



Prospects and Challenges of *Musharakah* and *Musharakah Mutanaqisah* Financing in Islamic Microfinance: Case Studies of Indonesia and Malaysia

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Article History

Received:
13 October 2025

Revised:
6 January 2026

Accepted:
14 January 2026

Keywords:
Islamic
microfinance,
musharakah,
musharakah mutanaqisah,
partnership
financing, profit
and loss sharing.

Kata Kunci:
Bagi hasil,
keuangan mikro
syariah,
musyarakah,
musyarakah mutanaqisah,
pembiayaan
kemitraan.



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Abstract. *Musharakah*, a unique Islamic mode of financing, involves joint contributions of capital and labor by both financier and entrepreneur. This profit and loss sharing (PLS) contract is considered one of the most ideal Islamic financing models, embodying the principles of cooperation and partnership. A specific application of this model is the diminishing partnership contract, known as *Musharakah Mutanaqisah* (MM). This study explores the implementation of *musharakah* and MM in Islamic microfinance through a qualitative comparative case study of two institutions: *Bank Pembiayaan Rakyat Syariah* (BPRS) Amanah Ummah Bogor, Indonesia, and *Entrepreneurship Development Program* (i-Taajir) under the Centre for Islamic Economics IIUM-CIMB Islamic Bank, Malaysia. Data were collected through interview, financial reports, institutional documents, and secondary sources, and analyzed thematically. The findings reveal that while both institutions apply *musharakah*-based financing to empower micro-entrepreneurs, they face challenges related to risk management, regulatory frameworks, and limited client understanding. Managerial implications suggest the need for better financial literacy programs, internal capacity building, and policy support to optimize *musharakah* implementation in microfinance settings. This study offers recommendations for enhancing the sustainability and operational effectiveness of equity-based Islamic financing models in the microfinance sector.

Abstrak. *Musyarakah* merupakan salah satu akad pembiayaan dalam ekonomi syariah yang unik, di mana terdapat kontribusi modal dan tenaga dari kedua belah pihak, yaitu pemodal dan pengusaha. Akad berbasis bagi hasil (profit and loss sharing/PLS) ini dianggap sebagai model pembiayaan ideal karena mencerminkan prinsip kemitraan dan kerja sama dalam Islam. Salah satu bentuk aplikasinya adalah akad kemitraan berkurang atau *Musyarakah Mutanaqisah* (MM). Penelitian ini bertujuan untuk mengeksplorasi implementasi akad *musharakah* dan MM dalam konteks keuangan mikro syariah melalui pendekatan studi kasus kualitatif komparatif terhadap dua lembaga keuangan mikro syariah, yaitu Bank Pembiayaan Rakyat Syariah (BPRS) Amanah Ummah Bogor, Indonesia, dan Program Bimbingan Usahawan (i-Taajir) yang dikelola oleh Centre for Islamic Economics IIUM-CIMB Islamic Bank, Malaysia. Pengumpulan data dilakukan melalui wawancara, laporan keuangan, dokumen institusional, serta sumber sekunder lainnya, kemudian dianalisis secara tematik. Hasil penelitian menunjukkan bahwa kedua institusi telah menerapkan pembiayaan berbasis *musyarakah* dan MM untuk memberdayakan pelaku usaha mikro, namun masih menghadapi tantangan seperti manajemen risiko, regulasi yang belum optimal, dan keterbatasan pemahaman nasabah.

INTRODUCTION

Islamic microfinance institutions (IMFIs) have gained increasing relevance in promoting financial inclusion by offering shariah-compliant financing to the underserved communities. Among various contracts used in Islamic finance, *musharakah* and *mudharabah* embody Islamic economic principles such as fairness, risk-sharing, and social justice, as it is basically a partnership-based profit and loss sharing (PLS) model (As-Salafiyah et al., 2025).

While both *mudharabah* and *musharakah* are foundational contracts in Islamic finance and are rooted in profit-and-loss sharing (PLS) principles, empirical data and institutional practice reveal that *mudharabah* is less frequently applied in comparison to *musharakah*. This trend is influenced by several key factors. First, *mudharabah* places the entire financial risk on the capital provider, as the entrepreneur does not share in losses unless due to misconduct. This structure raises concerns for Islamic financial institutions regarding risk exposure and moral hazard (El Fakir & Tkiouat, 2015). Second, *musharakah* allows for shared control and monitoring, offering a more balanced approach to risk and return. Third, regulatory and operational challenges, including difficulties in monitoring business performance and assessing profits accurately. This makes *mudharabah* contracts less attractive for institutions aiming for financial stability. As a result, many Islamic banks and microfinance institutions have gradually shifted toward *musharakah* or even *murabahah*, despite the latter being debt-based and not reflective of PLS ideals.

Despite its foundational role in Islamic finance, *musharakah* is underutilized, with most Islamic banks favoring debt-based instruments like *murabahah* due to perceived lower risk and easier administration (Hamsir et al., 2025; Miah & Suzuki, 2018). This trend has raised concerns regarding the long-term alignment of Islamic banking practices with *maqasid al-shariah* (the higher objectives of Islamic law), which emphasize equitable wealth distribution and social welfare (As-Salafiyah et al., 2025).

Recent studies have sought to revitalize *musharakah* through structural innovations. For instance, Shah (2025) critiques the current application of *Running Musharakah* in Pakistan, revealing how it deviates from true risk-sharing by guaranteeing fixed profits for banks. Meanwhile, Ali et al. (2024) emphasizes the sustainability potential of equity-based financing such as *musharakah* in achieving value-based intermediation and aligning Islamic finance with ESG and SDG goals. Furthermore, Asyiqin and Alfurqon (2024) highlight how *Musharakah Mutanaqisah* (MM), a diminishing partnership model, can address key limitations in conventional *murabahah* financing, particularly in the housing and microfinance sectors.

However, legal, operational, and regulatory challenges continue to impede the widespread adoption of *musharakah* and MM models (Asyiqin & Alfurqon, 2024). These include inconsistencies in profit-sharing mechanisms, lack of legal clarity, and limited financial literacy among clients and institutions. Consequently, there is a growing need for empirical research that examines the real-world implementation of these models in diverse contexts.

This study responds to that need by analyzing the application of *musharakah* in BPRS Amanah Ummah (Indonesia) and MM in the i-Taajir program of IIUM-CIMB Islamic Bank (Malaysia). Through comparative case studies, the paper evaluates the operationalization, benefits, and limitations of equity-based contracts in microfinance settings. The findings are expected to contribute to the discourse on developing inclusive, shariah-compliant, and sustainable Islamic microfinance models.

