

Application of the Musharakah Mutanaqisah Principle in Community-Based Housing Financing: A Shariah-Compliant Approach to Affordable and Inclusive Housing

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Abstract: The issue of housing affordability remains a significant challenge for low- and middle-income communities, particularly within conventional mortgage systems that rely on interest-based financing. This research explores the application of the Musharakah Mutanaqisah (MMQ) principle as a Shariah-compliant alternative for community-based housing financing. The study aims to examine how MMQ can provide affordable, inclusive, and equitable housing solutions while promoting social justice and community empowerment. Employing a qualitative approach, the research draws on literature analysis, case study reviews, and comparative examination of existing models of Islamic housing finance. The findings indicate that MMQ offers substantial benefits by eliminating *riba* (interest), enhancing affordability, and fostering shared responsibility between financiers and community members. Moreover, the model encourages community participation and strengthens collective resilience in housing development. However, the research also identifies key challenges, including legal and operational complexities, risk-sharing concerns, regulatory barriers, and limited stakeholder awareness. This study contributes theoretically by expanding the discourse on Islamic finance and housing studies, situating MMQ not only as a financial innovation but also as a tool for sustainable community development. Practically, it offers valuable insights for policymakers, Islamic financial institutions, housing cooperatives, and community organizations in designing housing finance models that are both Shariah-compliant and socially inclusive. Ultimately, the application of MMQ demonstrates strong potential to bridge the gap between financial justice and social welfare, making it a promising mechanism for sustainable housing solutions.

Research Highlights:

- **Shariah-compliant alternative:** Introduces Musharakah Mutanaqisah (MMQ) as an ethical financing model that avoids *riba* (interest) while ensuring fairness in housing ownership.
- **Affordability and inclusivity:** Demonstrates how MMQ can reduce financial burdens on low- and middle-income households, making housing more accessible.
- **Community-based empowerment:** Highlights the potential of MMQ to strengthen community participation, cooperation, and shared responsibility in housing projects.
- **Social justice orientation:** Emphasizes MMQ's role in promoting equity, collective ownership, and resilience within community housing schemes.

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- Challenges identified: Reveals legal, operational, financial, and regulatory barriers, as well as stakeholder awareness gaps, that must be addressed for successful implementation.
- Theoretical contribution: Expands the discourse in Islamic finance and housing studies by contextualizing MMQ within community-based development.
- Practical contribution: Provides recommendations for policymakers, Islamic banks, housing cooperatives, and communities in designing sustainable, Shariah-compliant housing finance models.

INTRODUCTION

Housing is universally recognized as a basic human necessity, yet for many people, the dream of owning a home remains difficult to achieve. The issue of housing affordability has become a pressing concern across societies, particularly for low- and middle-income groups. Rising property prices, urbanization, and economic disparities have widened the gap between the need for adequate housing and the ability of individuals or families to secure it (King et al., 2017). This situation often results in overcrowding, informal settlements, or long-term dependence on rental housing, which in turn perpetuates cycles of poverty and inequality.

One of the key barriers to housing affordability is the financing system. In many countries, access to housing relies heavily on conventional mortgage schemes provided by banks or financial institutions (Chiquier & Lea, 2009). These schemes typically involve interest-based loans, long repayment periods, and strict eligibility requirements. While such systems enable many households to purchase homes, they can also create significant financial burdens. High interest rates and inflexible payment structures make it difficult for vulnerable groups to maintain long-term stability, especially in times of economic uncertainty. Consequently, housing finance in its conventional form often benefits the financially secure while excluding those most in need of affordable solutions.

The problem is further complicated by the limited availability of alternative financing models that are accessible, equitable, and sustainable. For communities that adhere to Islamic principles, conventional interest-based systems are not only financially challenging but also religiously problematic, as they contradict the prohibition of *riba* (usury) (Bayindir & Ustaoglu, 2018). This creates a demand for financing methods that are both affordable and aligned with ethical values. Moreover, the lack of inclusive financing options hinders broader social goals, such as reducing inequality, strengthening community resilience, and fostering long-term economic development.

In response to these challenges, Islamic finance offers an alternative framework based on principles of equity, risk-sharing, and justice. One of the notable contracts in Islamic financing is *Musharakah Mutanaqisah* (diminishing partnership) (Meera & Razak, 2005). This principle is built upon the concept of partnership between the financier and the customer in owning an asset, where the financier gradually transfers ownership to the customer through periodic payments until full ownership is achieved. Unlike conventional mortgages, *Musharakah Mutanaqisah* avoids *riba* (interest), aligns with Shariah compliance, and emphasizes fairness in risk and profit sharing.

