

# [Micro credit through ‘bai-muajjal’ mode of islamic banking financing system essay...](https://assignbuster.com/micro-credit-through-bai-muajjal-mode-of-islamic-banking-financing-system-essay/)

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ABSTRACTThe rural-based industrial sector in developing nations contributes greatly towardseconomic development by generating employment opportunities and mobilizing ruralsavings towards productive sectors. Micro-credit given by Islamic banks through the Bai-Muajjal mode of financing is a unique means of developing saving habits among ruralentrepreneurs. The article includes the outcome of the author’s research processdeveloped to discover how the Bai-Muajjal mode of Islamic banking finance serves toinstitutionalize the saving habits of rural-based small industry owners and to what extentthis lending technique successfully mobilize rural savings towards productive and profitableprojects. The article consists of three different sections. Firstly, it highlights the methodological andtheoretical aspects used for the research.

The second section includes a brief descriptionof different financing modes of Islamic banks and an empirical, study-based discussion asto how different Islamic banks lend funds to the rural-based small industry owners inBangladesh. The final section of the article represents an analysis of the research resultshowing to what extent the Bai-muajjal mode of Islamic banking finance contributes todeveloping savings habits among rural entrepreneurs and mobilizing the savings towardsproductive projects. NTRODUCTIONThe rural-based small and cottage industry (SCI) sector in developing nations contributes greatlytowards economic development by generating employment opportunities and mobilizing ruralsavings towards productive sectors. It is revealed from many researches that this SCI sector is oneof the most neglected sectors of economy in almost all least developed and developing nations ofthe world.

Among others rural-based small entrepreneurs suffers from lack in working capital, institutional credit facilities and poor management. Due to the shortage of capital they arecompelled to borrow funds from local moneylenders at a high rate of interest. This practice bringsendless miseries to the rural-based small industry owners. With regards to the burden of debts ofthe rural poor there is a proverb in developing nations, which says, ‘ The rural poor are born in debt, lives on debts and die in debts’. It is observed from the study that most of the rural people are savings minded and they try to savefrom whatever little earnings they have. Unfortunately, the efforts of these people remainunattended. Formal as well as informal lending organizations seldom consider the issue of ruralsavings as an important factor for generating working capital for rural SCI owners.

Institutionalization of saving habits through lending procedures might contribute to a greater extentin developing saving mentality among rural-based SCI owners and also to mobilize these savingstowards productive sectors. In recent years different Islamic banks in Bangladesh started giving micro-credit towards grass-rootlevel SCI projects in rural areas1. Some of the lending procedures of this financing system aredesigned in such a way that in order to obtain a micro-credit, a client must show minimum personalsavings in order to be qualified for a loan. Islamic banks normally use the Bai-Muajjal mode offinancing while lends funds to the grass-root level small and cottage industries in rural areas of thecountry. In this article, I tried to highlight on how Islamic banks micro-credit policy through the Bai-Muajjal mode of financing contributes towards developing and institutionalizing saving habits oftheir clients. The study was carried out in Bangladesh and used a theoretical model; ‘ Institutional-NetworkApproach’ (Alam 2003). The theoretical frame of references was developed during the tenure ofmy research on the subject, ‘ Islamic Banking Finance to Small and Cottage Industries’ at the LundUniversity, Lund, Sweden.

While conducting the empirical study, I interviewed 125 rural-basedsmall industry owners who were clients to different Islamic banks in the country. These clienteles ofIslamic banks were running grass-root type (poultry/dairy firms and handloom industries) of smalland cottage industries. Among others, the Social Investment Bank Limited (SIBL) is one of theIslamic banks that give micro-credit to grass-root level SCI owners under Bai-Muajjal mode offinancing.

Based on the said theoretical perspective, empirical data are analyzed, in order to seeas to what extent the Bai-Muajjal mode of financing of Islamic bank contributes towards developingsaving habits and the way the bank institutionalized this habit of the rural SCI owner. The articlealso highlights on the extent to which this particular lending procedure of the bank assists clients inmaking proper utilization of their borrowed funds and also in developing lender-borrower network1 The Social Investment Bank Limited (SIBL) is one of the few Islamic banks that render financial servicesin the money market of Bangladesh. Besides other sectors of economy the bank gives micro-credit to the grass-root level small and cottage industry owners under its Bai-Muajjal financing mode. The loans are given in kind and ranges from minimum US $ 100 and maximum US $ 500. relationships. In order to understand the lender-borrower relationships in depth, a qualitative nature of research methodology was used in the study. Since, case studies reveal various facts about aparticular phenomenon and allow a researcher to get very close to his or her informants, I used acase study method while collecting data from the field.