This paper is divided into five sections. Section one presents the introduction, outlining the background and rationale of the study. Section two provides a literature review on the theoretical foundations of *musharakah* and MM, highlighting previous research and existing gaps. Section three describes the research method, including the qualitative approach and case study analysis. Section four presents the

results and discussion, focusing on the implementation of *musharakah* in BPRS Amanah Ummah Bogor, Indonesia, and MM in the Entrepreneurship Development Program (i-Taajir) CIE IUM-CIMB Islamic Bank, Malaysia. Finally, section five draws conclusions and offers practical recommendations.

LITERATURE REVIEW

Profit and Loss Sharing (PLS) as the Theoretical Foundation

This study is grounded in the Profit and Loss Sharing (PLS) theory, which forms the backbone of Islamic partnership contracts such as *musharakah* and *musharakah mutanaqisah* (MM). The PLS principle is based on the equitable distribution of profits and risks between contracting parties, promoting justice, transparency, and shared responsibility in business dealings. It represents a distinct departure from conventional interest-based lending by encouraging risk-sharing rather than risk-transfer (As-Salafiyah et al., 2025).

In Islamic finance, *musharakah* allows both capital providers and entrepreneurs to contribute resources and share outcomes based on agreed ratios. The MM variant enhances this model by introducing gradual transfer of ownership, making it suitable for asset acquisition and Islamic home financing (Ruslan & Jaffar, 2012).

The theoretical appeal of PLS lies in its potential to enhance financial inclusion, particularly in microfinance. It fosters entrepreneurship and offers a viable shariah-compliant alternative to *riba*-based credit. However, its practical application faces challenges such as moral hazard, adverse selection, and asymmetric information, which can discourage Islamic financial institutions from fully implementing these contracts (El Fakir & Tkiouat, 2015).

Several scholars have highlighted how risk aversion and negotiation dynamics influence the optimal profit-sharing ratio between partners. For example, Mehri et al. (2017) used an adverse selection model to show that the more risk-averse the manager, the more profit share they require, which affects the PLS agreement outcomes. Likewise, game theory has been applied to examine incentive structures that encourage higher effort and fairer profit distribution among partners (El Fakir & Tkiouat, 2015).

Despite these constraints, PLS remains a strategic response to financial exclusion and economic injustice. Its alignment with *maqasid al-shariah* makes it particularly relevant in microfinance, where empowerment, equity, and poverty reduction are key goals (As-Salafiyah et al., 2025).

Musharakah and Its Role in Islamic Financing

Musharakah, a term of Arabic origin, is a joint enterprise where all partners share the profit or loss in the joint venture (Usmani, 1999). This arrangement, which is a contract between a financier and an entrepreneur, ensures that both parties actively contribute capital for a specific project and are involved in managing the venture, depending on their mutual agreement. The proportion of profit-sharing for each party is determined in the agreed contract, and losses are shared based on the capital contribution (Otoritas Jasa Keuangan, 2025). *Musharakah*, as one of the ideal Islamic financing contracts, encourages active participation and embodies the principles of cooperation, partnership, and profit and loss sharing.

From an Islamic perspective, *musharakah* is in line with the nature of business, which is uncertain at some point, unlike the interest rate system, which predetermines the profit at the beginning of the contract. Allah SWT stated, “*Indeed Allah alone has the knowledge when the last hour will come, and He is who sends down the rain and He alone knows what is in the wombs, and while no soul knows what it will earn or reap*”

tomorrow, and nobody or soul knows in which land it will die and buried. Indeed, Allah alone is the All-Knower, All-Aware.” (Quran, 31: 34). This verse highlights that only Allah knows the result of what will be earned in the future from business activities conducted by entrepreneurs. There are three possibilities for business activities’ results: profit, loss, or break-even point. Entrepreneurs can try their best to achieve profit in every business venture, but other factors are not within their control, such as structural changes, changes in consumers’ tastes and preferences, etc., that could badly affect their businesses and eventually lead to losses.

Besides Quranic verses, the important position of *musharakah* is also supported by the Prophet’s sayings. In one hadith narrated by Abu Hurairah, Rasulullah SAW said, “*Allah said: Allah’s hand is with both the partners unless any one of them indulge in cheating and when any one of them indulges in cheating then Allah takes back his hand from both the partners.*” (Hadith Abu Daud). This shows that partnership contract is encouraged from the perspective of Islam.

From an economic point of view, Usmani (1999) argues that *musharakah* can play an important role in an economy following Islamic norms. He explains that among the important characteristics of *musharakah* are the distribution of profit, the ratio of profit, and the sharing of loss based on mutual agreement. These crucial aspects of *musharakah* align with the nature of business and hence can encourage improving the real business sector in the economy. Despite its strong theoretical basis, *musharakah* remains underutilized in practice compared to other contracts like *murabahah* or *ijarah*.

Farooq and Ahmed (2013) found that in Pakistan, *musharakah* is underused due to managerial reluctance, lack of skilled entrepreneurs, and absence of government support. These barriers have led Islamic banks to favor fixed-return contracts such as *murabahah* over PLS-based contracts like *musharakah*. Similar findings in Southeast Asia highlight operational and risk management barriers in fully adopting *musharakah* financing. Warninda et al. (2019) show that while *musharakah* does influence earnings volatility in Islamic banks, its use remains marginal compared to debt-based instruments. Nonetheless, scholars argue that wider use of *musharakah* would improve the resilience of Islamic financial institutions and promote financial inclusion (Ali et al., 2024).

***Musharakah Mutanaqisah* (MM) and Its Role in Islamic Financing**

Diminishing *musharakah* or *Musharakah Mutanaqisah* (MM) partnership contracts is relatively new in Islamic finance. It is believed that MM is closer to the spirit and goals of shariah and should, therefore, be practiced more often by Islamic financial institutions (Asian Institute of Finance, 2013). It is an innovative structure combining co-ownership and lease-to-own mechanisms, offer a shariah-compliant alternative to interest-based home and asset financing.

According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standards (2008), *Musharakah Mutanaqisah* refers to “*a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This transaction starts with forming a partnership, after which the buying and selling of the equity occur between the two partners. It is, therefore, necessary that this buying and selling should not be stipulated in the partnership contract. In other words, the buying partner can only promise to buy. This promise should be independent of the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract. One contract cannot be entered into as a condition for concluding the other.*” This type of contract can be utilized for many purposes, including home and car financing, working material and equipment financing, business project financing, and many more.

This structure has been increasingly adopted in Islamic banks across Malaysia and Indonesia, especially for home financing and micro-entrepreneurship tools. Several scholars have emphasized MM's potential. For example, Baber (2017) contrasts MM with BBA (*Bay' Bithaman Ajil*), noting MM's superior alignment with shariah principles due to its risk-sharing nature. Asyiqin and Alfurqon (2024) further argue that MM overcomes key limitations of *murabahah*, such as high upfront costs and rigidity, making it more suitable for low-income and microfinance clients.

