# Diminishing Musharaka Product of Islamic Banks: A Sharia'a Compliant Substitute of Term Finance

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## Abstract:

Partnership based business is the fundamental concept of doing commercial activity under Islamic rules and principles. To comply with Sharia'a principles within the boundaries of banking law in Pakistan, Financial Engineering provided the solution for all activities.

One of the modes of financing in conventional banking system is Term Finance in which the client repays principle and profit at predefined time intervals. This need can be fulfilled by using Islamic Alternate i.e. "Diminishing Musharaka".

This paper investigates the viability of this financing mode as compare to conventional Term Finance which is being utilized by conventional banking system for the same purpose. The paper also highlights the growth of Diminishing Musharaka in quantitative terms as well as its acceptability by end users and Islamic Financial Institutions in the form of portfolio growth for this mode of financing. To quantify its growth, historical time series data with its quarterly trend is used from Islamic Banking Bulletin issued by State Bank of Pakistan. Some key advantages and disadvantages are also mentioned by analyzing them critically. Related Sharia'a rulings and their linkage to this mode of financing are discussed in this study to further support it in Islamic perspective. Benefits associated with this mode and practical applications are discussed with some recommendations. The study is beneficial for Islamic Financial sector, central banks and students of Islamic Banking & Finance. It also aimed to enhance the knowledge of students and users of this product.

***Key words:*** Financial Engineering, Diminishing Musharaka, Conventional Bank, Term Finance, Islamic Financial Institution.

## Introduction

This paper investigates the viability of Diminishing Musharaka (DM), a mode of asset financing which is being focused by Islamic Banks of Pakistan. Due to increasing demand of capital requirement by individuals and companies, this method is being adopted and its portfolio is constantly increasing. In response to public demand, Diminishing Musharaka is more convenient and is a perfect substitute of Term Finance which is commonly used for financing to meet the demand of capital requirement. Additionally, some other modes of financing are being utilized for the same purpose by Islamic Banking Industry like Ijarah Muntahia Bittamleek, Murabaha, Musharaka etc. but this financing mode is becoming more popular from the perspective of Islamic Banks as well as of its customers. This study concentrates on suitability of Diminishing Musharaka as a mode of financing in Pakistan.

Dr. Asrar H. Siddiqui[1] (Siddiqui) defines Term Finance as borrowing a fixed amount from bank, repayable in periodic installments or lump sum at future date. He declares it a loan which can either be extended against security or without security in which the former is called Secured Loan whereas the latter is called Clean Loan. The borrower has to serve mark-up on the disbursed amount available for his use as well principal amount. Banker receives periodic installment or lump sum amount disbursed to the client along with profit.

Term loan is also called as installment loan which is the blend of interest and principle for repayment. In installment loans, repayment is combination of principal and interest which is repaid periodically as per defined intervals. Both parties keep the schedule simple to easily understand obligations of each party (Buckland, Robinson and Visano).

Frank Wood & Alan Sangster (Wood and Sangster) treats Term Loan as Hire Purchase which means creating charge on asset. In this mechanism, the asset belongs to supplier whereas the purchaser pays installments until the payment of final installment or the purchaser buys the asset. The purchase may give the asset back to supplier if he / she stops installment or does not want to continue the hire purchase.

According to legal maxims defined in Islamic Jurisprudence "*al-kharaj bi al-dhaman*" is related to linkage of return an asset with risk of ownership, and *al-ghurm bi al-ghunm"* is related to justified gain with the risk. Since the reward in Term Finance in not linked with risk related to asset, it is prohibited in Islam.

In Term Finance, fixed amount / rate of interest is charged by the lender without having partnership in the business or having the risk of asset. This type of financing is not allowed as per guidelines given by Islamic Jurisprudence. Islam has provided solution of ever sphere of life including financial dealings. Accordingly, Sharia'a Scholars in coordination with Financial Engineers provided the Sharia'a compliant solution in the form of Diminishing Musharaka which is the combination of Musharaka, Ijarah, and Sale.

