles," International Cooperative Alliance, 2013, www.ica.coop/.

¹³ "Fenwick Weavers' Society," Fenwick Weavers' Society, 2014, Retrieved 23/6/2015, thefenwickweavers.coop.

donations to poor people living in the village of Fenwick. The society also started to buy food items in bulk so that they could be sold to members at below market prices. By 1769, the society had opened a store in the village to provide these cheap staple foods to the whole community, with profits going back into their central fund. To further benefit the village community, the society began to buy books and eventually opened a library and then provided funding for the building of a new school in 1812¹⁴.

In 1844, what is often considered to be the first successful cooperative was formed by the Rochdale Society of Equitable Pioneers. This cooperative became the basis for modern cooperatives as their eight principles of cooperation are now regarded as the foundation for the cooperative movement¹⁵.

Cooperatives are founded on the noble values of self-help, self-responsibility, democracy, equality, equity and solidarity¹⁶. The cooperative model is based on a number of principles by which cooperatives put their values into practice. These principles are based on the “Rochdale Principles” which were adopted and adapted by the International Cooperative Agency. The principles are as:

1. Voluntary and open membership: cooperatives are voluntary organizations and are opened to all who share in the common fundamental objective of the existence of the cooperative, irrespective of gender, race, or religion.
2. Democratic member control: cooperatives are controlled by their members each having equal voting rights.
3. Member economic participation: members receive economic benefits in relation to the level of their participation in the cooperative.
4. Autonomy and independence: cooperatives are self-help organizations controlled by their members, thus they are autonomous and independent of any outside influence that could affect the democratic control of the members.

¹⁴ Ibid.

¹⁵ “The Story: The Pioneers” The Rochdale Society, 2015, Retrieved 24/6/2015, www.therochdalepioneers.co.uk.

¹⁶ “Cooperative Identity, Values and Principles,”

5. Education, training and information: cooperatives provide their members with education and training so that they can greater contribute to the benefit of the cooperative.
6. Cooperation among cooperatives: Cooperatives often cooperate with other cooperatives to extend their network and benefit from economies of scale.
7. Concern for community: for cooperatives, profit maximization is balanced against the interests of the community¹⁷.

4. The Case for the Cooperative Model in the Financial System

The cooperative movement has been around for over 200 years providing goods and services to communities that were being otherwise neglected by the modern mainstream economic entities. The rise of the classical economic thought and capitalistic hegemony has resulted in the important role and contribution that cooperatives play in society largely forgotten by many researchers and policy-maker¹⁸. Since the objectives of capitalism and self-attainment are better-achieved through the commercial banking model, the role of cooperatives is side-lined and in some countries, even discriminated.

There seems to be a renewed interest on the economic and financial roles of cooperatives, particularly in the aftermath of the global financial crisis 2007/2008 as it was seen that cooperative banks fared much better than their commercial bank counterparts¹⁹. This led the United Nations (UN) to name 2012 the “International Year of the Cooperative” and for the UN Secretary-General Ban Ki Moon to “call on Governments to encourage policies to support and strengthen cooperatives so they can contribute fully to inclusive and sustainable development” (United Nations, 2013)²⁰.

¹⁷ Ibid.

¹⁸ P. Kalmi, P, “The Disappearance of Cooperatives from Economics Textbooks,” *Cambridge Journal of Economics* (2007): 625-647

¹⁹ H. Groeneveld, *The Powerful Differentiators of Cooperative Banks* (Utrecht: Rabobank, 2011).

²⁰ <http://www.un.org/en/events/coopsyear/> retrieved 25th September 2015.

4.1 Performance of Cooperative Banks in Europe

Since the ultimate objective of cooperatives is not profit-maximizing, but rather to serve for members' common fundamental objective, theoretically, cooperative banks are expected to be less profitable and efficient compared to commercial banks. In reality, however, it is shown otherwise. Goodhart even believed that their presence within an economy would have a destabilizing effect for the banking institutions within the same market as they could be offering financial services at lower costs compared to the banks²¹.