***Musharakah* and MM in Microfinance Context and Its Challenges**

There is a notable gap in the literature regarding the use of *musharakah* and MM in microfinance institutions (MFIs). Most studies focus on housing or real estate financing, with limited attention to their adaptation for micro-enterprises. However, Abdul Jabar et al. (2018) showed that an Islamic cooperative like KOPSYA has successfully applied MM models in community-based microfinancing, offering promising insights for broader MFI adoption. Furthermore, Lojo-Bajrić and Hadžić (2020) suggest that using market rent-based calculations for profit margins can make MM contracts more adaptable and competitive for smaller-scale applications.

Despite its potential, MM faces practical challenges. Asadov et al. (2018) document that Islamic banks often use conventional benchmarks like LIBOR or market rental values to calculate profit margins in MM contracts, which may undermine shariah principles. Legal issues such as *wa'ad* enforceability, default handling, and ownership structure also complicate implementation, as discussed by Haneef et al. (2011) and Kashi and Mohamad (2017). Moreover, regulatory inconsistencies between jurisdictions add further complexity. A recent comparative study by Asyiqin and Alfurqon (2024) highlights how differences in national regulations between Indonesia and Malaysia can impact the effectiveness and clarity of MM implementation in housing finance.

While various studies have discussed MM in the context of Islamic banking and home financing, fewer have focused on its practical application in Islamic microfinance institutions (IMFIs). In particular, case studies from Indonesia and Malaysia exploring real-world implementation in community settings remain scarce. This study aims to fill that gap by examining two active IMFIs, BPRS Amanah Ummah and i-Taajir, applying *musharakah* and MM contracts for micro-entrepreneurship development.

METHOD

This study adopts a qualitative comparative case study (QCCS) approach to explore the implementation and challenges of *musharakah* and MM financing in two Islamic microfinance institutions (IMFIs): BPRS Amanah Ummah Bogor, Indonesia, and the i-Taajir program under IIUM-CIMB Islamic Bank, Malaysia. The QCCS method was chosen due to its strength in analyzing complex, real-world practices while preserving the contextual uniqueness of each case (Bartlett & Vavrus, 2016; Knight, 2015).

This study is structured around horizontal and vertical case comparisons, focusing on similarities and contrasts in the institutional, legal, and operational settings of both IMFIs. This approach aligns with comparative case study strategies that emphasize place, structure, and system as organizing principles for social research (Knight, 2015).

Data were collected through interview, document analysis of institutional reports, policy documents, legal frameworks, and program implementation manuals. Where accessible, semi-structured interviews and secondary data sources were also used to enrich the analysis and capture perspectives on contract structuring, risk-sharing mechanisms, and governance models. The multi-source approach enhances credibility and internal validity (Lock & Seele, 2018).

To analyze the data, the study integrates elements of Qualitative Comparative Analysis (QCA), which allows for configurational analysis of causal relationships between multiple variables such as regulatory context, stakeholder engagement, and operational outcomes (Kane & Kahwati, 2022; El Sherif et al., 2024). QCA's ability to account for multiple conjunctural causation makes it highly suitable for examining how different conditions combine to produce successful or constrained *musharakah* applications (Thomann, 2019; Finn, 2022).

By synthesizing case-oriented reasoning with set-theoretic analysis, the research aims to provide a nuanced understanding of how Islamic equity-based financing can be adapted and scaled in diverse microfinance environments. This combination of QCCS and QCA responds to the growing call for methodological pluralism in Islamic finance and development studies (McAlearney et al., 2016).

RESULTS AND DISCUSSION

The Application of *Musharakah* Financing: Case Study of *Bank Pembiayaan Rakyat Syariah* (BPRS) Amanah Ummah Bogor, Indonesia

BPRS Amanah Ummah Bogor in brief

In Indonesia, Islamic banks can be classified into three types: Islamic commercial banks, Islamic business units of conventional banks, and Islamic financing rural banks (Otoritas Jasa Keuangan, 2025). The first category refers to a full-fledged Islamic bank, while the second one is a special division established by conventional banks to offer Islamic banking services within the conventional parent bank. The operational coverage of both types of Islamic banks is throughout the country. The last category is Islamic financing rural bank or *Bank Pembiayaan Rakyat Syariah*, abbreviated as BPRS. Unlike the first two categories, Islamic financing rural banks only operate in specific rural and urban areas, such as villages in a city or regency. It also focuses on micro, small, and medium enterprise customers. According to the Financial Service Authority of the Republic of Indonesia, the country has 13 Islamic commercial banks, 20 Islamic business units of conventional banks, and 162 Islamic financing rural banks as of June 2025 (Otoritas Jasa Keuangan, 2025).

One of Indonesia's rural Islamic financing banks that has displayed outstanding performance is BPRS Amanah Ummah, located in Leuwiliang, Bogor district, West Java province. It was established on August 8, 1992, after obtaining permission letters from the Finance Ministry and the Central Bank of Indonesia on December 19, 1991, and May 18, 1992, respectively (BPRS Amanah Ummah, n.d.). Its performance has been recognized as one of the best Islamic financing rural banks that have been able to implement professional managerial skills and, at the same time, comply with the shariah rules.

For instance, BPRS Amanah Ummah has gained national recognition for its role in advancing Islamic microfinance. In 2025, the bank was awarded the 'Best Rural Bank Sharia' by CNBC Indonesia for its innovation, financial resilience, and consistent use of sharia-compliant contracts such as *musharakah* to empower micro-entrepreneurs (CNBC Indonesia, 2025). This external validation reinforces the institution's relevance as a case study in the application of equity-based Islamic financing models.

BPRS Amanah Ummah has also received the prestigious Infobank 14th Sharia Award 2025 in October 2025, earning the Platinum Champion title in the category of BPRS with Excellent Financial Performance, along with an award for Outstanding Performance as "The Excellence Performance Sharia Financial Institution for 10 Consecutive Years." This award recognizes the commitment and consistent growth of BPRS Amanah Ummah in Indonesia's Islamic banking sector (Pratama, 2025).

To assess the recent performance of BPRS Amanah Ummah, several key financial indicators were evaluated, including Non-Performing Finance (NPF), Return on Assets (ROA), Financing to Deposit Ratio

(FDR), The Ratio of Operational Expenses to Operational Revenue (BOPO), Return on Equity (ROE), and Minimum Capital Adequacy Requirement (MCAR) as illustrated in Table 1. These indicators are essential for understanding the bank's profitability, operational efficiency, and its alignment with financial inclusion goals.

Based on the table, the NPF ratio, which reflects the quality of financing assets, shows fluctuating performance. The peak occurred in 2020 (3.74 percent) likely due to the economic slowdown during the COVID-19 pandemic. Although it improved to 2.98 percent in 2023, it rose again in 2024 to 3.63 percent, indicating a slight deterioration in financing quality, possibly linked to increased risk exposure from *musharakah* contracts. However, this score is still much lower compared to the national performance of 7.4 percent as of March 2024 and 10.36 percent as of June 2025 (Otoritas Jasa Keuangan, 2025). This can be taken as evidence that BPRS Amanah Ummah has successfully encouraged their micro, small-scale, and enterprise customers to fulfill their obligation to repay the financing.