The term "Musharaka" is derived from "Shirkah" which means sharing (M. T. Usmani)[2]. Partnership, Musharaka or Shirkah are used interchangeably and it is encouraged by Islamic Jurisprudence to perform business under Musharaka. In modern banking system, it is a partnership in which client and bank participate to own assets or property to share profit or loss. In order to meet the demand of customers in a Sharia'a Compliant manner, Islamic Banks use profit and loss sharing mechanism instead of debt-based modes of financing. Musharaka fulfills this purpose by the way of partnership in asset with sharing of risk and reward associated with that asset.

Diminishing Musharaka is a modern term used by Islamic banks as a mode of financing to meet the demand of asset or capital requirement. It is a kind of Musharaka in which customer and financier participate to have joint property, equipment or any other asset where the customer's share increases gradually and financier's share reduces until the customer become 100% owner of that asset (Hussain)[3]. On specified time intervals, the client purchases the share from financier in the form of unit(s) as per agreed term and conditions until the client becomes sole owner of underlying asset.

Practically, it is an amalgamation of three independent contracts i.e. Musharaka, Ijarah, and sale. The first contract serves the purpose of purchasing asset jointly, second is used to take rental on bank's share from customer, and third is used for sale of bank's share to the customer. In the first stage, the customer enters into an agreement of Musharaka where the asset is purchased at mutually agreed participation ratio. After purchase of the asset, the financier offers the usufructs of his / her ownership share of that asset to the client on specified rental terms and the client accepts to utilize the asset against rental payment on agreed time intervals. Periodically, the client offers to purchase unit(s) from the financier which ultimately reduces the financier's share in the asset and increases the share of client by purchase on each transaction (Osmani and Abdullah).

## Literature Review:

Financing for assets is a major segment which produces attractive revenue in the financial industry of Pakistan. Islamic Banks focus on asset-based products by financing through different modes as per nature of their business to avoid usury or *Riba*. There are several products and mode of financing available to meet this purpose of investing money in Sharia'a compliant manner. Due to feasibility and acceptability of Diminishing Musharaka, it is convenient from the perspective of customer as well as Islamic Bank to execute their financing transactions under this mode. Diminishing Musharaka is the extension of Musharaka which is the best mode encouraged by Islamic Jurisprudence for doing business in Sharia'a compliant way (Meezan Bank).

Musharaka Mutanaqisah starts when the customer chooses the asset and applies for financing to the financial institution. Second step starts after approval of the financing where the financial institution and the customer enter into agreement of partnership. At third step, customer takes institution's share on lease. Fourth step is about customer's periodical payment consisting on rental payment and payment for purchase of institution's share. At final stage, the partnership is culminated on transfer of whole asset to the customer (Rahman, Hilmy and Saifurrahman).

Diminishing Musharaka is a type of joint ownership in property of asset in which any of the partners promises / undertakes to buy the ownership share of the other partner(s) gradually until the ownership of the joint property or asset completely transferred to the purchasing joint owner (State Bank of Pakistan).

Diminishing Musharaka is a kind of partnership used as a mode of financing where a partner can redeem his / her share having a call option of put option (Meezan Bank).

Diminishing Musharaka is a partnership transaction in which the partners agree to terminate partnership gradually by means of purchase of one partner's share by other partner. Diminishing Musharaka Financing is a combination of Musharakah, Ijarah and Sale transaction. Therefore, all rules pertaining to Musharakah, Ijarah and Sale transactions are applicable to this transaction (BankIslami Pakistan).

Diminishing Musharaka is a form of partnership, which ends with one partner purchasing the entire share of the other partner's property in that project by a redeeming mechanism, agreed by both parties (Dubai Islamic Bank).

