

Financing for Agro Projects in Islamic Banks

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Abstract. Islamic financing in agriculture is aimed to prevent any involvement of *haram* elements in agriculture-based projects. It is also important for entrepreneurs to use banking and financing instruments which is *Shariah*-compliant. This paper aims to propose financing mechanisms for Muslim entrepreneurs in funding their agro projects through *Shariah*-compliant instruments in Islamic banks, based on *Fiqh Muamalat* contracts. The methodology of this paper is through qualitative research based on document-analysis on previous articles and literatures on several types of *Fiqh Muamalat* contracts. The general finding of this paper shows that there is a need to have *Shariah*-compliant financing for agro projects in Islamic banks, derived from *Fiqh Muamalat* contracts.

Keywords: Agro projects, Islamic agriculture, agriculture financing, Islamic banks

1. Introduction

In order to begin a large project, businessmen and entrepreneurs require large sum of funds (as capital) to finance their projects. This is where the term “finance” and “financing” are useful. The definition of the word “finance” is “the science that describes the management, creation and study of money, banking, credit, investments, assets and liabilities” [1], while “financing” is defined as “the act of providing funds for business activities, making purchases or investing” [2]. Since money is the main object frequently used by business people in managing their business projects, local banking institutions always been involved to support and provide funds for entrepreneurs, including Muslim agro entrepreneurs in financing their agro projects.

Muslims are encouraged to involve in entrepreneurial business, since it was a part of *Sunnah* practiced by the beloved Last Prophet Muhammad (*SAW*), and even there was several *dalils* mentioned in the Holy Quran and Hadith which mentions about business and its benefits. Allah also mentioned that humans were *khalifahs* of the Earth, which means that humans not only should become his own leader but also should administer the natural resources gifted by Allah, which is coincidental with recommendations to Muslims involving in agro-business.

Financing had several benefits to agro projects. The main objective of using financing facilities available in local banks is to provide working capital to begin new agro projects and also to expand it further with the funds [3]. Financing in agriculture had played a great role in bringing out the flow rate of the economic activity in view of producing agro-based goods and services, by the means of local resources [4].

Nowadays, local banking and financial institutions in Malaysia offer Islamic banking and finance products and services, after the National Shariah Advisory Council advises Bank Negara Malaysia to include *Shariah*-compliant instruments. This is because Islamic banking and finance, due to its moral and ethical Islamic practices, was highly trusted and accepted by the people including non-Muslim, and the benefits gained could be shared by both institutions and people. Therefore, businessmen and entrepreneurs are

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recommended to use these products and services to support their projects and ensure the outcome is truly *halal* (permissible).

2. Literature Review

Allah wanted humans to work on land, including agriculture and food production, which are promised to be the most *halal* income for mankind. The teachings and guidance mentioned in the *al-Quran* and *as-Sunnah* was perfectly written to aid humans with rules of resources and product allocation. Allah mentioned that the natural resources is always infinite, not as claimed by Western markets or scholars, unless humans departed from the teachings and guidance which had been foretold by Islam. Unfortunately, Muslim nowadays being too dependent to products and services offered by other countries, especially Western countries, and even being governed by their rules and regulations. It is urged that Muslim should prevail and secure their food to secure our country. Muslim should also cooperate together to develop their own agriculture and food resources so they could become competitive as other developed countries [5].

Financing for agriculture sector under Islamic banking system (Islamic banks which reinforces Islamic Banking Act 1983 and Islamic Banking Scheme) had increased from 31.5 billion in 2007 to 41.3 billion in 2010 [6]. This increase is a good indication that between 2007 until 2010, the roles of Islamic banking and financing institutions in supporting the government in agriculture sector development and Islamic funding for agro entrepreneurs are appreciated and needed truly, and sometime in the future, more Islamic financing institutions are able to provide more Islamic financing.

Lack of financing is one of the main reasons why agriculture industry cannot be developed further in Malaysia. Furthermore, both Islamic and conventional banking system are not intensively provide funding to agriculture or due to several factors, including risk of agriculture, incompatible sources of financing, lack of banking experts and people marginalize the agriculture sector [7]. Until now, Agro Bank is the only bank able to provide funding and financing facilities to Agro entrepreneurs intensively, although some of the products offered are not Shariah-compliant yet [8].

In Malaysia, there are few Islamic banks or Islamic windows of conventional banks do offer Islamic financing facilities for agro entrepreneurs in agriculture. Known banks to offer such facilities include Agro Bank (previously known as Bank Pertanian Malaysia Berhad), Bank Kerjasama Rakyat Berhad Malaysia Berhad (commonly known as Bank Rakyat) and Maybank Islamic Berhad. Nevertheless, due to importance of agriculture to our country, there are banks (including mentioned previously) that provide financial helps to agro entrepreneurs [9].

In some research on the Holy *al-Quran*, Allah had mentioned 83 verses related to concepts of agriculture. Some good examples had been stated in Surah *al-An'am* (verse 141) and Surah *an-Nahl* (verse 11). These verses mention about the variety of plants and its products which gifted by Allah for human needs and as one of the proofs of Allah the Most Wise. The *al-Qur'an* itself mentioned about agriculture, horticulture, botany, and geology the most. There are three main concepts of agriculture in Islam; 1) Islam encourages the people to involve in agriculture since it is the easiest way to gain good rewards (*thawab*) while earning beneficial and *halal* income, 2) Islam encourages marketing agro-products, but prohibits any form of frauds or monopoly, and 3) Islam, however, discourages any agricultural activities with doubtful and invalid purposes according to Islam, such as planting grapes to produce beer, although the grapes itself is *halal* [10].