In terms of return on assets (ROA), the bank performance shows a steady decline over the period, from 3.31 percent in 2019 to 2.39 percent in 2024, reflecting a decrease in profitability relative to total assets. This may be due to rising operational costs or increasing NPF, which affects net returns. Meanwhile, FDR measures the bank's financing efficiency relative to third-party funds. It was relatively stable above 70 percent in most years except in 2020–2021. The slight decline in 2024 may indicate cautious financing strategies in response to credit risk or liquidity management concerns. This indicates that BPRS Amanah Ummah should improve its financing portion to increase its FDR to achieve the FDR minimum standard of 78.00 percent based on the Central Bank of Indonesia Regulation Number 17/11/PBI/2015.

Table 1 Financial ratio of BPRS Amanah Ummah from 2019 to 2024

No.	Financial Ratio	2019	2020	2021	2022	2023	2024
1.	Non-Performing Financing (NPF)	2.62	3.74	2.83	3.34	2.98	3.63
2.	Return on Assets (ROA)	3.31	2.99	2.89	2.73	2.87	2.39
3.	Financing to Deposit Ratio (FDR)	73.60	66.15	67.34	73.31	73.98	71.96
4.	The Ratio of Operational Expenses to Operational Revenue (BOPO)	71.71	73.39	73.85	77.69	76.02	79.80
5.	Return on Equity (ROE)	27.87	24.10	25.67	25.81	26.13	26.50
6.	Minimum Capital Adequacy Requirement (MCAR)	26.66	19.43	21.52	21.02	20.87	18.91

Source: BPRS Amanah Ummah Financial Report, 2024.

The next bank performance indicator is the ratio of operational expenses to operational revenue (BOPO), which indicates a bank's efficiency in managing its operating costs. The lower value of BOPO indicates better efficiency of the bank. According to Table 1, the rising trend (from 71.71 percent to 79.80 percent) suggests increasing operational inefficiency. A BOPO close to or above 80 percent may indicate growing operational burdens, which could negatively affect net profit margins. However, this performance is still better than the average performance of Islamic financing rural banks at the national level, which is more than 80.00 percent (Otoritas Jasa Keuangan, 2025).

Moreover, Return on Equity (ROE) remains high and stable throughout the period, showing the bank's consistent ability to generate returns from shareholders' equity. Despite a slight dip during the pandemic, the 2024 ROE of 26.50 percent reflects strong capital productivity.

Lastly, Minimum Capital Adequacy Requirement (MCAR) is a measure of financial resilience. Although it remains above the minimum regulatory threshold (typically 8 percent to 12 percent), the declining trend from 26.66 percent in 2019 to 18.91 percent 2024 suggests that capital buffers are gradually weakening, possibly due to expansion in risk-weighted assets.

Table 2 exhibits the distribution of customers' contracts of BPRS Amanah Ummah in 2023 to 2024. It is found that the bank implemented nine different Islamic financing modes including *murabahah*, multipurpose financing, *istishna*, *musharakah*, *mudharabah*, *ijarah*, *qardh*, *qardh rahn*, and *qardh hajj*.

In both 2023 and 2024, *murabahah* remained the most dominant financing contract at BPRS Amanah Ummah in terms of both the number of customers and the total financing proportion. In 2023, it accounted for 1702 customers, representing 76.12 percent of total financing. Although the number of *murabahah* customers slightly declined to 1647 in 2024, it still comprised the largest share, albeit reduced to 69.88 percent, indicating a trend toward diversification in financing contracts.

Significantly, *musharakah* financing experienced remarkable growth. The number of customers increased from 11 in 2023 to 31 in 2024, with its financing share rising more than twofold, from 6.16 percent to 14.53 percent. This increase reflects a strategic shift toward equity-based contracts and the bank's effort to promote profit-and-loss sharing schemes in accordance with Islamic finance principles. Notably, *mudharabah* financing, another profit-sharing contract, was completely phased out in 2024, after serving just 1 customer in 2023, suggesting limited interest or operational challenges in implementing this model.

The *ijarah* contract also showed a modest increase in customer numbers, from 148 to 170, though its proportional share slightly declined from 7.65 percent to 7.54 percent, suggesting consistent but stable utilization. In contrast, multipurpose financing declined both in absolute number and share, from 22 customers (0.21 percent) in 2023 to 14 customers (0.05 percent) in 2024, possibly due to stricter eligibility criteria or reduced demand for non-productive financing.

Istishna, a contract for project-based or manufactured goods financing, maintained a stable customer base, increasing slightly from 40 to 41 customers, but its share declined from 8.01 percent to 6.63 percent, likely due to increased uptake in other contracts like *musharakah*. *Qardh*-based contracts (including *qardh*, *qardh rahn* and *qardh hajj*) collectively served a relatively small portion of customers but showed significant growth in the *qardh rahn* category, from 262 customers in 2023 to 627 in 2024, indicating rising use of gold-based collateral loans, which are generally low-risk and short-term.

Table 2 Distribution of contract to customers of BPRS Amanah Ummah Bogor in 2023-2024

No.	Contract	2023		2024	
		Number of Customers	Financing Percentage to Total Financing Amount (%)	Number of Customers	Financing Percentage to Total Financing Amount (%)
1.	<i>Murabahah</i>	1702	76.12	1647	69.88
2.	Multipurpose	22	0.21	14	0.05
3.	<i>Istishna</i>	40	8.01	41	6.63
4.	<i>Musharakah</i>	11	6.16	31	14.53
5.	<i>Mudharabah</i>	1	0.44	-	-
6.	<i>Ijarah</i>	148	7.65	170	7.54
7.	<i>Qardh</i>	2	0.07	2	0.08
8.	<i>Qardh Rahn</i>	262	1.32	627	1.27
9.	<i>Qardh Hajj</i>	2	0.01	3	0.01
Total		2554	100.00	2535	100.00

Source: BPRS Amanah Ummah Document, 2024 (unpublished institutional data).