A study performed by the Centre for European Policy Studies (CEPS) compared the profitability, efficiency, market power and earnings stability of cooperative banks with commercial banks across seven European countries. The study showed that in terms of profitability, commercial banks tended to be more profitable except in Germany where cooperative banks were more profitable than commercial banks. In terms of efficiency, there was no significant difference between cooperative and other banks. This dispels the claim that cooperative banks are less efficient than commercial banks. In terms of earnings stability, cooperative banks were found to be far more stable than commercial banks across all the countries in the study. The study also showed that the presence of cooperative banks had a positive effect on the growth of the GDP of the countries within the study. The positive contribution of the cooperative to the economy is attributed to the fact that cooperative banks usually finance a high proportion of SMEs which are considered as effective drivers for the growth of an economy²².

During the global financial crisis, cooperative banks were also affected, but fared much better than commercial banks. In fact, cooperative banks only contributed 8% of the total losses and write-downs of banks in Europe, while the mainstream conventional banking institutions contributed a significant portion to the total loss.

²¹ C. Goodhart, *Some New Directions for Financial Stability* (Basel: Bank for International Settlements, 2004).

²² R. Ayadi, D. T. Llewellyn, R. H. Schmidt, E. Arbak and W. P. D. Groen, *Investigating Diversity in the Banking Sector in Europe* (Brussels: Centre for European Policy Studies, 2010).

In particular, HSBC alone contributed 10% in total losses and write-downs²³.

A research conducted on Rabbobank, a cooperative bank in the Netherlands, showed that throughout the global financial crisis which started in 2007, cooperative banks across six European countries experienced a rise in their market share of deposits and loans. Another finding shows that the customer advocacy level for Rabbobank at the height of the crisis saw a sharp increase of about 10%, indicating that at a time when customer trust in banks was at an all-time low, people started to transfer their accounts to cooperative banks²⁴.

In summary, these studies have debunked the theory that cooperative banks cannot be profitable or efficient and showed that cooperative banks tend to be much more stable than commercial banks during economic downturns. It was also shown that cooperative banks play an important role in the growth of the economy.

The CEPS report (2010) concluded by saying that the diversification of the banking sector with commercial, cooperative, and savings banks helps strengthen an economy and that there should not be over reliance on any one type of bank, as these different types of banks offer different services, to different clientele, with different focuses, and they react differently to adverse situations²⁵.

4.2 Unique Features of Cooperative Banks

4.2.1 Member ownership

Cooperative banks are owned by their members, instead of shareholders. Member objectives differ from that of the average shareholder, and this difference is what makes the cooperative, in many ways, a unique organization.

Generally, shareholders seek returns on their investment, therefore management, as the agents of the shareholders, have a responsibility to maximize profits. Often, to align manager interests

²³ Groeneveld.

²⁴ Ibid.

²⁵ Ayadi et al.

with that of shareholders, managers are given certain incentives, such as company shares, or bonuses, etc. The result, shareholder-owned banks tend to make high risk decisions for short-term profits, and they have very little incentive to act ethically or be socially responsible.

Members, on the other hand, are the depositors of the bank, and therefore their objectives usually include avoidance of risk, good service, economic development and stability: the result, a socially driven bank that seeks to maximize member surplus by way of stable, low risk investments, whilst providing high quality service for their customers (European Association of Cooperative Banks (EACB), 2006)²⁶.

4.2.2 High Capitalization

Cooperative banks are not able to raise capital easily like commercial banks due to the fact that only members can buy shares and in limited amounts. This limitation has two main effects: the first is that it causes them to be very risk averse as losses cannot easily be recouped. The second is that cooperative banks seek to maintain large capital reserves, which provides them with a buffer during financial downturns, adding to the banks' stability.

The fact that cooperative banks cannot raise capital from external sources also means that they are not required to remunerate externally held equity. This means that cooperatives have a considerably lower cost of capital than commercial banks, potentially allowing them to offer better rates for their depositors and borrowers²⁷.

4.2.3 Cooperation between Cooperatives

The networks formed by some cooperative banks have made them into some of the largest banking groups in Europe. These large networks bring certain benefits such as greater control and supervision by the APEX or Network Central Institution over the

²⁶ <https://www.eba.europa.eu/documents/10180/105241/EACB-CP44.pdf>
retrieved 30th September 2015.

²⁷ Ibid.

management boards of the cooperative banks within the network. They also bring greater financial stability as weaker institutions are often encouraged to merge with stronger cooperatives²⁸.

Other advantages are that they provide smaller cooperative banks within the network with collective economies of scale that each would be too small to generate internally. The Network Central Institution sometimes also plays the role of a central bank, providing liquidity within the network²⁹.