The article is designed in a few major sections. Firstly, it includes a brief description of the theoretical and methodological approaches that was used in the study. The discussion in the second section highlights on Islamic banks and its different investment techniques.

The third section includes a detailed description of the Bai-Muajjal lending procedures that the Social Investment Bank Limited uses, while lending micro-credit to the grass-root level SCI owners. The final section of the article represents an analysis of the results obtained from the study. THEORETICAL AND METHODOLOGICAL APPROACHESBased on Whitley’s (1992a) ‘ Business System’ institutional approach, an analytical frame of references is developed to study the lender-borrower relationships between different financing organizations and rural-based small and cottage industries. The theoretical model is designed in such a way that different small and cottage industries as well as financing organizations of similar nature are grouped and institutionalized into different ‘ SCI systems’ and ‘ Financing Systems’. The theoretical model is also used to carry out a comparative study as to how financing organizations under different financing systems differ from each other, while lending micro-credit to small and cottage industry owners under different SCI systems. In order to achieve the said objectives, I developed the concept of four components of different SCI systems and financing systems.

These components for example, are nature of organization, market organization, employment systems and authority and control systems. Accordingly to Whitley (1992b) a comparative analysis of the ‘ business system’ is the systematic study of these configurations and as to how they become established in markets. Like Whitley’s (1992b) ‘ Business Systems’, the Islamic Financing System is seen as a, ‘ financing business system of its own, with a foundation based on religion, having its own rules governed by the Islamic laws’. These rules differ from those of other financial systems. Like Whitley’s (1992a, 1992b) Business System, financing organizations of similar nature are grouped into different financing systems.

Thus, the concept of different financing systems for example; the Market-Based Financing System (MBFS), the Islamic Financing System (IFS), the Cooperative Financing System (CFS), and the Traditional Money Lending System (TMLS), is developed in the theoretical framework and these are viewed as particular arrangements of hierarchy-market relations that become institutionalized and relatively successful in a particular context. A similar arrangement is also done to institutionalize different rural-based small and cottage industries. The rural-based small and cottage industries of similar nature are thus, grouped into three different SCI Systems, such as the Grass-root level (GL), the Season-based (SB) and the Semi-mechanized (SM) SCI Systems.

Similar nature of financing organizations under different Financing Systems and small and cottage industries under different SCI Systems are regarded as economic actors acting within these organizational fields. Since, the concept of network as part of the hierarchy-market relationships is poorly developed in Whitley’s (1992b) ‘ Business Systems’ approach, Jansson’s (2002) network institutional model was also taken into consideration for developing the network aspects in the theoretical frame of references. In his network institutional model, Jansson (2002) highlights network relationships between the multinational corporations (MNC) in India and major external parties in the product/services market like customers, intermediaries, competitors and suppliers. It also gives some examples of external institutional factors that affect the networks.

Like the network relations between the MNC and major external parties’ financial organizations in the present study influence and are influenced by various commercial actors in the financial market and other markets in Bangladesh. Since one of the main objects of the research was to study the network relations between financial organizations and other major external parties in the financial market, especially the small and cottage industries, regarding the use of the network approach among many others (for example, Rasmussen, 1988; Kuklinski ; Knoke, 1988; Anderson and Carlos, 1976; Easton ; Araujo, 1991; Elg ; Johansson, 1992; Easton, 1992; Håkansson, 1993; Aldrich ; Whetten, 1981; Emerson ; Cook, 1984, Jansson, Saqib ; Sharma, 1995.), I found the concept of Janssons’s (2002) model appropriate for the present study. Thus, based on the existing theoretical models as mentioned above, the ‘ Institutional-Network’ theoretical frame of references (Alam, 2003) was developed for studying the lender-borrower relationships between economic actors in different Financing Systems and SCI Systems, especially with regards to financing towards small and cottage Industry (SCI) sector. The theoretical model also includes various background societal institutions like country culture, legal systems, religion, family/clan, government etc., that have direct as well as indirect influences on the lending and borrowing activities between different financing organizations and the rural-based SCI owners. The article is designed to highlight the empirical finding with regards to lender-borrower relationships between small and cottage industries under the grass-root level (GL) SCI system and Islamic banks under the Islamic Financing System (IFS).

