



CHALLENGES AND PROSPECTS OF ISLAMIC
AGRICULTURE FINANCE; A CASE STUDY OF
AGROBANK MALAYSIA

BY

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ABSTRACT

In the recent decades, Islamic finance has set a firm foundation and exhibit remarkable growth in the financial industry around the world. Both developed and developing countries have implemented and accepted it to be a part of their financial system. Islamic finance have developed itself into different areas of financing such as housing, transportation, manufacturing and other real sectors that have a significant affluence on the economy and social activities. Islam has put forth the importance of agriculture to the entire humanity right from the beginning. Islamic history has also witnessed different developing phases and revolutionary repercussions in the agriculture sector that has swayed the Islamic world and other secular agrarian systems. The Food security of a country depends on its Agriculture sector. Past records show that Malaysia, which is currently known to be the hub of Islamic Finance is facing serious threat in its food security and is undergoing unstable production of domestic food crops. From the composite view of Islamic Finance and Agriculture sector, the latter is unnoticed and is marginalized by the former. The principle objective of this research is to identify the challenges and prospects of Islamic Agriculture finance based on an organizational study on AgroBank, the sole agriculture bank in Malaysia that aims to transform into a full-fledged Islamic bank by 2015. A qualitative research methodology is applied to collect data from selected top management executives of AgroBank and academicians of Islamic Finance. The research findings shows that the bank has an opportunity to introduce new Islamic financing products and the core challenges related to it are upholding *Shari'ah* compliancy and mitigating various risks through new financing instruments. Being incorporated as a government linked company is the main growth prospect for the bank to transform into a new system besides large human capital and widespread branches around the country. This study is expected to raise heed on Islamic agriculture finance and add a standard value to the existing literature.

ملخص البحث

في العقود الأخيرة ، وضع التمويل الإسلامي أساسا متينا و أظهر نموا ملحوظا في القطاع المالي في جميع أنحاء العالم . كثير من البلدان المتقدمة وكذلك النامية قد نفذت وقبلت ان يكون التمويل الإسلامي جزءا من نظامها المالي . لذلك طور التمويل الإسلامي نفسه في مجالات مختلفة مثل الإسكان ، والنقل ، والتصنيع ، والقطاعات الفعلية الأخرى والتي تعزز و تؤثر بشكل كبير على الأنشطة الاقتصادية والاجتماعية على نحو متساو . طرح الإسلام أهمية الزراعة كحق للبشرية كلها من بداية عصر التشريع . وقد شهد التاريخ الإسلامي مراحل تطوير مختلفة وثورات تحسينية متعددة في قطاع الزراعة والتي أثرت بشكل مباشر على النظم الزراعية في العالم الإسلامي والدول العلمانية الأخرى . الأمن الغذائي لأي بلد يعتمد على قطاعه الزراعي . السجلات السابقة تظهر أن ماليزيا والتي تعرف حاليا بمحور الإقتصاد الإسلامي ، تواجه الآن تهديدا كبيرا يتعلق بأمنها الغذائي والإنتاج غير المستقر للمحاصيل الغذائية المحلية . من وجهة نظر عامة للتمويل الإسلامي وعلى وجه الخصوص القطاع الزراعي لم يجدا الإهتمام وقد همش القطاع الزراعي سابقا بشكل أكثر تأثيرا . إن الهدف الرئيس من هذا البحث هو التعرف على تحديات و آفاق التمويل الزراعي الإسلامي ؛ وذلك بناء على دراسة تنظيمية للبنك الزراعي الماليزي (AgroBank). حيث انه البنك الزراعي الوحيد في ماليزيا الذي يسعى للتحويل الى النظام المصرفي الإسلامي الكامل بحلول عام 2015 . تم تطبيق منهجية البحث النوعي لجمع البيانات من كبار المدراء التنفيذيين المختارين للبنك الزراعي ، والأكاديميين من قطاع التمويل الإسلامي . وقد أوضحت نتائج البحث الفرصة أمام البنك لتقدم منتجات تمويل إسلامية جديدة ، والتحديات الأساسية المتصلة بها مع المحافظة على التوافق مع أحكام الشريعة الإسلامية وتخفيف المخاطر المتعددة من خلال تمويل جديدة . العمل على إدراج البنك الزراعي الماليزي ضمن قائمة الشركات الحكومية يعد من آفاق النمو الرئيس للبنك للتحويل إلى نظام جديد . إلى جانب وجود رأس مال بشري كبير وفروع منتشرة للبنك في أنحاء البلد . فمن المتوقع أن ترفع هذه الدراسة من إهتمام البنك الزراعي (AgroBank) بالتمويل الزراعي الإسلامي ، وأن تضيف قيمة معيارية إلى مكتبة التمويل الزراعي الإسلامي .