In second quarter of the year 2008, there are about 1.48 billion people who are employed in Malaysian agriculture sector, which proves that the agriculture sector the most important sector for Malaysian economy development [11]. Meanwhile, among the members of Pertubuhan Peladang (Farmers Association) in Malaysia, there are about 700,000 people who are known to have direct involvement in agriculture. These people were mostly Muslim, and they are in need of further *riba*-free, Islamic funds, which are why it is urgent for Islamic financial institutions to provide Islamic finance to these farmers and agro entrepreneurs [12].

However, there are some authors had different view of agricultural financing. To begin a farming business at Bauchi, Nigeria, a large sum of funds are required to be made as a capital for the project. This would be a problem to farmers who could not prepare such huge capital requirement from their own savings,

unless using financial assistance from banks to accelerate the desired technology change [13]. Meanwhile, in Finland, a research was made on factors of financial risk on Finnish farms. Structural changes, higher debts and increasing energy costs cause higher financial risks, unless the farm size increase, the risks would be lower. This would mean that poor farmers with small farms would face higher financial risks compared to those who had larger farms [14].

Agriculture is a very risky economic activity. There are some elements in agriculture that is not controllable which causes unexpected economic returns to farm households. Farmers of developing countries had limited access to several local risk management instruments and financing facilities by local banks, forcing them to use inefficient traditional methods [15]. Local small farmers who lived in rural or remote areas lack access to reliable and affordable agricultural financing due to low education levels, subsistence farming dominance and inability to access the financing instruments factors [16]. Agriculture sector in Africa failed miserably with the poor farmers unable to improve their lifestyle through the sector, but the factors of the failure are caused by collapsed agricultural development banks, corruption, inadequate infrastructure, and poor soils and seeds for farming [17].

There are higher risks in agricultural investments due to various factors, although it is rare because the risks involve weather and natural disaster effects toward agro productions. Recent and advanced farming technology was able to minimize the effects. Although there are few banks offered Islamic financing facility, but due to importance of agriculture towards Malaysian economy, these banks are willing to provide financial support towards agro entrepreneurs, which is good opportunity to expand the agro business [18]. This statement was also supported in an article which examines the concept of agribusiness in Islam and financing facilities for agriculture by Islamic banks [19].

Another study also had been done to examine the concept of agriculture and agribusiness from the spirit of *al-Qur'an* and *al-Sunnah*. In this paper, *al-Qur'an* and *al-Sunnah* had given a clear message to the Muslim community that embarking in this sector is very important. Also, Islam has elaborated aspects of agriculture and land revival comprehensively since the beginning of Islam [20].

In the case of local Islamic banking institutions such as Agro Bank, Bank Kerjasama Rakyat Malaysia Berhad and Maybank Islamic Berhad, these banks used *Bay' Bithaman Ajil* and *Bay' al-Innah* contract when dealing with Islamic financing for agriculture. However, the contracts mentioned are not suitable for agribusiness according to *Shariah* view. This is because in *Fiqh Muamalat*, there are other more suitable contracts which could use for dealing for agri-business transactions such as *al-Muqasat*, *al-Muzara'ah* and *Bay' Salam*. At the same time, the application of *Bay' Bithaman Ajil* as selectable contracts used in current Islamic banks are argued and disagreed by several Muslim scholars, since they said that it is a back-door method against *riba* (interest) transactions. Before owning a property, a seller must fulfill some requirements in *Fiqh Muamalat* before the asset would later to be resold to other buyers [21].

In a study to analyze *al-Muzara'ah* contract and its possible application in Islamic banks, it is mentioned that there is an equal opportunity and possibility for Islamic banks in Malaysia to initiate the contract for helping agro entrepreneurs [22]. In 2011, another study had been conducted to analyze various contracts of cultivation from the perspective of Islamic Commercial Law. There are plenty of opportunities available for Muslim in Malaysia in order to embark in agro projects based on *Shariah* compliant Islamic financing [23].

3. Research Method

The paper adopts qualitative research based on several literature works on Islamic finance and agriculture. The literature works and articles will be analyzed to extract information regarding to financing methods and Islamic contracts which can be used by Muslim entrepreneurs in funding their agro projects through *Shariah*-compliant products and services offered by Islamic banking institutions. The document analysis will also be made to gain information on what types of *Fiqh Muamalat* contracts which is suitable for financing and funding agriculture-based projects.

4. Conclusion

There are several forms of financing facilities with *Fiqh Muamalat* contracts which are suitable to agro-entrepreneurs to finance agro-projects, which may benefit them as well. These Shariah-compliant instruments will also ensure that the outcome of the projects were truly *halal* (permissible) without any involvement of *haram* (non-permissible) elements, such as usury and interest. It is very important to Muslim agro-entrepreneurs to realize the benefits of financing their projects using Shariah-compliant financing and banking products and services not only because to guarantee the *halal* outcome, but also to ensure the entrepreneurs' work and effort will be an acceptable *ibadah* in their life.

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