The word ‘ Ijara’ indicates leasing. The leasing purchase is another technique followed by Islamicbanks in financing customers. This system is almost similar to the leasing activity provided intraditional banking. Leasing is a contract between the bank and the customer to use particularassets. In this case the bank is called lessor and the customer is called lessee who wants to usethe assets and pays rent. Zineldin (1990), in this regard argued that the leasing agreement isbased on profit sharing in which the bank buys the movable or immovable property and lease it toone of its client for an agreed sum by instalments and for a limited period of time into a savingaccount held with the same bank. These instalments are invested in Mudaraba investment(Venture) for the customer’s account.

The accumulated profit generated from the payments, andthe payments themselves are invested in the bank’s investment ventures over the time period oflease, contributing to eventual purchase of the leased assetsIjara-wa-iqtina (Leasing purchase)According to the Western leasing system the lessee pays specific rentals and a fixed rate ofinterest over a given period for the use of specific assets. But in the Islamic banking system ofleasing the risk related to leasing has to be shared between the bank and the lessee, in case ofany damage to the leased assets. The contract is called ‘ ijara-wa-iqtina’ i.

e. leasing purchase, when the ownership of the assets is transferred to the clients after the completion of the leasingcontract. Quard E HasanQuard E Hasan means an interest-free loan given by the Islamic bank to the needy people in asociety. The practice of dealing with this sort of investment differs from bank to bank. Quard EHasan is normally given to needy students, small producers, farmers, entrepreneurs andeconomically weaker sections of the society, who are not in a position to obtain loan or anyfinancial assistance from any other institutional sources. The main aim of this loan is to help needypeople in a society in order to, make them self-sufficient and to raise their income and standards ofliving. ISLAMIC BANKING FINANCE TOWARDS SCI SECTOROne of the major aims of Islamic banks under the Islamic Financing System is to render financialservices to the rural-based small and cottage industry sector.

In many ways, Islamic banks aresimilar to other privately- owned formal financial intermediaries. The main difference is that anIslamic bank neither accepts deposits nor invests funds to its customers on interest. Instead, thebank shares profit or loss. Nienhaus (1993) in this regards observes that the rural based small andcottage industry owners are not being benefited much either by the state-owned or the privatelyowned financial organizations. One might therefore find it interesting to observe how an Islamicbank acts as ‘ bank for rural SCI owners’; for example, how far an Islamic bank, with its motive ofinvesting funds on a ‘ profit and loss sharing’ basis, may contribute towards financing and promotingrural-based small industry sector. 10LENDING FUNDS THROUGH BAI-MUAJJAL MODE: AN EMPIRICAL REVIEWAs mentioned earlier, one of the Islamic banks called Social Investment Bank Limited (SIBL) givesloans to the small and cottage industry owners in rural Bangladesh. These clients of the bank areinvolved in poultry/diary firms, handloom industries etc.

These sorts of industries are grouped andinstitutionalized as the Grass-root level (GL) SCI System in the study. An in-depth interview wasconducted with 40 small and cottage industry owners belonging to the Grass-root level (GL) SCISystems. Among these respondents 20 are poultry firm owners and 20 handloom industry owners. The bank gives loans to clientele under the Bai-Muajjal mode of Islamic banking finance. Thelending procedures under this financing mode initiate in a different way than the normal loan givingprocess followed by other conventional banks.

A brief description of lending policy of the SocialInvestment Bank Limited towards the rural base grass-root level SCI owners is discussed in thefollowing section. The bank initiates groups and teams among customersThis bank gives interest-free loans to its customers on the condition that they first create a groupamongst themselves. Customers who intend to take loans are asked to form a group of fivemembers before the request for a loan may be assessed. Each group requires a volunteer groupleader to organize all aspects of the business and to assist the other group members in variousactivities. In such a group-wise loan, group members are jointly liable for the mistakes the othermembers might make. The bank then forms a team, which consists of five individual groups ofpoultry farmers. All the groups within a team are in turn also responsible for each other’s activitiesand they relate every instance back to their designated team leader.

The group leaders of fivedifferent groups work as members of a team-executive-committee and this committee selectsone president, one cashier, and one secretary. The bank’s staffs are responsible for training the group leaders. The training consists of informationsessions where everyone learns general ideas and techniques about their production activities. Forexample, in case of poultry firm, the team leaders of the poultry firms are taught how to care ofchickens at every phase of the chickens’ life; this includes how one ought to administer medicineand other nursing aids when the need arises. Structure of the group organizing by the bankUnder the supervision of the Social Investment Bank Limited staff, grass-root level SCI owners(respondents) organized the different groups comprised of five farmers in each group who wereinterested in borrowing funds from the bank. An officer is usually assigned by the bank to organizemeetings with each group on different days of the week. Thus, each group has the opportunity tocontact the bank directly, through the representative officer of the bank.