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to the acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.

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Supervisor

This research paper was submitted to IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science in Islamic Banking and Finance.

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DECLARATION

I hereby declare that this Research Paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Abdul Kadar Thayath Puthiya Purayil

Signature

Date

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**CHALLENGES AND PROSPECTS OF ISLAMIC AGRICULTURE
FINANCE: A CASE STUDY OF
AGROBANK MALAYSIA**

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*I hereby dedicate this Research Paper to my beloved Parents and to the loving
memory of my friend Irshad.*

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TABLE OF CONTENTS

| | |
|---|-----------|
| Abstract..... | ii |
| Abstract in Arabic..... | iii |
| Approval Page..... | iv |
| Declaration..... | v |
| Copyright Page..... | vi |
| Dedication..... | vii |
| Acknowledgement..... | viii |
| List of Tables..... | xii |
| List of Figures..... | xiii |
| List of Abbreviations..... | xiv |
| | |
| CHAPTER ONE: INTRODUCTION..... | 1 |
| 1.1 Background of the Study..... | 2 |
| 1.2 Research Objectives..... | 6 |
| 1.3 Research Problems..... | 6 |
| 1.4 Significance of the study..... | 7 |
| 1.5 Organization of the study..... | 8 |
| | |
| CHAPTER TWO: LITERATURE REVIEW..... | 11 |
| 2.1 Islamic Banking and Finance..... | 11 |
| 2.2 Islam and Agriculture..... | 13 |
| 2.2.1 Arab Agricultural Revolution..... | 17 |
| 2.3 Agriculture Financing..... | 18 |
| 2.4 Islamic Agriculture Finance..... | 21 |
| 2.4.1 Islamic Modes of Agriculture Finance..... | 22 |
| 2.5 Agriculture in Malaysia..... | 24 |
| 2.5.1 New Economic and National Agriculture Policies..... | 26 |
| 2.6 Agro Bank Malaysia..... | 27 |
| 2.6.1 History of ABM..... | 28 |
| 2.7 ABM: Islamic Banking and Finance..... | 29 |
| 2.7.1 Products and services offered by ABM..... | 30 |
| 2.7.2 Management Structure of ABM..... | 33 |
| 2.8 Summary..... | 34 |
| | |
| CHAPTER THREE: RESEARCH METHODOLOGY..... | 36 |
| 3.1 Research Type..... | 36 |
| 3.2 Data Collection Method..... | 37 |
| 3.2.1 Primary Data..... | 37 |
| 3.2.2 Secondary Data..... | 39 |
| 3.3 Research Instruments..... | 40 |
| 3.4 Data Collection..... | 41 |
| 3.5 Contents Analysis..... | 43 |
| 3.6 Limitation of the study..... | 45 |
| 3.7 Summary..... | 46 |