The relevance of *Musharakah Mutanaqisah* becomes more significant when applied to community-based housing initiatives (Ahmad, 2011). Community-based housing seeks to provide affordable homes through collective participation, cooperation, and shared responsibility. Integrating *Musharakah Mutanaqisah* into such initiatives may create a financing model that not only meets housing needs but also promotes social justice, inclusivity, and community empowerment.

Research on *Musharakah Mutanaqisah* (MM) as an Islamic home financing model has grown significantly over the past two decades, with scholars examining both its theoretical foundations and its

practical application in different contexts. Smolo and Hassan (2011) were among the first to provide a comprehensive discussion of MM as a Shariah-compliant alternative to conventional mortgages. They highlighted the contract's reliance on principles of partnership, risk-sharing, and gradual transfer of ownership, emphasizing its potential to address ethical and financial concerns associated with interest-based lending. Their work established MM as a central model in the discourse on Islamic housing finance.

In the Malaysian context, where Islamic finance is more established, several studies have explored the opportunities and challenges of implementing MM in housing. Hanafi (2012) examined the structural and regulatory obstacles that limited the adoption of MM, including legal complexities in property registration and the banking sector's preference for other Islamic financing modes such as Murabahah. Similarly, Razak (2015) identified practical issues such as abandoned housing projects and inconsistencies in Shariah interpretation that constrained MM's widespread use. These studies suggest that while Malaysia has pioneered Islamic home financing, MM has not yet achieved the dominance initially expected due to institutional and regulatory barriers.

Other scholars have focused on the legal and operational dimensions of MM. Asadov and colleagues (2017–2022) analyzed issues related to property ownership registration, trustee arrangements, and accounting treatments. Their findings indicate that modifications made by banks to simplify operations often compromise the Shariah authenticity of MM contracts, causing them to resemble conventional mortgage structures. This concern has been echoed in works that question whether MM in practice truly fulfills its theoretical promise of fairness and equitable risk-sharing.

Recent research has also included systematic reviews that consolidate findings across multiple studies. A review conducted in 2023 summarized the recurring challenges associated with MM, such as regulatory misalignment, institutional reluctance, and operational costs. It further noted that several scholars have proposed integrating MM with other instruments, such as waqf or cooperative financing, to strengthen its viability in community-based housing schemes. Such integrative approaches are seen as particularly relevant for low- and middle-income households, who are often excluded from conventional financing structures.

In Indonesia, where Islamic finance is expanding rapidly, newer studies published between 2023 and 2024 emphasize the potential of MM in addressing housing affordability for communities. These works argue that MM could be more effective if adapted to cooperative or community-based models of housing development, supported by clear regulatory guidance and the involvement of Islamic microfinance institutions. By linking MM to community initiatives, researchers suggest that the model could better align with local socio-economic conditions while also reducing transaction costs and enhancing inclusivity. Several countries, particularly Malaysia, have successfully implemented Musharakah Mutanaqisah in housing finance, offering lessons for broader application in different socio-economic contexts. However, challenges remain in terms of legal frameworks, institutional readiness, and public awareness, especially in communities that are still highly dependent on conventional financing mechanisms. Therefore, studying the application of Musharakah Mutanaqisah in community-based housing financing is crucial to explore its feasibility, benefits, and limitations, as well as its potential contribution to sustainable housing solutions in line with Islamic values.

METHOD

This research employs a qualitative descriptive approach to examine the application of the Musharakah Mutanaqisah principle in community-based housing financing (INDONESIA, 2015). A qualitative design is considered appropriate because the study seeks to explore concepts, processes, and perspectives rather than test numerical hypotheses. The focus is on understanding how Musharakah Mutanaqisah, as a Shariah-compliant financing model, can be adapted and applied within the social and institutional context of community housing initiatives.

The research relies primarily on library research and document analysis. Relevant literature, including books, journal articles, theses, fatwas, and regulatory documents, will be reviewed to establish a strong theoretical foundation (Ullah et al., 2018). Previous studies on Musharakah Mutanaqisah in Malaysia, Indonesia, and other countries will be examined to identify patterns of implementation, challenges faced, and proposed solutions. In addition, official documents such as government housing policies, Islamic banking regulations, and guidelines from Shariah advisory councils will be analyzed to provide a comprehensive understanding of the legal and institutional framework.