In case the clients feel theneed to discuss about any business or personal issue they may discuss the same with the officer. Opening of a savings account with the bankIn order to obtain a loan from the bank, every member in a group is required to open a savingsaccount with the bank and deposit an agreed-upon amount of money every week. The savingsaccumulate gradually and steadily using this method, for up to ten weeks.

The respondents openedsavings accounts with the bank under their own names. These types of accounts are called‘ Mudaraba Savings Accounts’ (Profit & Loss Savings Accounts). After the account had been11opened, each member of a group was expected to begin depositing both a minimum amount of TK. 25 and a maximum of TK. 502 every week. Collection procedure of the weekly depositsIt is the group leader’s duty to collect money during the week from the members of his or her groupand to record how much each person contributed in a ledger. At the end of every week, the leadersubmits the entire sum of cash, along with the record of names of the depositors, to the cashier ofthe team. The bank officer in charge of supervising the projects visits the project-site once in aweek and collects these deposits from the cashier of team.

The amount that is collected is thencredited to the respondents’ savings accounts. Requirement of minimum depositsThe staffs of the bank responsible for collecting information about customers determines whethervarious project proposals submitted by different customers intended to initiate using the bank’smoney were feasible. The bank handles the weekly sum of savings quite carefully because acustomer’s deposit figure must exceed 5% of the loan he/she applied for or he/she will not beentitled to receive any loans from the bank. For this reason, the bank officer regularly givesbusiness advice that will be necessary if his clients are to succeed. He encourages them to bepunctual with the deposits of their weekly savings so as to avoid hassles. Apart from this regularadvisement and encouragement, the bank officers in charge of the project also give therespondents training in their respective fields of expertise. Bank officers’ direct contactsDuring the ten-week saving period, it is also the duty of the bank officer-in-charge to inquire abouteach borrower’s working capability and the types of business they are interested in for the future. The bank officers meet every group at different times to educate them about the Islamic bankingsystems, and particularly about its techniques and its aims.

At the same time, he also gives theminformation about how their new banks have developed. After the saving period endsWhen the ten weeks of the term of the savings with the bank came to an end, the group leadersarranged a meeting with all the individual members of each group. In this general meeting, aresolution is drafted and passed regarding the amount of loan each member intended to borrowfrom the bank. A copy of this resolution was then prepared for the bank officer when he came tovisit the site. After considering this resolution, the visiting bank officer fixed a date with eachindividual member of the various groups and asked them to come to the bank with their groupleaders to sign the contract for the loans. Payment of loansWhen the above-mentioned processes ended the bank-sanctioned loans to the clients on a Bai-Muajjal (Credit plus profit) mode of financing.

As mentioned earlier, under this mode of financing, the bank does not issue the agreed-upon loan amount to the customer in cash, as is the custom ofmost conventional banks. When they signed their loan agreement with the bank, the respondentsunder review were asked by the bank to select a raw material supplier and to bring a pro-forma2 1, 00 USD is equal to 57. 4000 BDT, Live Rates as of 2001. 06. 24 (http://www. xe. net/ucc/convert. cgi)12invoice for the price of the raw materials that they required for their industry.

The respondentspromptly complied and immediately sought suppliers and collected invoices from them. Anotherbank officer was in charge of supervising this aspect of the project and giving any professionalassistance that was required of the clientele. Once the bank authorities were satisfied with theinvoice prices, the quantity of materials etc., made necessary arrangement to pay the moneydirectly to the suppliers. Soon after the payment was made to the suppliers of raw materials, thebank officer responsible follow up the matter in order to be sure that the customer received the rawmaterials. The bank then debits the same amount from each customer’s savings account, inaccordance to the amount each had stated was necessary for his/her specific needs. In this way, the bank ensures that the fund borrowed by small and cottage industry owners will be directedefficiently and that the customer will be successful in achieving his or her goal.