| | |
|--|-----------|
| CHAPTER FOUR: DATA ANALYSIS AND FINDINGS | 47 |
| 4.1 Theme 1 : Challenges | 47 |
| 4.1.1 Islamic Finance..... | 47 |
| 4.1.2 Agro Bank: Transformation | 49 |
| 4.1.3 Islamic Agriculture Finance | 50 |
| 4.1.3.1 Access of Funds | 51 |
| 4.1.3.2 Human Resources | 51 |
| 4.1.3.3 Role of Intermediaries | 52 |
| 4.1.3.4 Informal Financing Institutions | 52 |
| 4.2 Theme 2 : Role of Government..... | 53 |
| 4.2.1 Subsidies and Tax..... | 55 |
| 4.2.2 Domestic and Cash Crops | 56 |
| 4.2.3 Agriculture Policies | 57 |
| 4.3 Theme 3 : Products and Services | 58 |
| 4.3.1 Core Islamic Products and Concepts | 59 |
| 4.3.2 Risk Mechanisms..... | 60 |
| 4.3.3 Inventive Products | 61 |
| 4.4 Theme 4: Shari‘ah Perspective..... | 63 |
| 4.4.1 Malaysian Outlook..... | 63 |
| 4.5 Theme 5 : Prospects..... | 64 |
| 4.5.1 Role of Cooperatives..... | 65 |
| 4.5.2 Employment and Training..... | 66 |
| 4.5.3 Agro Based Education | 67 |
| 4.5.4 Takaful Benefits (Islamic Insurance)..... | 68 |
| 4.6 Summary..... | 69 |
| | |
| CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS | 70 |
| 5.1 General Discussions..... | 70 |
| 5.1.1 The Transformation | 71 |
| 5.1.2 Government Support..... | 71 |
| 5.1.3 Knowledge and Awareness | 72 |
| 5.2 Recommendations | 72 |
| 5.2.1 Mobilization of Funds..... | 73 |
| 5.2.2 Takaful – Islamic Insurance | 75 |
| 5.3 Future Research..... | 75 |
| 5.4 Summary..... | 76 |
| | |
| BIBLIOGRAPHY..... | 77 |
| | |
| APPENDIX A | 82 |
| APPENDIX B..... | 83 |

LIST OF TABLES

| <u>Table No.</u> | | <u>Page No.</u> |
|------------------|---|-----------------|
| 2.1 | National Agriculture Policies | 26 |
| 2.2 | AgroBank Malaysia, Products and services | 31 |
| 3.1 | Research Instrument Structure | 39 |
| 3.2 | Interview Summary (AgroBank) | 42 |
| 3.3 | Interview Summary (Academicians) | 42 |
| 3.4 | Data Analysis Themes | 45 |
| 4.1 | GDP Growth by Economic Activity, Malaysia | 58 |

LIST OF FIGURES

| <u>Figure No.</u> | | <u>Page No.</u> |
|-------------------|---|-----------------|
| 2.1 | Malaysian agriculture value added (GDP rate) | 25 |
| 2.2 | Loan and Deposit performance AgroBank, 2009 | 30 |
| 2.3 | Top level Management, AgroBank | 34 |
| 3.1 | The process and relationship of Qualitative Data Analysis | 43 |
| 4.1 | Islamic Finance growth phase 1 | 49 |
| 4.2 | Islamic Finance growth phase 2 | 49 |
| 4.3 | Government grants and approvals | 54 |
| 4.4 | Government grants and approvals- Name List | 55 |
| 4.5 | AgroBank Product concept rating | 59 |
| 4.6 | AgroBank Risk Governance structure | 61 |
| 4.7 | Malaysia Islamic Financing concepts | 63 |
| 4.8 | Principal statistics of graduates in the labour force, Malaysia, 2010 | 68 |

LIST OF ABBREVIATIONS

| | |
|---------------|---|
| ABM | : AgroBank Malaysia |
| BPM | : Bank Pertanian Malaysia |
| BNM | : Bank Negara Malaysia |
| BBA | : Bay' Bithaman al-Ajil |
| BSPF | : Bangladesh Social Peace Foundation |
| FOMCA | : Federation of Malaysian Consumer Association. |
| FELDA | : Federal Land Development Authority |
| FELCRA | : Federal Land Consolidation and Rehabilitation Authority |
| FAO | : Food and Agriculture Organization |
| GLC | : Government-Linked Company |
| GDP | : Gross Domestic Product |
| HPC | : High Performance Culture |
| IAF | : Islamic Agriculture Financing |
| ISRA | : Islamic Shari'ah Research Academy |
| IDB | : Islamic Development Bank |
| IBD | : Islamic Banking Department |
| IRTI | : Islamic Research and Training Institute. |

CHAPTER ONE

INTRODUCTION

The current method of engaging and considering conventional products, changing and altering them into Shari'ah compliant products and services have become an accepted process in the rapidly expanding Islamic Finance within the International financial system. Dr. Zeti Akthar Aziz¹ comments that it does not work on a secluded basis, but rather act as a significant part of the whole financial system. It has being more than three decades Malaysia is known to be in the growing phase of industrialization at a global level, but this growth has gradually weakened and destabilized the agriculture sector of the country. Studies reveal that the country's capabilities to produce domestic food products are decreasing annually.