The distribution of financing contracts between 2023 and 2024 reflects BPRS Amanah Ummah's effort to diversify its shariah-compliant financing portfolio, with a significant strategic push toward *musharakah* financing, aligned with national priorities to strengthen equity-based contracts in Islamic microfinance. The decline in *murabahah*'s proportional share, despite its continued dominance, signals a positive shift

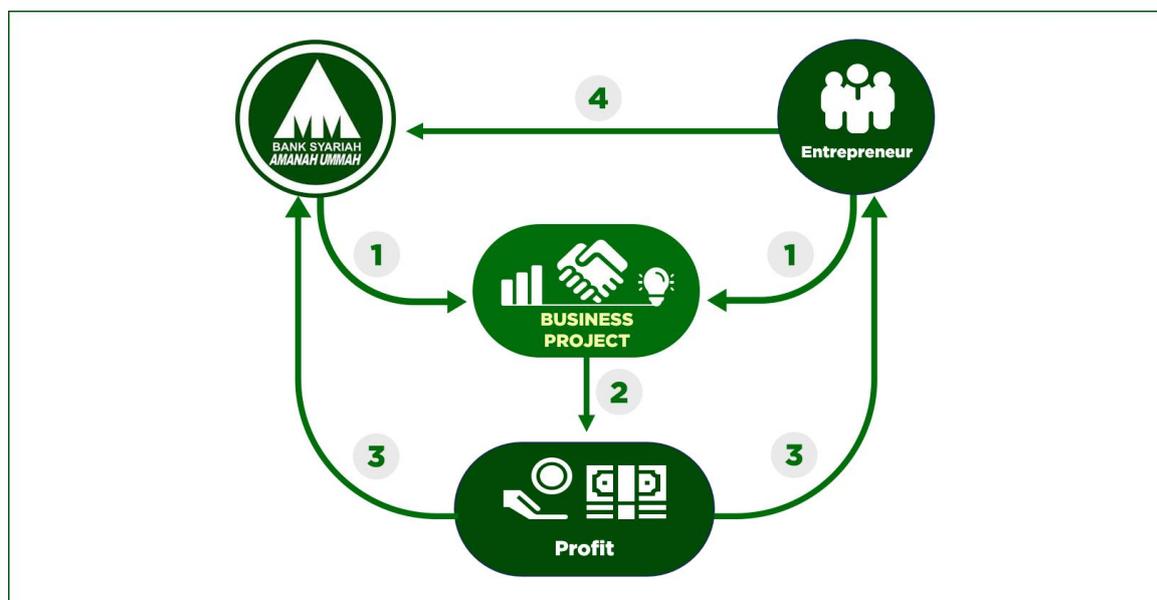
toward risk-sharing models. Furthermore, the increase in *qardh rahn* also suggests enhanced access to quick financing with collateral flexibility. These trends demonstrate the bank's responsiveness to market needs and its adaptive strategy in delivering inclusive Islamic financial services.

Musharakah financing in BPRS Amanah Ummah Bogor

In BPRS Amanah Ummah, *musharakah* financing mode is classified into two types. The first type is *musharakah* by project and the second one is regular *musharakah*. The former refers to the *musharakah* contract of business project agreement between the bank and the customer and the payment of the principal and the profit sharing are made at one time when the business project ends. The latter refers to *musharakah* contract where the payment of the principal and the profit sharing can be made monthly or bi-monthly within certain period until the contract ends. The second contract is usually suitable for the businesses which can generate profit periodically and the principal amount shared by the bank can be paid on the instalment basis. However, majority of the customers use the first type of *musharakah* contract.

Figure 1 shows the process flow of the application of the first type of *musharakah* contract in BPRS Amanah Ummah. The modus operandi of the contract are as follows.

1. BPRS Amanah Ummah and the customer agree to contribute certain amount of capital into one project. The portion of capital contribution, percentage of profit sharing or revenue sharing, time period and other conditions are incorporated into the agreement. The labor of the project is shared solely by the customer.
2. Business project is conducted within a period of time by the customer. At end of the contract, the profit generated from the business project is calculated.
3. The profit is shared between the bank and the customer based on the contract. The percentage of profit sharing varies from 80-20, 60-40, 50-50 and many more. In one hand, if the bank shared higher proportion of capital, the bank will get higher portion of profit sharing. On the other, if the customer contributed higher capital, he/she will get higher profit ratio.
4. The customer repays back the fund contribution shared by the bank at the end of the project. After sharing the profit and repaying the capital shared by the bank, the contract is concluded.



Source: Authors, 2020.

Figure 1 Process flow of *musharakah* practice in BPRS Amanah Ummah

Based on the National Shariah Board of the Indonesia Ulama Council's fatwa number 15/2000, Islamic finance or microfinance institutions can choose between profit-sharing or revenue sharing for *musharakah* contracts. In BPRS Amanah Ummah, the practice of *musharakah* uses revenue sharing. Accordingly, the revenue sharing ratio between the customer and the bank at point 1 in Figure 1 is based on mutual agreement between both parties. The value of the net revenue sharing ratio will vary between one customer and another based on several considerations, including the customer's ability, track record, experience, business efficiency, and projected profit. The types of businesses using *musharakah* financing usually include transportation projects, construction projects, restaurant projects, other Islamic microfinance or Islamic cooperatives, and many more.

Regarding the second type of *musharakah* contract, which is the regular *musharakah*, the process is similar to the first category. However, profit-sharing payments and principal repayments (points number 3 and 4 in Figure 1) are made periodically according to the contract. It also seems that the second type of *musharakah* employs the same concept of diminishing *musharakah* or MM.

Example of musharakah financing in BPRS Amanah Ummah Bogor

BPRS Amanah Ummah Bogor and one of Islamic cooperatives in Bogor agreed to have *musharakah* agreement for working capital project financing for 24 months in 11 May 2018. The following contract and calculation of *musharakah* can be found in Table 3 and Table 4, respectively.

Table 3 Sample of *musharakah* financing in BPRS Amanah Ummah Bogor

Name of Customer	:	BI Islamic Cooperative	
Name of Contract	:	<i>Musharakah</i>	
Objective of Financing	:	Working Capital	
Bank's Capital	:	IDR 2,000,000,000	10.35%
Customer's Capital	:	IDR 17,325,702,082	89.65%
Bank's Expected Profit	:	1	%
Period of Financing	:	24	Months
Contract Date	:	11-May-18	

Source: BPRS Amanah Ummah, 2018 (unpublished institutional data).

In Table 3, it is found that the capital shared by the bank is around one tenth (IDR 2,000,000,000) while the customer shared almost 90.00 percent (IDR 17,325,702,082) to the total joint venture. Therefore, the ratio of the revenue sharing follows the initial ratio of the capital sharing. The following Table 4 shows the calculation of the projection and realization of *musharakah* financing with IB Islamic cooperative. It is found that the customer will repay the principal every three months during the project amounting to IDR 250,000,000. The projection of the revenue sharing earned by the bank equals to around 10 percent to the outstanding principal. However, the realization of the revenue earned both by the bank and the customer as well as the principal instalment vary according to the business situation.