Diminishing Musharaka is most commonly used for the financing of fixed and movable assets, long term projects, etc. Customer and the Bank participate in joint ownership of a property, equipment or a commercial enterprise. The share of the Bank is divided into number of units. Customer purchases these units from bank one by one with periodic intervals, thereby increasing his / her share in the undivided property / asset gradually until the customer ultimately becomes sole owner of the property / asset. During the period of Musharakah bank charges rent for the use of that portion of asset which is owned by bank. The rent amount of the bank diminishes as its stake in the asset decreases after purchase of units (Bank Alfalah).

As per Sharia'a Standards issued by Accounting and Auditing organization for Islamic Financial Institutions (AAOIFI), Diminishing Musharaka is a type of partnership in which one of the partners promise to periodically purchase the share of another partner until the asset is fully transferred to one of the partners. This sale is purchase is on the basis of unilateral promise by one partner who is usually the customer of financial institution. Promise to purchase of share by one partner in independent from the partnership contract. Every partner has to contribute in the asset and its related expenses. The ratio of profit sharing should be pre-agreed which may vary from the ratio of investment, whereas the loss sharing ratio should be in accordance to the investment in asset. Promise to purchase the share may be binding, however, the sale should be on market value at the time of sale. (AAOIFI).

Structure of Diminishing Musharaka is to avoid interest (*riba*) which is a better alternative for financing over long durations. Diminishing Musharaka is most popular mode of financing in many countries including Pakistan, Malaysia, Indonesia, Qatar, Oman, United Arab Emirates, Kuwait, and Brunei (Mihajat).

Diminishing Musharaka is constructed on the basis of reactance which is something built by many parts. Technically, it is the engagement of financier into an asset which ultimately has to be transferred to the borrower (Naim). Diminishing Musharaka is developed in near past in which the client requests the financier to participate in the asset. Financier divides its share into units and the client purchases those units gradually until the client purchases all units from the financier and becomes the sole owner of that asset. It is divides into three steps i.e. 1$^{st}$ step to create joint ownership, 2$^{nd}$ step is to lease the financier's asset share to the client, and 3$^{rd}$ step elaborates the client's purchase of units from the financier (M. I. Usmani).

Musharaka Mutanaqisa is modern financing technique emerged with innovation and provides most appropriate financing tools. It provides clear exit and Sharia'a compliant mechanism for liquidation to financial institutions (Alghamdi).

Diminishing Musharaka was introduced by Samy Hamoud back in 1974 with the rulings of *Musharaka yantanhi bittamlik*. According to research in Malaysia, the customers are indifferent in opting Diminishing Musharaka of any other mode of financing as far as these are compliant with rules of Sharia'a. The basic benefit for choosing Diminishing Musharka is the flexibility in applicable rates which may be revised and the installment is ultimately rescheduled according to economic conditions. Documentation involved in Diminishing Musharaka is much complex and it involves number of agreements which increases the documentation cost. Similarly, the execution of documents is also technical which increase the time involved in this product (Khairul Hafidzi Mohd Subky).

Qaisar Bilal &Muhammad Rahim (Bilal and Rahim) discussed scope of diminishing musharaka, its procedures, stages and components in detail. Some Sharia'a rulings and their relations to this mode of financing are also discussed with remedial measures. They mentioned major hurdles faced by Islamic Banks using this products and highlighted lack of training, non-availability for substitute of KIBOR, complex tax regime and absence of Government support in true sense.

While discussing Musharaka, Muhammad Farooq & Mufti Muhammad Mushtaq Ahmed (Farooq and Mushtaq Ahmed)admitted that Diminishing Musharaka is more popular and acceptable by customers. As per their analysis, its market share is highest in financing portfolio. They further added that customers are dominant towards Diminishing Musharaka, Ijarah or Murabaha specifically in high yield projects.

Muhammad Akram, Mamoona Rafique, & Hassan Mobeen Alam (Akram, Rafique and Alam) discussed the broader aspect with reference to Pakistan by analyzing performance and growth of Islamic Banks. They evaluated the growth of Diminishing Musharaka by type of asset products being offered under this mode. According to them, this mode of financing is being offered to corporate / SME sector of Pakistan by full fledge Islamic Banks.