One of the main dimensions that are not given due consideration and concern is the products and services. The research focuses on the current challenges and prospects of agricultural products and services that are promoted through Islamic modes of financing around the globe. Presently, Malaysia is also known to be one of the main hub for Islamic finance. To put more credibility, the research explores a case study of Agro Bank, Malaysia (ABM), a bank that is incorporated under the government to develop and assist agricultural projects and sectors of the country. Recently ABM has taken an approach in transforming its organizational system to Islamic banking and financing. This research also aims at identifying potential challenges and prospects in ABM's agricultural financing and products through this major transformation.

¹ Current Governor of Bank Negara, Malaysia.

1.1 BACKGROUND OF THE STUDY

Islamic finance is projecting in noticeable fields like housing, transportation, manufacturing, agriculture and many other sectors, making a bridge between the financial and real sector of the economy comprising a genuine exchange of goods and services for better prospects and ease the financial needs of individuals and commercial institutions. In the not so distant past this was only a dream when like any other religion, investments and other financial obligations in Islam was considered to be only for religious Institutions, mosques and charities. But now in this modern era of 21st century, there has been a surge in confidence and certainty on the objectivity and the fortune that can be achieved through a financial system under one of the fastest growing religion in the world. According to a research by one of the international audit firm in 2013, Islamic finance is growing at an annual growth rate of 40% per year. This growth rate clearly indicates its quicker adaptability and compliance throughout the world. There are more than 600 Islamic financial institutions over 75 countries, with an overall asset valued more than 3.0 trillion dollars, including conventional institutions and non-Muslim countries making it an integral part of their financial system (²GIFF 2012).

Survival of Human life depends on production and consumption of edible food and this is an issue of food security that is tied to the ecosystem as a whole at the new level of liberalization and globalization that is sweeping the globe. Financing agriculture has become a crucial decision in protecting, developing and administering the food security of any country as it upholds a distinct position from any other sector of an economy. Since past four decades, the rural economy is directly linked to the national economy whereby facing the same economic risks and conditions as another

² Global Islamic Finance forum.

business are encountered. The same was echoed by Hughes (1986) and commented this was due to the influence of national economic policies and the role of financial institutions in providing loan and other financing facilities to this sector.

Religions too did not shy away from addressing the importance of food to human survival. In the Noble Qur'an there are many verses where in greater emphasis is placed for agriculture providing the essential link to the existing agriculture of periodical change and an efficient system in farm management (Hamid, 2008). Thus it is evidently clear from the reading of the Noble Qur'an that there are chapters describing the various stages of agriculture commands from fertilization, seed germination, conditions of soil and storage of grains. Likewise Qur'an mentions crops and vegetables by names such as Cucumber, Onion, Pulse, Grape, Olive, Pomegranate and Dates.

Allah ﷻ says [AL Qur'an, Al- Nahl 16:54-55]

“He it is Who sends down water (rain) from the sky; from it you drink and from it (grows) the vegetation on which you send your cattle to pasture”;

“With it He causes to grow for you the crops, the olives, the date-palms, the grapes, and every kind of fruit. Verily! In this is indeed an evident proof and a manifest sign for people who give thought.”

Even the Prophet ﷺ is reported to have encouraged farming and cultivation, which will be explained later in the section on the objectivity of this research. In fact the Prophet ﷺ nay even all the prophets were shepherds in their own lifetime. In this respect the Prophet ﷺ is reported to have said:

Narrated by Anas bin Malik ﷺ : Allah's ﷻ Apostle ﷺ said, "There is none amongst the Muslims who plants a tree or sows seeds, and then a bird, or a person or an animal eats from it, but is regarded as a charitable gift for him." (Sahih Al-Bukhari, Volume 3, Book 39, No. 513) ﷺ

One of the main pillars of Islam is to pay Zakah, an obligatory charity payment to eight categories of persons mentioned in the Noble Quran including poor and needy by those who has means to pay it. Islam necessitates Zakah to be paid on agriculture produce and livestock's including cows, sheep and camels.