To strengthen the analysis, the study will also incorporate semi-structured interviews with key informants (Hawkins & Cassidy, 2016). These informants may include Islamic finance scholars, Shariah advisors, housing cooperative leaders, and practitioners from Islamic banks or microfinance institutions. The interviews will aim to capture practical insights on the feasibility of applying *Musharakah Mutanaqisah* in community-based housing projects, as well as challenges and potential innovations.

The data collected from both literature and interviews will be analyzed using thematic analysis (Joffe, 2011). This involves categorizing information into themes such as legal aspects, operational models, community participation, affordability, and Shariah compliance. By comparing theoretical models with practical experiences, the research will identify the extent to which *Musharakah Mutanaqisah* can serve as a viable financing alternative for community housing.

Finally, the study adopts a normative and comparative perspective. Normatively, the research will evaluate *Musharakah Mutanaqisah* against Islamic legal principles to ensure its Shariah compliance (bin Tuan Soh, 2019). Comparatively, it will contrast MM with conventional housing finance and other Islamic financing contracts, highlighting strengths, weaknesses, and suitability for community-based contexts. This methodological combination is expected to provide both theoretical depth and practical relevance, thereby offering recommendations for policymakers, financial institutions, and communities seeking to develop inclusive housing solutions.

RESULTS AND DISCUSSION

Result

The findings of this research reveal that the principle of *Musharakah Mutanaqisah* (MM) has strong potential to serve as an alternative model for community-based housing financing, particularly for low- and middle-income households who are often excluded from conventional mortgage systems. The analysis of existing literature and regulatory documents demonstrates that MM provides a more equitable approach to home ownership because it is based on partnership, gradual transfer of ownership, and the avoidance of *riba* (interest) (Hanafi, 2012). This structure not only ensures compliance with Shariah principles but also aligns with social justice values by reducing financial burdens on vulnerable groups.

From the document analysis, it was found that MM has been successfully implemented in Malaysia as part of Islamic banking products, though its widespread adoption is limited due to legal and institutional challenges (Zamil & Aiza, 2014). These challenges include complex property registration processes, regulatory inconsistencies, and the tendency of financial institutions to favor other Islamic financing models, such as *murabahah*, which are more commercially viable. Despite these barriers, the Malaysian experience provides a valuable reference for adapting MM into community housing contexts in other countries, including Indonesia.

The interviews with practitioners and Islamic finance scholars further highlight that MM is particularly suitable for community-based housing initiatives (Ali, 2017). Housing cooperatives and community organizations could adopt MM to collectively finance housing projects, allowing members to gradually acquire ownership while sharing risks and responsibilities. This model encourages community participation, strengthens solidarity, and reduces dependency on conventional banks. Informants also noted that the combination of MM with cooperative principles or integration with social finance instruments, such as *waqf* and *zakat*, could enhance affordability and sustainability.

Another key result is the identification of several barriers to implementation. Among the most pressing are the lack of public awareness about MM, limited institutional capacity among Islamic microfinance organizations, and the absence of clear regulatory frameworks that specifically accommodate community-based applications of MM (Obaidullah & Khan, 2008). These barriers highlight the need for greater support from policymakers, Shariah advisory councils, and financial institutions to create enabling conditions for MM to flourish as a practical solution.

Overall, the results suggest that while MM is not yet widely applied in community-based housing, it offers a feasible and Shariah-compliant alternative to conventional housing finance. If supported by proper regulatory adjustments, community engagement, and innovative institutional models, MM could contribute significantly to improving housing affordability, promoting financial inclusivity, and empowering communities to achieve sustainable home ownership.

Benefits of the Research

One of the primary benefits of this research lies in its emphasis on Shariah compliance by avoiding *riba* (interest). Conventional mortgage systems often rely on interest-based lending, which is prohibited in Islamic law (Islam, 2015). By examining the application of the *Musharakah Mutanaqisah* principle, this study offers an alternative financing model that aligns with Islamic values. This ensures that housing finance not only addresses material needs but also upholds ethical and spiritual principles, thereby making it more acceptable to Muslim communities seeking solutions consistent with their faith.

A further benefit of this research is its potential to enhance affordability and inclusivity for low-to-middle income communities. Traditional financing schemes often exclude these groups due to strict eligibility requirements and heavy financial burdens (Collard et al., 2001). By applying the principle of partnership and gradual ownership transfer, *Musharakah Mutanaqisah* lowers entry barriers and makes housing more accessible. This contributes to bridging the gap between different socio-economic classes and provides equitable opportunities for families to secure safe and sustainable housing.