Table 4 Calculation of *musharakah* financing (projection and realization) between BPRS Amanah Ummah and IB Islamic Cooperative

No	Schedule	Outstanding	Projection of Principal Instalment	Projection of Revenue Sharing for Bank	Realization of Revenue of the Customer	Realization of Principal Instalment	Realization of Revenue Sharing for Bank	%	Accumulation	Realization of Instalment	Percentage Equivalent
		1	2	3	4	5	6	7	8	9	10
1	11 Jun 2018	2,000,000,000	-	20,000,000	2,298,663,910	-	38,387,687	192%	192%	38,387,687	1.92%
2	11 Jul 2018	2,000,000,000	-	20,000,000	1,064,232,357	-	10,642,324	53%	123%	10,642,324	0.53%
3	11 Aug 2018	2,000,000,000	25,000,000,000	20,000,000	2,420,749,839	250,000,000	22,997,123	115%	120%	272,997,123	1.15%
4	11 Sep 2018	1,750,000,000	-	17,500,000	2,215,593,158	-	17,724,745	101%	115%	17,724,745	1.01%
5	11 Oct 2018	1,750,000,000	-	17,500,000	1,993,802,732	-	15,950,422	91%	111%	15,950,422	0.91%
6	11 Nov 2018	1,750,000,000	25,000,000,000	17,500,000	2,481,854,788	250,000,000	18,862,096	108%	110%	268,862,096	1.08%
7	11 Des 2018	1,500,000,000	-	15,000,000	2,191,285,929	-	14,243,359	95%	108%	14,243,359	0.95%
8	11 Jan 2019	1,500,000,000	-	15,000,000	2,307,793,937	-	15,000,661	100%	107%	15,000,661	1.00%
9	11 Feb 2019	1,500,000,000	250,000,000	15,000,000	2,565,843,678	250,000,000	16,677,984	111%	107%	266,677,984	1.11%

Table 4 Calculation of *musharakah* financing (projection and realization) between BPRS Amanah Ummah and IB Islamic Cooperative (continued)

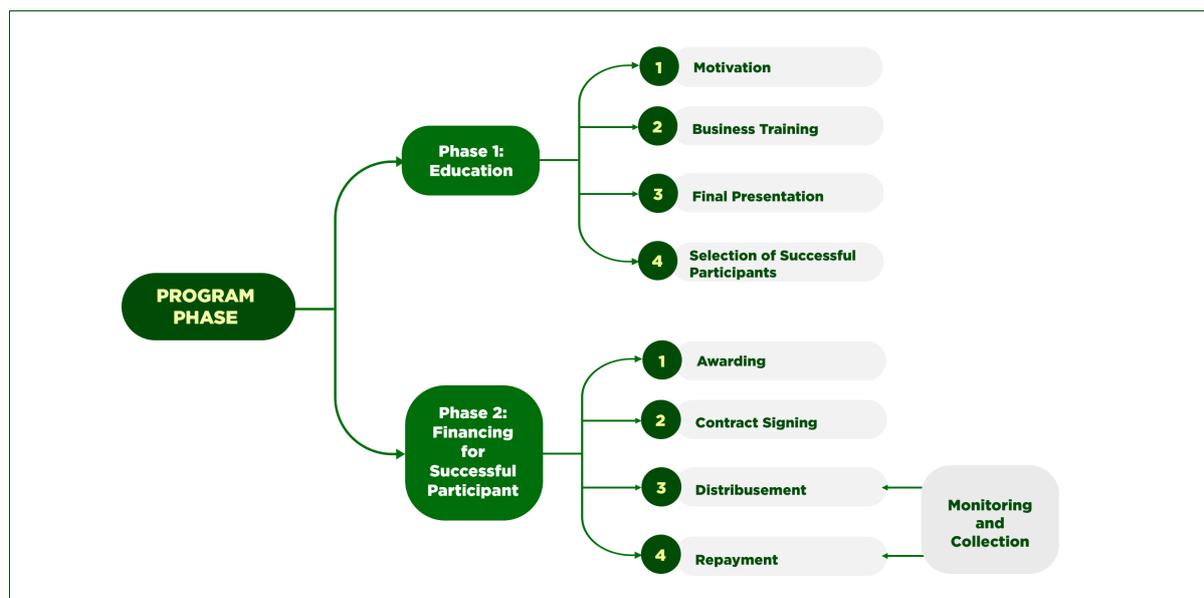
No	Schedule	Outstanding	Projection of Principal Instalment	Projection of Revenue Sharing for Bank	Realization of Revenue of the Customer	Realization of Principal Instalment	Realization of Revenue Sharing for Bank	%	Accumulation	Realization of Instalment	Percentage Equivalent
		1	2	3	4	5	6	7	8	9	10
10	11 Mar 2019	1,250,000,000	-	12,500,000	2,263,166,509	-	12,221,099	98%	106%	12,221,099	0.98%
11	11 Apr 2019	1,250,000,000	-	12,500,000	2,370,181,193	-	12,798,978	102%	106%	12,798,978	1.02%
12	11 May 2019	1,250,000,000	250,000,000	12,500,000	2,732,291,691	250,000,000	14,754,375	118%	107%	264,754,375	1.18%
13	11 Jun 2019	1,000,000,000	-	10,000,000	3,230,261,253	-	22,934,855	229%	116%	22,934,855	2.29%
14	11 Jul 2019	1,000,000,000	-	10,000,000	1,747,721,483	-	8,738,607	87%	114%	8,738,607	0.87%
15	11 Aug 2019	1,000,000,000	250,000,000	10,000,000	3,163,949,474	250,000,000	13,604,983	136%	116%	263,604,983	1.36%
16	11 Sep 2019	750,000,000	-	7,500,000	2,894,987,845	-	9,553,460	127%	117%	9,553,460	1.27%
17	11 Oct 2019	750,000,000	-	7,500,000	2,984,845,984	-	9,849,992	131%	117%	9,849,992	1.31%
18	11 Nov 2019	750,000,000	250,000,000	7,500,000	-	250,000,000	-	0%	Not Available	250,000,000	0.00%
19	11 Des 2019	500,000,000	-	5,000,000	-	-	-	0%	Not Available	-	0.00%
20	11 Jan 2020	500,000,000	-	5,000,000	-	-	-	0%	Not Available	-	0.00%
21	11 Feb 2020	500,000,000	250,000,000	5,000,000	-	250,000,000	-	0%	Not Available	250,000,000	0.00%
22	11 Mar 2020	250,000,000	-	2,500,000	-	-	-	0%	Not Available	-	0.00%
23	11 Apr 2020	250,000,000	-	2,500,000	-	-	-	0%	Not Available	-	0.00%
24	11 May 2020	250,000,000	250,000,000	2,500,000	-	250,000,000	-	0%	Not Available	250,000,000	0.00%
Average			2,000,000,000	270,000,000	40,927,255,760	2,000,000	274,942,750	-	-	2,274,942,750	1.17%

Source: BPRS Amanah Ummah, 2018 (Unpublished institutional data).