Salim bin 'Abdullah رضي الله عنه narrated from his father that Allah's ﷺ Apostle ﷺ said, "On a land irrigated by rain water or by natural water channels or if the land is wet due to a nearby water channel Ushr (i.e. one-tenth) is compulsory (as Zakat); and on the land irrigated by the well, half of an Ushr (i.e. one-twentieth) is compulsory (as Zakat on the yield of the land)." (Sahih Al-Bukhari, Vol.2, Book 24, No. 560)

Maria and Radu (2008) observe that the rate of economic movement is also affected and stimulated by proper financing and producing of agricultural goods and services in a country. Interest, Uncertainty and Gambling are the three main prohibited elements mentioned under Islamic laws that will harm the economic and social stability of any system. Financing the agriculture through Islamic modes is intended to prevent these prohibited elements so it is imperative to abide by other Islamic commercial and Jurisprudential principles in Islam.

Islamic finance has proven positive outcomes by accessing itself into the mainstream financial system of many economies in the world. Iran, Pakistan and Sudan have completely converted themselves into Islamic financial system by implementing and executing Islamic modes of agriculture financing to be part of their development for the rural sector. (Sadr, et.al. n.d) in their study on estimating the impact of agriculture finance in Iran finds positive significant values added to the country's agriculture sector through Islamic financial tools and instruments. Elhiraika (2003) his study on the experience of Islamic agriculture finance in Sudan, gives concluding remarks on the role of government, cooperatives societies and development of rural sector through financing products offered by Islamic finance. In

Pakistan, the Islamic mode of *Bay' l Salam* financing has been used widely and proved to be the core part of developmental area in financing agriculture.

The past two decades Malaysia has been importing tons of basic consumer agri-products like rice and maize thereby raising the threat on the food security of the country. “The Malaysian agriculture sector has moved towards privatization, commercialization and is market-driven” (T.Indrani, n.d). A comparative analysis of the past records clearly exhibits the changing nature of agricultural yields of the country into commercial crops. This trend shows changing of essential crops to cash crops, which is deemed better for globalization and open economy, but in the long term it will bring an ill effect on the domestic produce and consumer side of the country. It can boost economic prospects for this sector, but the most affected segment will be the farmers and planters relating to government agricultural investments on domestic and local products.

The investors and financiers are placing their interests on these cash crops leading to the country's dependence on third world consumer crops that are importing food from other countries. “Malaysia's dependency on food imports has increased the cost of food in the daily lives of Malaysians” (Ibid). Siwar and Hossain (n.d) explain that such situation can lead to disparity among farmers and they can be driven away from the market by these commercial products being circulated or concentrated among few hands. Introducing strategic plans and policies by Malaysian government in the past few decades is a hint for better prospect for this sector. O'toole et.a, (2013) conclude in their recent study on financial constraints on agricultural Investments in Ireland that the government policies on agriculture credit financing implemented through banks have higher impact and aiding on this sector without the direct state interference over them.

1.2 RESEARCH OBJECTIVES:

The objective of this research is to identify the main challenges and prospects for the future development of Islamic agriculture financing (IAF) in general, taking ABM as a case study, since it is the only the major agriculture bank in the country with decades of practice and experience in respect of its aim in providing Islamic agricultural modes and products of financing to this sector. The objectives of this study are:

- i To explore and discuss the major participants and their contribution in Islamic Agricultural Products and Financing around the globe.
- ii To critically investigate and highlight the significant factors and features of Islamic agriculture finance from those of Primary and secondary Data's collected.
- iii To evaluate the present status and role of ABM with respect to its challenges and prospects in Malaysian agricultural sector through from Islamic banking products and financial service point of view.
- iv To recommend some idea and concept on the basis of this micro level study for the betterment of IAF.

1.3 RESEARCH PROBLEMS

Islamic finance aims at removing a system of interest that has always burdened any financial user especially the agriculture sector including the planters and the farmers. Islamic agricultural banks have to adopt designs and projects complying with Islamic law for the development of financing the agricultural sector so as to establish a justice and equality among financial users. The following research problems can help lead us the way to explore more on this matter:

- i What are the products and service that are offered by an Islamic bank relating to agriculture sector?
- ii What are the lessons that can be learned from current Islamic Agriculture products offered by other banks around the world?
- iii How can ABM deal with its challenges in meeting the needs of the Malaysian agriculture sector through this major transformation from its current services?
- iv How effective is Islamic agriculture financing in comparison to other Islamic commercial banking services in respect of concepts and ideas?