Dr. Badr-El-Din A. Ibrahim & Mohammad Osman Khalifa (A. Khalifa and Khalifa) explained Banking Musharaka which is the representation of Musharaka with combination of other forms. Some practical aspects pertaining to gradual purchase are also discussed. They suggested some modification in existing products based on this mode of financing. Limitations and advantages are narrated in sequential order. Modification for Diminishing Musharaka includes the revaluation of asset at different time intervals to exercise the exact value of the asset.

Noor Muhammad Osmani & Md Farooq Abdullah (Osmani and Abdullah) critically analyzed Diminishing Musharaka by focusing its usage on home financing in Malaysia. Principles of Sharia'a are described for Musharaka Mutanaqisa contract and are compared with *"al-bay bi-thaman a'ajil"* by describing features of both modes. Comparative approach is used in this study by using qualitative method. In conclusion, this mode of financing is declared more Sharia'a compliant as compare to other modes which are being practices in Malaysian Islamic Banks for similar purpose.

Sharia'a based and Sharia'a Compliant modes of financing are bifurcated by Muhammad Hanif & Abdullah Muhammad Iqbal (Iqbal and Abdullah) where the Diminishing Musharaka categorized as Sharia'a Compliant mode. As per their opinion, Diminishing Musharaka is primarily used in real estate sector. To execute transaction under this category, the customer requests to have an asset and agrees to make payment of certain share in the purchase price while the remaining is being paid by the bank. Primary data tools are used in this paper as methodology by observation and questionnaire. In conclusion, the need of awareness and professional knowledge is emphasized.

Mufti Syed Sabir Hussain (Hussain) described musharaka in detail with its validity from sources of Sharia'a by giving reference from Qur'an and Sunnah. He termed Diminishing Musharaka as modern shape of musharaka which is being used in Islamic Banks. He elaborated its pricing mechanism, procedure, kinds and related contracts in detail. He further discussed the mechanism for distribution of profit and loss with examples.

Musharaka is divided into two categories i.e. *Shirkat ul Milk* and *Shirkat ul Aqd* where former is for partnership in property while the latter is used for joint enterprise. *Shirkat-*

*ul Aqd* is further divided into three categories namely *Shirkat-ul Amwal, Shirkat-ul A'mal* and *Shirkat-ul Wujooh* which are used for commercial enterprise, for services and based on credibility respectively (M. T. Usmani). He discussed Diminishing Musharaka in detail by describing it a joint ownership of client and financier in asset or enterprise. He elaborated its modality, practical and operational aspects by giving examples. Practical implication, usage of this product for house finance, services business, and trade are discussed in detail. He further added that by using this mode, the financier enables his client to become the sole owner of the asset by gradually purchasing his shares.

Diminishing Musharaka is also explained by Muhammad Ayub[4] (Ayub)under participatory modes of financing. He called it as a more suitable product in current banking system and mentioned the practical example of HBFC. In his book, he discussed the method, its related contracts and preferred technique to implement it in a Sharia'a compliant manner by sequencing contracts.

## Methodology:

Hybrid method is used in this report but mainly focusing on qualitative method. It is descriptive in nature because it describes the mode of financing, its theoretical and operational aspects, contracts involved and recommendation by sources of Sharia'a. Discussion of renowned scholars, literature available on this topic and official website of State Bank of Pakistan are used to describe the report. Literature available on this mode of financing is also in qualitative form which elaborates its different aspects in terms of nature of product, Sharia'a rulings in favor of it and some practical aspects. Performance, growth and trend are shown in quantitative method by using the Islamic Banking Bulletin issued by State Bank of Pakistan from time to time. It also compares the stated mode of financing with other modes being used by Islamic Banks operating in Pakistan.