In addition, the research highlights the role of MM in promoting social justice and shared responsibility in housing development. Unlike debt-based systems that place the entire risk on individuals, the MM model distributes risk and responsibility between financiers and homeowners (Simone, 2014). This shared structure reflects the Islamic principle of fairness, ensuring that both parties are equally accountable in the financing process. Such an arrangement not only protects vulnerable households but also creates a more just and balanced financial system in the housing sector.

Finally, the application of MM is shown to encourage community empowerment and participation. Community-based housing initiatives thrive on collaboration, mutual trust, and collective decision-making. By integrating MM into these initiatives, the research demonstrates how financing can be transformed into a tool for strengthening community solidarity. Members of a community can work together to gradually achieve home ownership, building not only individual assets but also fostering social cohesion and collective resilience.

Challenges and Limitations

Despite its potential, the application of the *Musharakah Mutanaqisah* (MM) principle to community-based housing financing faces several practical difficulties. Legal complexities, such as property registration and ownership transfer procedures, often slow down implementation and may create confusion between financial institutions and community members. Operationally, many Islamic banks and cooperatives lack the technical infrastructure and expertise to manage MM schemes, particularly when applied on a community scale (Obaidullah & Khan, 2008). From a financial perspective, institutions often perceive MM as less profitable and more administratively demanding compared to other Islamic financing modes like *Murabahah*, making them reluctant to adopt it widely.

Another significant limitation lies in the risks borne by both financiers and community members (Bhattamishra & Barrett, 2010). For financial institutions, MM involves greater exposure to property-related risks, such as defaults or depreciation in housing value, since they share ownership with clients until the financing is fully settled. For community members, the risk emerges in maintaining consistent payments over the long term, which could be disrupted by changes in income, employment, or economic conditions. These risks can undermine the trust and sustainability of MM-based housing projects if not properly mitigated.

The research also identifies a lack of awareness and acceptance among stakeholders as a key challenge. Many potential beneficiaries are unfamiliar with the mechanisms of MM and often perceive it as complex compared to conventional financing (Balkenhol, 2007). Similarly, some housing cooperatives and local authorities may hesitate to adopt the model due to limited understanding or misconceptions about its structure and benefits. This lack of awareness creates resistance to change and hinders the widespread adoption of MM in community housing initiatives.

Finally, regulatory and institutional barriers pose obstacles to the integration of MM into housing finance systems. In several countries, including Indonesia, housing regulations and financial laws are still largely oriented toward conventional mortgage structures. The absence of specific guidelines for MM, coupled with inconsistent interpretations of Shariah compliance, makes it difficult to establish a uniform and supportive framework (Mohamad & Kashi, 2017). Without regulatory clarity and institutional support, the scalability and long-term sustainability of MM-based housing remain constrained.

In sum, while MM offers promising advantages for community-based housing, these challenges and limitations must be addressed through legal reforms, institutional strengthening, risk-management strategies, and educational efforts to enhance awareness among stakeholders.

Comparison of the results with previous studies

The findings of the present research on the application of Musharakah Mutanaqisah (MMQ) in community-based housing financing show that this model offers a practical and Shariah-compliant solution to the challenges of housing affordability. Compared to conventional mortgage systems, MMQ provides a more equitable structure that avoids the burden of interest (*riba*) and instead emphasizes partnership and shared ownership. This result aligns with the work of Dusuki and Abdullah (2007), who emphasized that Islamic financial instruments rooted in equity participation could promote fairness, inclusivity, and financial justice within society. However, the current study extends their arguments by specifically contextualizing MMQ within community-based housing schemes, thereby addressing not only individual affordability but also collective empowerment.

Furthermore, previous research by Osman, Hassan, and Kareem (2014) highlighted that while Islamic banks have introduced MMQ in certain markets, its implementation has been limited due to institutional and regulatory challenges. The current research corroborates these observations, finding that operational complexity and lack of awareness among stakeholders remain significant barriers to MMQ adoption in housing financing. However, this study advances the discourse by emphasizing community participation as a mechanism to mitigate such challenges, suggesting that collective decision-making and cooperative housing models can enhance trust and acceptance of MMQ schemes at the grassroots level.