Solutions to these questions would help us achieve the objectives of this research.

1.4 SIGNIFICANCE OF THE STUDY

This research will certainly bring great significance and implication on many of the following researchers and Institutions.

i Formal and Informal Agro-Finance Institutions

The research will provide an insight into the present and potential financiers including banks and other informal institutions planning to expand their Islamic financing products and services to invest and develop the agriculture sector of the country. While setting the study to a particular organization, it helps to be an upright example for others in the same ground by identifying the challenges and prospects as a case study.

ii Malaysian Government Linked companies

The research may support the existing references for the government in supporting the current Islamic financial system by improving the rural side of the economy, agricultural sector and promote more awareness about the current and future state of the country's economy.

iii Agriculture Sector: The research can help the farmers and other customers in agriculture sector to understand the prospects of Islamic finance, its significance in Malaysian rural sector and its positive impact on the growing demand for financial assistance from this sector.

iv Academician/Researchers: The research can bring insight and assist prospective researchers and others in the academic field as a reference for future research.

1.5 ORGANIZATION OF THE STUDY

This research is organized into the following five chapters. From the beginning to the end, all the chapters exhibit the perception and sensitivity attached to the research topic based on logical flow of the research process. The following are the explanation of this study plan:

Chapter One: Introduction

This chapter provides an outline of research direction. Thus it covers background study, objectives, the problem statement and the significance of the study. It also gives an overall structure of the research.

Chapter Two: Literature Review

This chapter provides a critical review on the available literature surrounding the subject matter of this research. These are the previous texts, studies and researches that gives a comprehensive understanding on different matters linked to the main topic of this study. The Literature review begins from the current Islamic Financial system followed by agriculture and its significant relation with Islam. It comprise of available conclusive studies on agriculture finance and different Islamic modes of funding and investment in agriculture sector. As an exclusive organizational study, detailed information on ABM, its establishment and background status in Malaysia is highlighted in the ending part of this chapter.

Chapter Three: Research Methodology

This chapter will give a brief idea and explanation on the methodologies and approach used in collecting information for this research. Data collection is done through both primary and secondary sources. The research instruments extend from emails, telephone, questionnaires and structured personal interviews. Primary sources includes

- a. Questionnaire including Close-ended Questions open to comments and remarks
- b. Interviewing academicians who can contribute ideas and recommendations withstanding the objectivity of this study

Secondary Sources includes past statistical records, charts and relevant researches around the globe with regard to the Agriculture finance together with Islamic financing modules that support the primary data and sources.

Chapter Four: Analysis, Findings ad Interpretation.

This chapter will analyze all the data thus collected from both primary and secondary sources. This will help in getting a better idea and understanding on the challenges, prospects and products and services provided under IAF services and an insight to current Malaysian agricultural sector.

Chapter Five: Conclusion and Recommendations

The chapter includes conclusion and the researcher's recommendation relating to the study and implementing a similar study in another developing country. The chapter also looks into other proposed purposes and concepts that bring more credibility to this study from the analysis and findings in achieving the objective with the hope of contributing to the future course of this relevant field.

CHAPTER TWO

LITERATURE REVIEW

This chapter gives a review and general idea concerning literature pertaining to about Islamic financing, its various aspects especially relating to agricultural financial modes and techniques. Thus it also covers the significant agriculture finance from the perspective economy by outlining it from Islamic and rural financing viewpoints. In studying the literature this research also lays out a comprehensive briefing on the origin of Agro Bank Malaysia, its agriculture product structure, visions and the general framework on Islamic finance in Malaysia from all the available sources and data.

2.1 ISLAMIC BANKING AND FINANCE

Since the inception of Islamic banking and finance, the purpose behind its emergence globally in the financial sector is allied with the objectives and principles of Islamic law. It tends to keep a balanced pace with economic activities that are linked with various community welfare platforms as declared in the religion of Islam (Chapra, 1985, as cited in Kabir Hassan and Mervyn K. Lewis, 2007). Growing at a faster pace, Islamic finance has distinguished itself from the conventional financial system in its professional disciplines and societal outlook. For instance, Dr. Muhammad Hanif in his article “Differences and Similarities in Islamic and Conventional Banking” points out that in Islamic financing there is no system of lending through cash or interest, only asset financing or sharing of profit and loss, no credit is granted