The Application of *Musharakah Mutanaqisah*: Case Study of *Program Bimbingan Usawahan Tijari* (i-Taajir) CIE IIUM-CIMB Islamic Bank, Malaysia

i-Taajir in brief

Program Bimbingan Usawahan Tijari (I-Taajir) is an entrepreneurship development program administered by the Centre of Islamic Economics (CIE) of International Islamic University Malaysia (IIUM). This relatively new program combines entrepreneurship training with Islamic microfinancing and has been conducted since April 2018. I-Taajir is a project jointly undertaken by an academic institution, CIE, in collaboration with an industry player, CIMB Islamic Bank Berhad. For CIE, i-Taajir has been a means to pragmatically implement theoretical models developed from prior research, as well as to realize the Centre's involvement in developing the economy of the surrounding communities, whereas for CIMB Islamic Bank Berhad Malaysia, it is to fulfill their Corporate Social Responsibility (CSR) commitments.



Source: Authors, 2020.

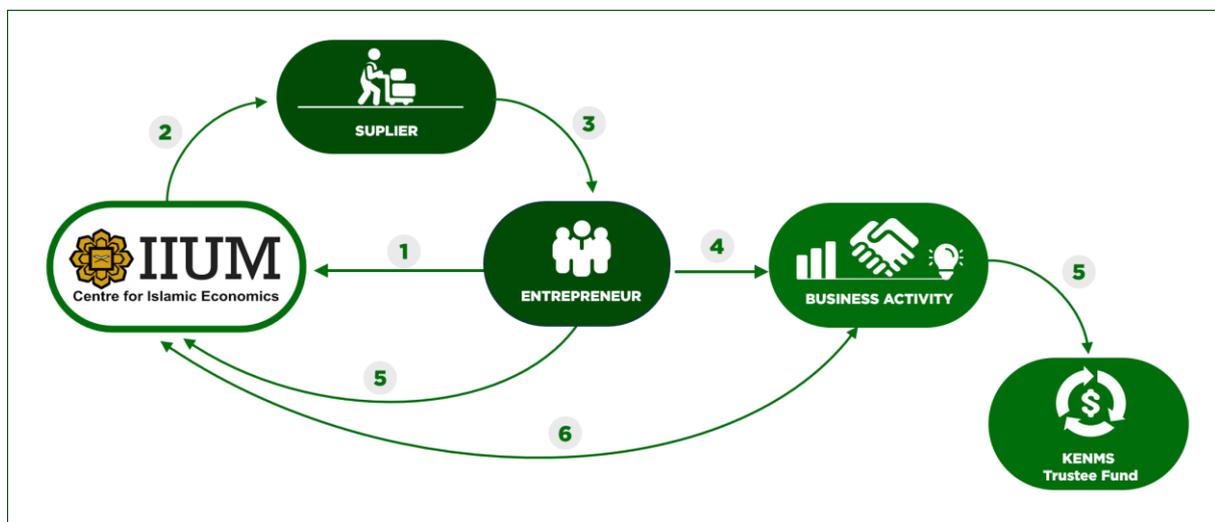
Figure 2 *Program Bimbingan Usawahan Tijari* (I-Taajir) phase

The program has three main objectives. The first objective is to provide education and training to targeted participants and students, while the second objective is to offer shariah-compliant microfinance facilities to the target group, thereby promoting equity-based financing as an effective tool for low-income groups to start their businesses. The use of an equity-based mode of financing is expected to have social impacts on the selected communities like Rumah Transit Kampung Sungai Kertas (RTSK) Batu Caves, Program Perumahan Rakyat (PPR) Kampung Baru Air Panas Setapak and Dun Sungai Kandis Selangor. In addition to targeting the surrounding communities, i-Taajir also promotes entrepreneurship among the IIUM community. The third and final objective of the program is to improve the levels of financial inclusion and the entrepreneurial spirit among the participating lower-income communities, to the point where these communities would come to appreciate equity-based financing modes as an effective, affordable and easily accessible source of financing.

The program consists of two phases, an education aspect and financing part. The Education Phase of the program is structured into five sessions involving motivation, business training, coaching workshops, business proposal presentation session and the subsequent selection of successful participants. The second phase of the program, which is the financing phase, consists of the awarding and signing of contracts for successful participants, followed by fund-disbursement and repayment. The fund-disbursement and repayment stage include monitoring and collection processes. The two phases of the program are depicted in Figure 2.

Musharakah Mutanaqisah (MM) financing in i-Taajir

This joint community project proposed four different Islamic financing modes to micro-entrepreneurs to test the viability of each mode. The four modes involved four contracts, namely, *mudharabah*, *murabahah*, *musharakah-mutanaqisah* and *qard al-hassan* contracts. Hybrid modes between two out of the four mentioned contracts are also possible. The contracts are awarded based on the amount of funds proposed by the participants, the financing objectives, and the nature of the business. In i-Taajir, MM contract is chosen for equipment or tools financing, which amounts to financing above RM5,000.



Source: Authors, 2020.

Figure 3 Process flow of *musharakah mutanaqisah* (MM) practice in i-Taajir

Figure 3 demonstrates the practice of MM in i-Taajir. Steps involved in this contract are as follows:

1. The participant identifies the tools or materials needed for the business and obtains an invoice from the supplier.
2. The participant provides 5 percent of the cost of the tools or materials, and i-Taajir provides 95 percent of the cost. I-Taajir appoints the participant as an agent to buy the tools or materials from the supplier, and they both jointly own the asset.

3. The supplier delivers the tools or materials to the participant.
4. The participant uses the tools or materials for the business activity.
5. The participant pays periodic rent and purchase of equity in separate contracts. Profit is deposited into KENMS Trustee Fund for developing future entrepreneurs.
6. The participant fully owns the asset after a symbolic sale.

One of the significant issues in MM financing is using an interest-based benchmark to calculate profit, which contradicts the shariah principle of avoiding *riba* (interest) (Asadov et al., 2018). Legal complexities arise regarding property ownership and handling defaults. Different models, such as registering the customer or the bank as the legal owner, pose challenges in enforcement and compliance (Haneef et al., 2011). Besides, it also has challenges in ensuring consistent shariah compliance and practical difficulties in operations, such as handling maintenance and insurance costs, which are often unfairly borne by customers (Asadov et al., 2018). The contract is not widely utilized due to regulatory hurdles and the complexity of its implementation. The solution is better regulatory frameworks to facilitate adoption (Alkhan, 2020).

Despite its issues, a study shows that implementing MM financing can help the community fulfill its prerequisites. The benefits of MM contracts for customers are financing with relatively longer terms and, importantly, spare parts that are more affordable (Nurhayati & Hasan, 2022). Therefore, this program attempts to practice this financing product to prove its advantage.