Direct supervision of borrowed fundsThe SIBL allows its customers free access to their entire borrowed fund, with an importantstipulation; before one is able to get unlimited access, one must prove to the bank that the amountbeing lent will only be spent to buy raw materials or other accessories for the development of thefarm. In order to do this; the customer must produce new invoices from the vendors of the rawmaterials each time he visits the bank. They may then utilize the whole amount all at once, orhowever else they may see fit. This is allowed to takes place only after the loan has beensanctioned and credited to the individual’s Profit and Loss Savings Account. Profits charged by the bankA further condition within the SIBL’s lending policies under Bai-Muajjal mode that deal with theclients in the Grass-root level SCI System is that the bank officials who deal with them calculate apercentage of profit on top of the invoice price after the customers present their invoices for thematerials they intend to buy. The principle of the Bai-Muajjal mode of financing is that the bank firstbuys goods for customers and then sells these goods back to them at a profit. The bank realizesthe principal amount of loans plus the profits from customers in separate, equal instalments.

In thisparticular case, the SIBL charged the small and cottage industry owners 14% of their net profitsmade on the goods bought by the bank for the customer. Soon after the purchase was made, therespondents became the owners of the goods and were responsible for its proper use. SecurityAs a security measure, the bank asks the respondents to produce their land property titledocuments as well as a letter of recommendation either from a person notarized by the bank orfrom an influential customer of the bank in the locality. Repayment of loansThe repayment of loans, including profits, was divided into a number of equal instalments.

TheSIBL fixed the instalment rate of repayment of the loan. This repayment time starts two weeks afterthe customer receives the loan or soon after the product is ready for sale in the market. BAI-MUAJJAL MODE OF FINANCING AND ITS EFFECTS ON SMALL AND COTTAGEINDUSTRY OWNERS: A CRITICAL ANALYSISThe study reveals that the mobilization of the rural savings is one of the prime aims of theorganizations in the IFS, where their lending techniques develop the saving mentalities among thecustomers, especially the rural-based SCI units. It is noted from the above discussions that the financing organizations within the Islamic Financing System while lending funds to firms in the Grass-root level SCI System demands deposits from their customers. The clients in this SCISystem accumulate these deposits through individual savings. Financing organizations in the IFSsupervise and monitor the customers’ savings activities through certain established rules. In thissection a detailed analysis is done to see how changed saving habits are regulated and savingsare mobilized towards productive projects by the financing organizations in the Islamic FinancingSystem through Bai-Muajjal lending mode of financing.

It is noted from the empirical record that the Social Investment Bank Limited through its Bai-Muajjallending technique develops new ways to save i. e. how saving is institutionalized to become new orbehavioural rule of these organizations. It is also found that the development of new saving habitsamong the SCI owners promotes network ties with different actors within and outside the SCI units. Since the Islamic Financing System introduced its special lending policy in the Grass-root level SCISystem, the saving of the SCI owners is governed by the new rules creating another saving habit. In order to borrow funds, the Grass-root level small and cottage industry owners are required toabide by these saving rules.

Thus, through the lending process new saving habits of the ruralpeople have been institutionalized. Habits viewed as an institutionHabits originate as serial repetition of behaviour within the complex interaction of human beings. Habits are either hereditary in nature or grows through imitation, but in both cases based onreplication of a precedent.

Every society considers social habit to be a significant factor indetermining social law and customs, and vice versa. According to Veblen (1919, p. 239), institutionsthemselves are comprised of ‘ settled habits of thought common to generality of men.’ Man issocialized by societal agents and forces, thus habits are an outcome of social behaviour, customs, traditions and law. Habits influence economic as well as non-economic activities of human beingsin their everyday life. Habit play out in human life in various ways.

Some habits are natural, essential for living such asphysical necessities of eating and sleeping, whilst other habits are acquired from the socialenvironment. Habit, as mentioned, is also established in human life through imitation of others. Regardless of the mode of entrenchment, habits have a great impact on the economic and socialactivities of a society. Good habits reduce the social burden and, arguably, vice versa. Hodgson(1988, p. 127), observes as “ We acquire habit in various ways. Sometime it is through the imitationof others. This does not always result from full conscious choice, as all animal species are bornwith some capacity to imitate.

The development of the intellectual and political skills of youngchildren is based largely on imitation, and we retain this faculty in later life, other without consciousthought about what we are doing”. While discussing on the subject rural savings and saving habit of Grass-root level small andcottage industry owners, I think it is needed to highlight on traditional saving habits that play animportant role in rural economy of Bangladesh. In order to have an overview on that the first part ofthe next section includes a brief discussion on the overall position of the traditional saving habitsand sources of rural savings. Then, it discusses the extent to which the organizations in the IslamicFinancing System contribute to mobilizing the rural savings towards the productive sectors. Traditional habits of savingsVeblen (1919) views habits as either hereditary in nature or that they grow through imitation.