## Performance of Islamic Banks

Quarterly Islamic Banking Bulletins[5] (State Bank of Pakistan) issued by State Bank of Pakistan indicate that share of Islamic banking sector is constantly growing at double digit. Performance of Islamic Banking as of December 2019 and its growth rate as compare to December 2018 is highlighted hereunder;

- ✓ Asset size reached to 3,284 Billion with increase of 23.6%
- ✓ Amount of deposits reached to 2,652 Billion with increase of 20.4%
- ✓ Total financing portfolio reached to 1,623 Billion, increased by 7.41%

## Growth of Diminishing Musharaka:

Sharia'a compliant modes banking and finance are allowed by State Bank of Pakistan under which Diminishing Musharaka is approved as a participatory mode of financing. Relative share of Diminishing Musharaka is continuously increasing in terms of amount as well as in terms of ratio in financing portfolio. As of December 2019, financing under this mode reached to 553 Billion which is 34.1% of Islamic Banking financing portfolio. Share of Diminishing Musharaka was highest in September 2016 which was 38.5% of Islamic Banking financing portfolio. Since June 2013 it continuously encompasses the highest share as compare to other modes of financing including Musharaka, Murabaha, and Ijarah.

## Comparison with Term Finance

Term Finance is conventional mode of financing which does not observe Sharia'a rules and principles rather it is purely debt-based transaction. Diminishing Musharaka is Sharia'a compliant solution which fulfills the similar need of customers.

- Nature of Transaction: Term Finance is purely loan transaction while Diminishing Musharaka is combination of Musharaka and Rental.
- Advance Payment: Advance payment of stake of client is not necessary in Term Finance whereas it is mandatory in Diminishing Musharaka.
- Treatment of Advance Payment: In Term Finance, advance payment (if applicable) is treated at Down Payment, however it is treated as customer's share / participation in Diminishing Musharaka.
- Relationship of Financial Institution and Client: In Term Finance, it is that of lender and borrower whereas, it is that of partners in Diminishing Musharaka.
- Involvement of Asset: Term Finance does not involve directly in the underlying asset except for security purpose whereas Diminishing Musharaka is directly linked with underlying asset.
- Risk: In Finance, the lender bears the credit risk with having the risk related to the asset, while in Diminishing Musharaka, the financial institution has to bear the risk of asset in addition to credit risk.
- Ownership related expenses: Term Finance is a loan transaction, hence all expenses are borne bythe borrower, while in Diminishing Musharaka, both partners share such expensed proportionately.

- Repayment: With each installment, the borrower repays principle along with interest on capital in Term Finance, while the client purchases units and the asset is gradually transferred to client in Diminishing Musharaka.
- Partial Payment: In event of making partial payment, Term Finance treats it reduction in outstanding loan amount, while in Diminishing Musharaka, it is treated as purchase of additional share from co-partner.
- Early Settlement: In case of early settlement, outstanding loan amount need to be repaired along with penalty in Term Finance, whereas the customer needs to pay outstanding share value of the financier at predetermined / market price in Diminishing Musharaka.
- Delay Payment: Charges related to delay payment in Term Finance are financial penalty being imposed to client, whereas in Diminishing Musharaka, such charges are received either in the form of additional rental for non-purchasing of unit in specified time or increase in the price of subsequent unit(s).
- Sharia'a Compliance: Term Finance does not need to be Sharia'a compliant while Diminishing is Sharia'a compliant alternate which is in compliance with Sharia'a rules and principles.
- Agreements / Contracts: Three separate independent contracts in Diminishing Musharaka are applied, while in Term Finance, single contract is executed.
- Default: In case of default in Diminishing Musharaka, the financier has the right of recourse on that particular asset of Musharaka, whereas in Term Finance, the financier has the general right of recourse against the borrower.
- Change in Price: Asset price may vary according to fluctuation in market price of the asset, while in Term Finance, price of the asset cannot be increased. However, applicable interest rate may be revised in Term Finance.
- Transfer of Ownership: In Diminishing Musharaka the client purchases units gradually and ultimately the asset is transferred to the client. On the other hand, in Term Finance, the financier executes the loan transaction, hence there is no concept of transfer of ownership to the client.