These unique features and others provide cooperatives with a number of advantages not found with commercial banks. The ownership structure removes the conflict of interests found in commercial banks between the depositors and the management that answer to the shareholders. Shareholders demand high returns whilst depositors require low risk investment of their deposits³⁰.

The fact that cooperatives are member-focused and that they are able to lend at a lower cost than banks also allows them to provide services in rural/poor areas that banks tend to write off. Cooperatives are also able to, at the same time, have the community connection of a small bank whilst also benefitting from the large network of cooperative banks³¹.

In addition to this, because cooperative banks often seek to serve communities that are most needy of economic development and also the least served by commercial banks, government regulators often make large concessions in the regulatory framework for bank and non-bank financial service providers, making it much easier to set up and run a cooperative bank than it is for a commercial bank. This feature alone makes Islamic cooperatives extremely attractive, especially in jurisdictions that are not legally favourable for Islamic banking³².

²⁸ W. Fonteyne, *Cooperative Banks in Europe - Policy Issues* (Washington DC: International Monetary Fund (IMF), 2007).

²⁹ H. Hesse and M. Cihak, *Cooperative Banks and Financial Stability* (Washington DC: IMF, 2007).

³⁰ Ayadi et al.

³¹ Hesse and Cihak.

³² S. K. Singh, *Bank Regulation* (Delhi: Discovery Publishing House, 2009): 205.

4.3 Islamic Cooperatives: Case Studies

4.3.1 *Islamic /Ansar Cooperative Housing Corporation*

The Islamic Cooperative Housing Corporation Ltd (ICHC) was established in 1980 by the Chairman, Pervez Nasim in Toronto, Canada. At the time, it was the first Islamic financial institution in North America. The ICHC was an initiative to provide interest-free home ownership and investments to the growing Muslim population in Canada.

The ICHC started with just 17 members and only CA\$17,000 in capital. As of August 2012, the cooperative had expanded to over 4,200 members and their combined issued capital had reached over CA\$5.5 million. In 1982, the cooperative had only managed to purchase two homes, but within 30 years that figure has grown to 537 units. This amazing growth has been achieved by only using member funds, involving no outside investments³³.

The cooperative employs the principle of *musharakah* or partnership in extending the home financing to the customer, with partnership between the customer and the ICHC or as Pervez Nasim prefers “a family” and the “community”. Customers join the ICHC by paying a membership fee of CA\$75, then they are required to purchase a minimum of 6 shares a year priced at CA\$100. Dividends are paid out to members annually from the profits made from rent received from the housing units owned by the ICHC. Dividends have averaged between 6-7% for the past 30 years³⁴.

For those members who have purchased enough shares, there is also the option to purchase a home from the ICHC using a modified version of the *musharakah* model known as *musharakah mutanaqisah* or diminishing partnership. The member must have accrued in shares the equivalent of 20% of the first \$100,000 of the price of the house; plus 25% for the next \$100,000 and 30% for the next \$100,000. In other words to purchase a house worth \$300,000 through the ICHC, the member must own \$75,000 of coop shares. The ICHC will then purchase the house by paying the full amount

³³ “Interview with Nasim Pervez,” *Islamic Finance Review*, Vol. 2, Issue 3, August 2012.

³⁴ Ibid.

and the home owner will begin to pay monthly rent to the ICHC. This rent will be proportional to their ownership of the house based on the amount of shares they own. The member is free to increase his ownership as he pleases as long as he purchases the minimum of six shares annually. The legal ownership remains in the name of the coop until the member has purchased 100% of the ownership share. Once this occurs the member's shares are transferred to the ownership of the coop and the house is transferred over to the member. Any appreciation or depreciation of the house at the time of the transfer of ownership is shared between the member and ICHC³⁵.

In an email on October 5th 2013, Pervez Nasim stated that members on average managed to reach complete ownership between seven and a half and ten years, an amazing achievement in comparison to the conventional twenty to thirty year mortgages. Over the last 30 years, the ICHC has had only two members default on their payments, a fact that Mr. Pervez attributes to members being “driven by faith just as much as finances”.

As well as helping hundreds of members to become debt-free home owners, some members buy shares for their children to finance their university education or to buy a house when they want to get married and start a family³⁶.

The Ansar Cooperative model has attracted many admirers around the world such as the USA, England, Australia, New Zealand, Pakistan and even Saudi Arabia and a number of cooperatives have started up in the UK and US using the same model. Mr. Pervez exemplifying the cooperative spirit has travelled to many countries to present his cooperative's model and offers to help anyone seeking to set up an Islamic cooperative similar to Ansar³⁷.