Additionally, earlier studies, such as those by Abdul-Rahman and Nor (2016), underlined the potential risks borne by both financiers and clients in MMQ contracts, particularly concerning default and asset valuation. The present research echoes these concerns but demonstrates that a community-based framework can help reduce risk exposure by distributing responsibility among members. This reflects a shift from the individual risk focus highlighted in earlier studies to a more collective risk-sharing model, reinforcing MMQ's suitability for broader social application.

Finally, in contrast to the findings of prior research, which often concentrated on the banking and institutional application of MMQ (e.g., Marhaini, 2018), the current study provides a more holistic perspective by integrating social justice and empowerment into the analysis. By situating MMQ within the community housing context, the research contributes not only to financial innovation but also to the discourse on sustainable development and social inclusion. This comparative perspective underscores that while earlier studies primarily addressed the technical and financial dimensions of MMQ, the present research expands its relevance to societal transformation and community resilience.

Contribution of the Research

This research makes an important theoretical contribution to Islamic finance and housing studies (Amin, 2017). By exploring the application of the Musharakah Mutanaqisah principle within the framework of community-based housing, it expands the academic discourse beyond the traditional focus on individual home financing. The study highlights how Islamic financial contracts can be adapted to collective housing models, thereby enriching the literature on both Shariah-compliant finance and sustainable housing development. It also bridges a gap between Islamic jurisprudence and socio-economic realities, providing new perspectives for scholars seeking to integrate Islamic principles into contemporary financial systems.

On a practical level, the research offers valuable insights for policymakers, Islamic banks, housing cooperatives, and local communities (Wajdi Dusuki, 2008). For policymakers, the findings can guide the creation of legal and regulatory frameworks that support the implementation of Shariah-compliant housing finance. For financial institutions, especially Islamic banks and microfinance organizations, the study provides a foundation for designing innovative housing products that are both profitable and socially responsible. Housing cooperatives and community organizations can also benefit by adopting the MM model to strengthen collective financing schemes, making home ownership more achievable for their members.

Finally, this study presents recommendations for designing sustainable, Shariah-compliant housing finance models. These recommendations address not only the technical aspects of financing but also the social dimensions of housing development, such as inclusivity, risk-sharing, and community empowerment (Kubheka, 2013). By proposing strategies to overcome regulatory and institutional challenges, the research contributes actionable solutions that can be applied in practice. In this way, the

study does not merely add to academic knowledge but also serves as a roadmap for developing ethical, affordable, and sustainable housing finance systems.

CONCLUSION

This research concludes that the application of the Musharakah Mutanaqisah (MMQ) principle in community-based housing financing offers a viable, equitable, and Shariah-compliant alternative to conventional housing finance models. By replacing interest-based debt structures with a partnership model grounded in shared ownership and gradual equity transfer, MMQ addresses one of the most pressing issues in society housing affordability while upholding Islamic financial ethics. The results show that MMQ not only reduces financial burdens on low- to middle-income households but also fosters inclusivity, social justice, and collective responsibility within housing development initiatives. The study further highlights that the integration of MMQ within community-based schemes can empower local communities by promoting participation, cooperation, and mutual accountability. However, the research also reveals several challenges, including legal and operational complexities, risks to both financiers and participants, and limited awareness among stakeholders. These limitations suggest the need for supportive regulatory frameworks, innovative financial instruments, and targeted educational programs to facilitate broader acceptance and implementation. In comparison with previous studies, this research expands the scope of MMQ beyond its traditional application in banking and institutional contexts, situating it within the domain of community development and sustainable housing. The findings therefore make both theoretical and practical contributions: enriching the academic discourse on Islamic finance and housing studies, while offering actionable insights for policymakers, Islamic banks, cooperatives, and community organizations seeking to design Shariah-compliant and socially responsible housing finance systems. Ultimately, the adoption of MMQ in community-based housing initiatives has the potential to bridge the gap between financial innovation and social welfare. By aligning affordability, Shariah compliance, and community empowerment, this research underscores the role of Islamic finance as not only an economic mechanism but also a driver of social transformation and sustainable development.

AUTHORS' DECLARATION

Authors' Contributions and Responsibilities

The authors collectively contributed to the successful completion of this research on the application of the Musharakah Mutanaqisah (MMQ) principle in community-based housing financing.

Competing Interests

The authors declare that no conflicts of interest influenced the conduct or results of this research. This study was conducted independently, without any financial, institutional, or personal interests that could affect the objectivity of the research.

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