Table 1: Sample Working Example of Diminishing Musharaka *(Shirkat ul Milk)* by Islamic Bank

| | |
|---|---|
| Asset Value | 1,200,000 |
| Bank's Musharaka Share | 960,000 |
| Rental Rate | 15.00% |
| Tenure | 1 Year |
| Payment Frequency | Monthly |

| **Payment Date** | **Total Monthly Payment** | **Unit Value** | **Rental Amount** | **Outstanding Bank's Share** | | **Customer's Share** |
|---|---|---|---|---|---|---|
| May 1, 2020 | 92,000 | 80,000 | 12,000 | 880,000 | 73.33% | 26.67% |
| June 1, 2020 | 91,000 | 80,000 | 11,000 | 800,000 | 66.67% | 33.33% |
| July 1, 2020 | 90,000 | 80,000 | 10,000 | 720,000 | 60.00% | 40.00% |
| August 1, 2020 | 89,000 | 80,000 | 9,000 | 640,000 | 53.33% | 46.67% |
| September 1, 2020 | 88,000 | 80,000 | 8,000 | 560,000 | 46.67% | 53.33% |
| October 1, 2020 | 87,000 | 80,000 | 7,000 | 480,000 | 40.00% | 60.00% |
| November 1, 2020 | 86,000 | 80,000 | 6,000 | 400,000 | 33.33% | 66.67% |
| December 1, 2020 | 85,000 | 80,000 | 5,000 | 320,000 | 26.67% | 73.33% |
| January 1, 2021 | 84,000 | 80,000 | 4,000 | 240,000 | 20.00% | 80.00% |
| February 1, 2021 | 83,000 | 80,000 | 3,000 | 160,000 | 13.33% | 86.67% |
| March 1, 2021 | 82,000 | 80,000 | 2,000 | 80,000 | 6.67% | 93.33% |
| April 1, 2021 | 81,000 | 80,000 | 1,000 | - | 0.00% | 100.00% |

## Discussion and findings

Historical data shows that Diminishing Musharaka is growing constantly and its share is highest as compare to other modes of financing. Basic reason of this growth is that it is Sharia'a compliant substitute of Term Finance which is commonly used by conventional banking system of Pakistan. Another important reason is that banks are focusing on this mode due loss sharing by the client as well as compliance of their business nature as financial intermediary. Diminishing Musharaka is outcome of Financial Engineering in Islamic way which is developed keeping in view the demand of customers (Hussain).

Practically, it is combination three independent contracts i.e Musharaka between parties, Ijarah of financier's share and Undertaking to purchase of musharaka asset by client (Ayub). At first stage, partnership is executed to have asset for co-ownership of both parties by participating their agreed ratio / share. In second contract, after availability of the asset, one party provides his share on rent to second party for use of its usufructs. In third contract, the client offers to periodically purchase the share of financier. Islamic banks, being financial intermediary earn profit on their financing as well as gradually sell their share to client enabling him to become the sole owner of the asset. This mode of financing is being frequently used in Islamic Banks for financing of home, vehicles, consumer durables, and machinery. Products offered by this mode are being used primarily for consumer financing products (Akram, Rafique and Alam).