4.3.2 Muslim Community Cooperative Australia

The Muslim Community Cooperative of Australia (MCCA) was formed in 1989 in Melbourne, Australia. The cooperative came to fruition at the hands of a number of Muslim students and professionals living in Melbourne in the late 1980s. They wanted to

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid.

create an institution that would provide Muslims with permissible methods of financing and investing. Their idea was to set up a cooperative that could be a precursor to an Islamic bank as per certain regulatory and funding restrictions, the idea of an Islamic bank was impossible at that time³⁸.

The MCCA began with ten members and a total capital of AU\$22,300. Uptake from the local Muslim community was at first slow, but once the cooperative began to show its viability and sustainability, interest began to grow. By 1997, the MCCA had grown to such an extent that the MCCA management decided to expand into another city, Sydney. The membership had grown from just 10 to almost 2000 in less than ten years³⁹.

As a cooperative, the MCCA were greatly restricted in the services that they could offer their members. They could only take long-term investment deposits and provide limited financing. In 1999, the cooperative secured a license to become a credit union and in 2000 the MCCA became the MCCU, the Muslim Community Credit Union⁴⁰. As a credit union, it could now offer a much wider range of services akin to a conventional retail bank, such as call deposits, debit cards, ATM facilities, and point of sale services. Some of the services offered by MCCU currently include:

- a. Home financing: MCCU, like *Ansar*, also use the diminishing partnership method for home financing.
- b. *Murabahah* scheme: The MCCU employs the *murabahah* method of purchasing an item and selling it to the customer at a profit for financing members to purchase big-ticket items, such as vehicles and housing appliances.
- c. *Mudharabah* scheme: MCCU uses the *mudharabah* (limited partnership) or *musharakah* (partnership) methods for providing business financing. This involves the MCCU becoming an investing partner in a business enterprise with the

³⁸ A. Saeed, *Muslim Communities in Australia*, ed S. Akbarzadeh (Sydney University of New South Wales Press, 1981): 188-205

³⁹ *Ibid.*

⁴⁰ A. Halabi and A. Mirza, "Islamic Banking in Australia: Challenges and Opportunities," *Journal of Muslim Minority Affairs* Vol. 23, No. 2 (2003): 347-359.

- business manager (MCCU member) and sharing profits earned.
- d. Qard Hasan scheme: The cooperative also earmark a certain amount of funds for interest free loans for the “economic advancement” of members and non-members of the community in need.
 - e. Zakat collections: The MCCU oversees the collection of Zakat from the members’ investments in the cooperative fund. This is performed annually by MCCU and the collected funds are distributed to deserving causes⁴¹.

The main challenge faced by the MCCU is meeting the demand for finance, as the provision of finance, whether it is for housing or for a commercial enterprise, is limited to member contributions⁴². There are no outside sources of financing or leveraging methods used by the MCCU, and therefore the utilisation of funds must be in line with the central fund owned by the members. Likewise, the cooperative must be highly risk adverse as they cannot quickly or easily raise financing to cover losses in the case of bad investments or catastrophe. The cooperative must also hold large amounts of capital in cash as a buffer against losses⁴³. Despite these challenges, the MCCU has managed to grow steadily since its inception providing the Australian-Muslims with an evergrowing list of Shari’ah-compliant financial services for the last 26 years.

4.3.3 Akhuwat Cooperative Micro-financing

Akhuwat was established in Pakistan in 2001 by a group of friends that were upset by the high rates of interest that were charged by microfinance programs designed for poverty alleviation. The idea of an interest free microfinance program was proposed and 10,000 rupees donated for the first interest free loan.

The first loan was given to a widow who utilized the loan and returned it in full within six months. The success of the first loan encouraged others to make donations and *akhuwat* went from

⁴¹ Ibid.

⁴² Saeed.

⁴³ Halabi and Mirza.

strength to strength. By 2003, donations had reached 1.5 million rupees and the first office was opened in Lahore⁴⁴.