Example of MM financing in i-Taajir

I-Taajir and a participant named Mr. S agreed to a MM contract for tool financing for 18 months on 8 September 2019. The contract and calculation of MM can be found in Table 5 and Table 6, respectively.

Table 5 Sample of MM financing in i-Taajir

Name of Customer	:	Mr. S	
Name of Contract	:	<i>Musharakah</i>	
	:	<i>Mutanaqisah</i>	
Objective of Financing	:	Tool Financing	
Price of Tool	:	RM5,400	
i-Taajir's Initial Contribution	:	RM5,130	95.00%
Customer's Initial Contribution	:	RM270	5.00%
Monthly Rent	:	RM20	
Additional Monthly Redemption	:	RM276	
Expected Total Monthly Payment	:	RM296	
Period of Financing	:	18	Months
Contract Date	:	8-September-19	

Source: Centre for Islamic Economics IIUM, 2019 (unpublished institutional data).

Based on Table 5, it is found that the initial contribution of the customer is only 5 percent, while i-Taajir contributes the remaining 95 percent. The monthly rent is determined based on mutual agreement, where before the contract signing on 8 September 2019, the i-Taajir representative asked the participants regarding their willingness to pay for the rental of the tool. The additional monthly redemption of the tool is RM276, following the formula given by Meera and Abdul Razak (2005). Table 6 shows the calculation of MM in i-Taajir. Accordingly, the customer's ownership will be 100 percent in the eighteenth period which concludes the contract.

Table 6 Calculation of MM financing in i-Taajir

Month	Monthly Rent (RM)	Monthly Redemption (RM)	Total Payment (RM)	Participant's Ownership Ratio	Rental Division			IRR= 44%	
					Participant	I-Taajir	Participant's Equity (RM)	I-Taajir's Equity (RM)	I-Taajir's Cashflow (RM)
	A	B	C = A + B	D	E	F	G	H	I
0							270.00	5130.00	(5130.00)
1	20	276	296	0.05000	1.00	19.00	547.00	4853.00	296
2	20	276	296	0.10130	2.03	17.97	825.03	4574.97	296
3	20	276	296	0.15278	3.06	16.94	1104.08	4295.92	296
4	20	276	296	0.20446	4.09	15.91	1384.17	4015.83	296
5	20	276	296	0.25633	5.13	14.87	1665.30	3734.70	296
6	20	276	296	0.30839	6.17	13.83	1947.47	3452.53	296
7	20	276	296	0.36064	7.21	12.79	2230.68	3169.32	296
8	20	276	296	0.41309	8.26	11.74	2514.94	2885.06	296
9	20	276	296	0.46573	9.31	10.69	2800.25	2599.75	296
10	20	276	296	0.51857	10.37	9.63	3086.63	2313.37	296
11	20	276	296	0.57160	11.43	8.57	3374.06	2025.94	296
12	20	276	296	0.62483	12.50	7.50	3662.55	1737.45	296
13	20	276	296	0.67825	13.57	6.43	3952.12	1447.88	296
14	20	276	296	0.73187	14.64	5.36	4242.76	1157.24	296
15	20	276	296	0.78570	15.71	4.29	4534.47	865.53	296
16	20	276	296	0.83972	16.79	3.21	4827.26	572.74	296
17	20	276	296	0.89394	17.88	2.12	5121.14	278.86	296
18	20	276	296	0.94836	18.97	1.03	5416.11	-16.11	296
19	20	276	296	1.00298	20.06	-0.06	5712.17	-312.17	296

Source: Centre for Islamic Economics IIUM, 2019 (unpublished institutional data).

Prospects and Challenges

From the two case studies presented above, it can be concluded that *musharakah* and MM contracts have promising prospects to be used as financing instruments by Islamic microfinance institutions. Based on the observation and the interview conducted by the authors, some of the positive aspects of *musharakah* and MM contracts are summarized as follows.

1. In partnership contract, each partner contributes capital or fund to be used in productive activities. This shows that *musharakah* contract enables entrepreneurs to develop or expand their businesses.
2. In addition to capital, each partner who participates in *musharakah* contract can also contribute his/her expertise. This contribution includes technical skills, business supervising activities, and business consultancy provision which could make the business to prosper.
3. In MM, the contract allows customers to contribute a minimum amount of funds to acquire assets. For example, in the case of i-Taajir, with only 5 percent of the capital contribution, the participant can acquire the necessary tools to start a business.
4. The *musharakah* contract reflects the spirit of sharing encouraged in Islam.

However, the institutions also face challenges when implementing the contracts of *musharakah* and MM. These are:

1. The risk involved, i.e., profit and loss sharing, invites moral hazard from the customers' perspective. For instance, for the customers who earned high profits, there are cases where they

did not disclose the realization of the actual profit to avoid sharing higher profits with the financier.

2. Not many people are aware of this type of contract and they are only aware of *murabahah* contract, which is debt-based contract. There seems to be negative perception among the participants or customers on the *musharakah* and MM contracts.
3. There exists a mismatch between the source of funds and their utilization. The majority of the sources of funds are short-term, whereas financing usually takes a longer time period.
4. Customers with high-profit projection profiles usually prefer a mark-up-based contract like *murabahah* to a partnership contract like *musharakah*. According to the customers, the *murabahah* contract is relatively simpler and cheaper than the partnership contract.
5. There is a moral hazard problem in *musharakah* financing. Some customers make overly optimistic business projections to convince the institution. Regarding realization, the bank should bear this type of risk.
6. In terms of legal documentation and related issues, according to Subky et al. (2017), the challenges of MM in practice are issues of *wa'ad* (purchase undertaking), enforceability of *wa'ad*, stipulating *wa'ad* during default and issue on risk sharing. Besides, the challenge also occurs in the documentation cost.

CONCLUSION

Musharakah is generally believed to be one of the ideal Islamic financing contracts as it reflects the spirit of cooperation, partnership, and profit and loss sharing. The practice of this contract in Islamic microfinance is still limited compared to markup-based contracts. At the practical level, the prospects of both *musharakah* and MM can allow customers or participants with a minimum capital to run their businesses with the spirit of profit and loss sharing. However, moral hazard and customers' awareness and understanding on *musharakah* and MM are among the challenges faced by these partnership contracts. Therefore, this study recommends several solutions that should be implemented to improve the practice of both contracts. These are:

1. Customers should be educated and socialized about both *musharakah* and MM to give them a proper understanding of the contracts. The synergy between academicians and practitioners can provide effective education and socialization offline and online.
2. Improve the capability of Islamic microfinance officers to identify customers' financial profiles related to the business. This can help the institution reduce moral hazard.
3. Identification of the potential industry to be financed using partnership contract.
4. Information gathering from trusted third party regarding the character of the customers.
5. Continuous and direct supervision from the Islamic microfinance institutions. At the same time, Islamic microfinance institutions should be willing to provide business consultancy based on the needs of the customers.

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