Diminishing Musharaka is further elaborated with following example. A client wants to purchase a house but he does not have enough money to purchase it. He goes to Islamic bank for financial assistance where after due diligence, the bank agrees to process his / her application for financing upto eighty percent for purchase house jointly. The client undertakes to purchase the bank's share in five years by paying sixty equal payments. It is also agreed that the bank will charge rent on its share of eighty percent which will be gradually decreased as per reduction in the participation ratio by selling its share. After purchase of house, the bank starts receiving profit in the form of rent of its portion and client makes payment of rent as well as agreed price of monthly units. At the end of term, client acquires the complete ownership and bank transfers the asset to client (Osmani and Abdullah). In above mentioned example, at initial stage, the bank and client enter into agreement for purchase of house on Musharaka basis. At the time of purchase, they become co-owner of the house with eighty percent share of the bank and twenty percent share of customer. To enable the client for using that house, the bank provides its share on rent to client. At that point, the bank divides its share in sixty units and offers sale of one unit per month to its client. The client starts monthly payment for rental at predetermined rate / market rate as well as for purchase of one unit. Ownership related expenses are borne by both parties on the basis of their stake in the house while maintenance expenses are paid by the client as per market practice. At the maturity of financing, when the client has purchased all units from bank, the house becomes sole ownership of client and the bank transfers the house to the client according to pre-agreed terms.

It is also worth considering that while the customer takes any asset with financial help of financial institution whether in the form of Ijarah, Murabaha or Musharaka, he / she perceive that he/she is the part owner and his/her share is increasing with each payment. This perception only becomes true by the way of Diminishing Musharaka where each purchase of unit increases customer's share.

## Conclusion

Nature of Islamic financing is based on Sharia'a compliant transactions and its banking system is majorly focused on profit and loss sharing methods. Islamic banks, being intermediary are allowed to provide financing only in Sharia'a compliant way. Funds generation from different sources as well as financing and investment to different segments is made in accordance with Sharia'a rules and principals. Statistical data mentioned above shows the constant increase of Islamic Financial Institutions, their assets and deposits are evident of its acceptability. Growth of Islamic banking sector is on fast pace and State Bank of Pakistan being a regulator is focusing to support this segment (Akram, Rafique and Alam).

While practicing Diminishing Musharaka as a mode of finance, there are some problems as followed.

- Diminishing Musharaka is executed on the principles of *"Shirkatul Milk"* while the intention of financier is to generate profit i.e *"Shirkatul Aqd"*.
- Sale and Purchase of periodic unit(s) is executed on book value while it should be on market value.
- Sale evidence is not made available to the customer on each sale of unit(s).

Although Islamic Banking is widely accepted, yet there is need for promoting institutions, comprehensive training of human resource and education to general public (Farooq and Mushtaq Ahmed).

Moreover, the focus of Government is also required to provide level playing field for Islamic Banking sector in term of tax reforms, availability of sufficient SLR eligible securities approved by Sharia'a and arrangement of Islamic Inter Bank Offer Rate.

## Recommendation

Diminishing involves extensive documentation which attracts additional cost and revenue stamping / execution charges. Such documentation also creates hurdle for client and the financier and also increase time duration for execution. Number of documents / agreements need to be reduced to lessen the cost of transaction and time involved.

Practical version of Diminishing Musharaka to be extended from limited number of products to other related products including financing to corporates and SMEs. This will also require innovation and financing engineering in *Shirkat ul Aqd*. Outreach of Diminishing Musharaka to broaden specifically towards agriculture sector, educating sector, and small industries.

To increase the confidence to clients, it should be used with true spirits of Islamic rules and principles. Application of this mode of financing need to re-structured in a way that assure the clients with transparency.

Islamic Financial institutions should review their products, process flows, procedures, and implementation stages frequently. In case of any gap between customer's perception and applied operation procedures, it should be restructured immediately in line the Sharia'a rules and principles.

Value addition is a continuous and ongoing process which should also be applied in Diminishing Musharaka. Additionally, simplification of transaction is necessary to facilitate client without hurdles.

Awareness programs to be conducted with end users to educate them the concept, practicality, and difference from conventional term finance. Awareness sessions may also be conducted in collaboration with management universities, financial institutions, and Islamic Finance centers. This will also increase customer's confidence on Islamic Banking and Finance.

Standardization is also required in procedure, practice and documentation and practices to be exercised across the industry.

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