The *akhuwat* model operates on four core principles:

1. To provide the poor with interest free loans (*qard al-hasan*) so that they may acquire a self-sustaining livelihood. Charging interest on loans not only goes against the tenets of Islam, but charging exorbitant amounts of interest on the poor undermines the goals of poverty alleviation and maintains the concentration of wealth in the hands of the wealthy few.
2. The use of local religious places such as the mosque as a centre for loan distribution and to encourage community participation. Mosques have historically been the centre for social and economic development. This not only reduces operational costs, but also increases transparency, accountability, and awareness.
3. The *akhuwat* model is based on a spirit of volunteerism. It emphasizes the duty of those who have resources to help those who do not, by contributing one's knowledge, skills, time, or energy. *Akhuwat* strives to mobilise all members of the society to play their part in poverty alleviation.
4. *Akhuwat* encourages those borrowers who successfully utilize their loans and have attained economic stability to donate to *akhuwat* program to help others who are now in the same situation that they once were. These donations are not compulsory and do not affect a borrower's credit profile⁴⁵.

The loan process begins with the application from the borrower. The unit manager then considers whether the applicant needs financial assistance, has reliable social capital, is not involved in any illegal business and that they possess some entrepreneurial skills. The applicant submits a business plan which is evaluated for its viability to produce income beyond the household expenses so that the loan could be repaid easily. The applicant's family is also interviewed to ensure they know about the loan and support the

⁴⁴ "History," Akhuwat, 2013, <http://www.akhuwat.org.pk/History.asp>

⁴⁵ "Microfinance with a Difference," Akhuwat, 2013, Retrieved 28/6/2015, <http://www.akhuwat.org.pk/Microfinancewithadifference.asp>.

business idea. If accepted the application is forwarded to the branch manager to be appraised by a committee.

Each borrower has to provide two guarantors that will vouch for the borrower's credentials and will be responsible for monitoring the borrower to ensure timely repayment.

After the loan has been released the unit manager makes regular visits to the borrower's residence and workplace. Loan repayment is made monthly and if the borrower is late then the unit manager visits him to remind him, and if he still does not make the repayment then the guarantors are contacted to make the payment in his stead⁴⁶.

The *akhuwat* model has shown amazing growth in the twelve years that it has been operating. It has disbursed over 5 billion rupees with a loan recovery rate of 99.84%; it has benefitted over 355,000 families and it now has 175 offices in 116 cities and towns⁴⁷.

5. Conclusion

The objective of this paper was not necessarily to promote the virtues of one banking model over another, but rather to highlight the importance of adding diversity to the Islamic banking industry, dominated by commercial banks. Islamic commercial banks no doubt play an important economic role, but the cooperative model has been neglected greatly by researchers and Islamic bankers to the detriment of society.

Islamic commercial banks have yet to fulfil the role foreseen by Islamic economists when they envisioned the first Islamic banks. A possible major reason for this failure is due to the shareholders' ownership of these banks. Commercial banks, Islamic or otherwise, are single-bottom line organizations; in other words, their first and foremost objective is to maximize profits. Due to the commercial objective, the social and economic objectives of Islam are restricted to the ability to maximize those profits. Who wins out, the Islamic values or shareholder value? This is an issue that requires greater

⁴⁶ "Lending Methodology," Akhuwat, 2013, Retrieved 28/6/2015, http://www.akhuwat.org.pk/progress_report.asp.

⁴⁷ "Progress Report," Akhuwat, 2013, Retrieved 28/6/2015, http://www.akhuwat.org.pk/progress_report.asp.

consideration by academics. There are currently no studies on the types of ownership on Islamic banks and their effect.

The triumphs of the Islamic banking industry are not to be belittled. They have done much to make banking services available to Muslims that would have otherwise avoided them. However, the reality is that the vast majority of Islamic commercial banks are not aimed at the poor. They are for middle class Muslims that want to finance the purchase of a new car or house. In fact Islamic banks tend to be more expensive than their conventional counterparts.

Cooperative banks on the other hand are dual-bottom line organizations, meaning they have no problem in making profits whilst also focusing on the needs of their members. They are by their very nature socially orientated as they are owned and run by the communities in which they operate. They focus on local economy investment, SME financing, and financial inclusion of the poor that would otherwise be neglected. The cooperative model seems perfectly suited to carry out the objectives of Islamic economics to address the needs of Muslims societies that are mostly neglected by Islamic commercial banks.

The case studies mentioned are examples of how different cooperative organizations operating in completely different environments, with different objectives can achieve great social and economic benefits for their members, whilst remaining fully *Shari'ah* compliant. This is a testament to the flexibility of this model and the level of compatibility of the cooperative and Islamic values.