Theauthor further argues that institutions themselves are comprised of settled habits of thoughtcommon to the general public. Saving habits influence economic as well as non-economic activitiesin almost all societies. Ashe and Cosslett (1989, p. 94) reports that the household savings in theinformal sector is an essential element in the growth of developing economies, partly because theinformal sector is larger than the formal enterprise or public sectors. It is observed from the study that the rural-based SCI owners are usually habituated to save funds. Saving tendencies are a hereditary part of these people’s nature. The majority of respondents inthe SCI units in rural areas informed that, although they used to save money on their own initiative, they could hardly use these funds in a profitable way. It was also known from the study that therural-based SCI owners are used to saving money for different purposes.

Some of these arediscussed below. Motives behind the traditional savingsSaving is found to be a very common habit among the majority of the rural-based small andcottage industry owners. But the motive behind creating saving differs from person to person andfrom family to family. While interviewing the Grass-root level small and cottage industry owners itwas found that almost all respondents were trying to save a little from what they had. But themotive behind the savings was different. 21 respondents among 40 SCI owners interviewedexpressed the motive of savings was to accumulate funds for the matrimonial ceremonies of theirchildren. Ten clients intended to use savings for buying gold or land. Three of them intended tospend for religious and cultural functions and seven invest in business.

These figures aredemonstrated in percentage by the following figure. Figure 2. Utilization of savings25%52%5%18%Gold or landMatrimonialceremoniesCultural andReligiousfunctionsInvest inbusiness(Source: Field study on SCI in Bangladesh 1997)The above figure shows that more than 50% respondent having children were worried for themarriage of their daughter and they start saving a little of what they have for their matrimonialceremonies. Only 18% showed their interest in utilizing their savings for the business or productivepurposes. They were afraid of using their savings funds for business purposes because of theirlack of entrepreneurial mentality, the risk involved, and the lack of experience in business.

Therefore, large amounts of rural savings are not being utilized in any productive activities, insteadbeing locked in unproductive sources. CHANGING SAVING HABITS: THE ROLE OF THE ISLAMIC FINANCING SYSTEM. The lending policy of the financing organizations in the IFS gives prime priority to the saving habitsof people. As one of their lending principles, owners of the grass-root level SCI owners arerequired to deposit a certain percentage of the borrowed funds with the bank. They are required tomake these deposits from their weekly savings.

The following section includes a discussion aboutvarious reasons as to why the Social Investment Bank Limited give preference to their clientsaccumulate weekly deposit, thereby creating new habits of saving for these organizations and inthat way institutionalizing new ways of saving. Developing a saving mentalityThe SCI owners in the grass-root level SCI system are poor rural people, who have very littleeducational qualifications and professional skills. They are therefore, unable to understand how tosave in a proper way for example using savings in productive ways. In order to develop the savingmentality among rural SCI owners the financing organizations within the Islamic Financing Systemarrange their lending activities in such a way that the borrowers initiate group savings before theyapply for loans. It takes a few weeks for the SCI owner in the grass-root level SCI system to obtaina loan.

During this period, the Islamic banks contact their customers from time to time, to discussvarious issues concerning their projects, and to monitor the progress of the group savings in orderto develop the proper savings mentality. Thus, the organizations within the Islamic FinancingSystem establish close contacts with the SCI owners in the grass-root level SCI system andencourage them to save and plan how and in which way to spend their savings. In developing thesaving mentality of the clientele the bank assists and encourages them to accumulate their idlefunds and to use the same for productive purposes. Educating about saving habitsAs noted above, although the SCI owners in the grass-root level SCI system are poor, many ofthem spend whatever they have saved in unproductive ways, for example, on dowries at marriageceremonies. Since the organizations within the Islamic Financing System do not start lendingbefore the groups savings are initiated, the lending rules themselves educate the clients about theadvantage of savings. Moreover, bank officials, through personal contact, discuss various issuesregarding the drawbacks of the old saving habits. Thus, it is concluded that the rural SCI ownersare educated about how to make proper utilization of their savings in productive ways.

New savinghabits are thereby being institutionalized. By giving them a proper understanding of the value oftheir savings, the lending organizations within the IFS encourage poor SCI units to start savingfrom the little they have in their hands. Uniting customers’ effortsThe bank also had the idea of developing the saving habits to establish unity among people fromdifferent walks of social life.

The lending activities initiated through the group savings establishedunity among rural people of different social categories, since it encourages different individual SCIowners to work together in harmony. Thus, new saving habits not only unite the rural SCI ownersbut also their skills and efforts. This ultimately results in the investment of funds towards productiveactivities. The rule to collect individual savings encourages customers to fulfill the group obligations. Thus, the savings of the individuals are mobilized from unproductive uses towardsproductive fields. INSTITUTIONALIZATION OF SAVING HABITSIn his discussion of social life and group behaviour, Hughes (1939) observed that anything sociallyestablished can be called an institution.

It is mentioned earlier sections that the rural people inBangladesh try to save from whatever income they have, but this habit is neither taken care of norguided by any lending organization. Human habits do not change without a change in catalyticcircumstances. For example, if one is inclined to believe that a change of habits or a developmentof a new habit in everyday life is like to be of benefit, materially or financially, one may not hesitateto transform habits as a conscious act of volition. Within the societal domain, however, it mayrequire an institutional process or policies adopted by either by the government or the individualinstitution. By way of example, let us refer to the case of saving habits among people in a society. Needless to remind, that every spending that is incurred by people may not be productive. This, nodoubt, happened due to certain behaviour or routine activity, which people are customized intoover the years. A proper motivation and guide for people to save money may end up with a goodresult if, in return, they are shown a profit oriented and productive project in which to invest theirsavings.

Bai-Muajjal mode of savings as observed in the earlier section, changes socially established savinghabits of rural-based SCI owners. The traditional habit is changed to a newly developed savinghabit. The entire lending procure of the Islamic bank is consists of certain rules, procedures whichin a way was used in organizing the behaviour of the bank’s clientele. Thus it may rightly be saidthat, through the Bai-Muajjal lending process saving habits of the rural SCI clientele are institutionalized. Regarding institution Jansson (2002) observed that, an institution usually means rules, procedures, and conventions typical for a more specific way of organizing human behavioura (legitimized) social grouping of some kind- for example family, clan organization, nation, market game or ceremony. Within these institutions are found rules and conventions typical of specific organization, which led to habitual and routinized behaviour or action. The critical analysis of the Bai-Muajjal mode of Islamic banking finance indicates that the entire process of savings and its uses contribute towards developing other new habits. For example, the people of the different SCI units start to think along the lines of productive activities.

The savings activities are organized and arranged in such a way that they develop lender-borrower relationships and establish close ties with co-workers within the locality. Furthermore, the newly developed, saving habits direct them to think in advance regarding a particular project in which they might invest their savings. The traditional, saving habits of SCI owners discontinue with the gradual development of new habits. This mobilization of the savings takes place through institutionalization of new saving habits. Institutionalization of saving habits is a process of changing spending behaviour of the rural poor and promoting a goal oriented saving habits among these people. The following figure demonstrates the processes by which the entire credit giving process of the Social Investment bank Limited regulate and institutionalized the saving habits of the rural-based grass-root level SCI owners. Figure 3: Process of developing saving habit by Bai-Muajjal financingInstitutionalization of saving habits through lending processIt is noted from the above figure that the entire lending procedures used by the Social InvestmentBank to give loans to the owners of the grass-root level SCI system contribute to the deinstitutionalizationof old saving habits and institutionalization of new saving habits. The savinghabits of the clients are established through certain rules.

The process used by the bank is aunique means of organizing human efforts and behaviour. It is thus concluded that an importantpart of the lending policy of this bank is aimed at institutionalizing saving habits of the rural-basedSCI owners and organizing savings towards productive activities. Characteristics of the institutionalized saving habitsCONTRIBUTE TOGROUP SAVNINGSAS ISLAMIC BANKADVICESTHE INDIVIDUAL SAVINGSALONG WITH BANKCREDITSUSED FOR PRODUCTIONSAVINGS OUT OFINDIVIDUAL EARNINGSOPEN INDIVIDUAL ACCOUNTAND DEPOSIT THE WEEKLYSAVINGS TO THE BANKISLAMICBANKADVICESTHE BANK GRANTS LOANSBASED ON THE INDIVIDUALSAVINGS18? The new institutionalized saving habits of the SCI owners in the grass-root level SCI systemare characterized by the following factors.? Savings are generated from self-earning? Savings are initiated and supervised by the financing organizations in the Islamic FinancingSystem? Savings are deposited with the financing organization? Customers knows about the purposes of their savings? Savings are returned back to customers as capital for production? Capital formation is done through depositing savings with the financing organizations? Savings are utilized in productive sectors? Savings are utilized in a proper way to create job facilities? Saving habits develop network relations within the co-workers and with financingorganizations. CONTRIBUTION OF INSTITUTIONALIZED SAVING HABITSThe following section includes a brief description regarding the contribution of the institutionalizedsaving habits. Generates working capitalIt was observed from the study that working capital is a major hindrance for rural-based small andcottage industry owners, lack of which often compels them to use their borrowed funds toovercome their capital shortage rather than investing it for production.

In this regard Ashe &Cosslett (1989), observes that the lack of working capital often leaves owner little resources otherthan to buy from certain suppliers on credit and at very high prices, thus exacerbating the commonproblem of chronic indebtedness. A lion’s share of working capital may be generated from the private savings of the rural people. Toa certain extent the inadequacy of working capital can be overcome by inculcating the habit ofsavings in the business nature of the small and cottage industry owners. Apart from that, the lackof entrustment among the rural based small industry owners is also another major hindrance thatmakes financial intermediaries fail to realize their expected benefit from their investment. It is foundfrom the study that major portion of working capital of the grass-root level SCI owners interviewedcomes from other sources than personal savings. Among 40 respondents, to raise funds forworking capital, 15 borrowed funds from friends, 20 from relatives and 5 used their family savings.

This figure is shown in percentage by the following figure. 19Figure 4. Sources of working capitalFriends38%Relatives49%Familysavings13%Source: Empirical studies on grass-root level SCI in Bangladesh (1997)It is noted from the above figure that only 13% of SCI owners raise their working capital frompersonal or family savings. This indicates that rural-based SCI owners use other sources thanpersonal savings.

In case they fail to raise funds from friends and relatives they are bound to useborrowed funds as working capital, which ultimately hampers production activities and results in thedeficiencies of cash flow. When the Islamic banks give loans to the grass-root level SCI units, they want to make sure thatthey have sufficient funds for their working capital. Since SCI units in many cases used their fundsfor other purposes than they were originally borrowed for, the savings give the financingorganizations an assurance that the borrowed funds would be used for the right purpose. Proves credit worthiness and adds securityThe study reveals that as a rule, in order to obtain a loan the SCI owners in the grass-root levelSCI system must deposit a certain amount of their savings with the bank. This stipulation not onlyensures saving but also allows Islamic banks to judge the credit worthiness of rural-based smalland cottage industry owners. Islamic banks, like other conventional banks, also take freeholdproperties as a security from customers.

In many cases there is no problem even for rural-basedSCI units to give such securities. Due to economic hardship, it is tough to give any cash amount assecurity. As part of their lending policies, financing organizations in the Islamic Financing Systemencourages borrowers to save. This ultimately makes financing organizations sure that borrowersare really worthy of giving credit to. A saving attitude also makes customers mentally strong andencourages them to work hard to prove their worthiness to the lending organizations.

Creates mutual obligations between the partiesThe lending of funds by Islamic financing organizations to grass-root level SCI units may be termedas ‘ giving and taking policy.’ By this term, I want to mean that the lending policy of the financingorganization in the IFS is arranged in such a way that, borrowers first of all must deposit in order tobe qualified for a loan. It creates a mutual obligation between the lenders and borrowers. The SCI20owners are bound to fulfill their obligation by depositing savings with the bank. Once customerscomply with this condition, as rule the bank gives loans to them. This system makes the SCIowners conscious of making proper use of their borrowed funds. It also develops initiative amongSCI owners to work hard and to be sincere in dealing with bank loans and encourages them tosave more as they need to repay the loans after a certain period of time. The amounts of loans areof course higher than the savings that SCI owners deposited with the bank.

The obligation of thebank is looked from the standpoint that they become more vigilant to observing that the loans arebeing properly utilized, failure of which might cause a great financial loss to them. Thus, it isconcluded that the Bai-Muajjal lending policy of the Islamic Financing System through developingsaving habits creates mutual obligations between the lenders and borrowers. CONCLUSIONIn conclusion it may be said that as seen above the spending habits of the people in ruralBangladesh are habits influenced by societal institutions (Alam 2000, 2002) such as family/clan, religion, country culture etc.

Since a major portion of rural savings is not used in productivepurposes, it brings economic misery in a society and contributes towards intense poverty amongrural people. A least developed country like Bangladesh is in need of an organization-based guideto safeguard the rural savings and to make use of these idle funds. Since many rural poor are notaware of the proper utilization of their savings, the institutionalization of saving habits through theBai-Muajjal mode of lending procedure, educate them to spend their savings towards productivevenues.

It is thus, apparent from the above discussions that the Bai-Muajjal mode of Islamicbanking finance is a unique means of institutionalizing and developing saving mentality among therural-based small and cottage industry owners and mobilizing their savings towards productivepurposes.