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The Use of Mudarabah – Islamic Business Finance as a Practical Means of Economic Empowerment.

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Introduction.

The term Mudarabah according to Muhammad Sharif Chaudhry (2003) is seen as a special kind of business partnership where one partner gives money to another for investing it in a commercial enterprise. This investment comes from the first partner who is called “rabbul mal” while the management and work is an exclusive responsibility of the other, who is called “mudarib”.

Objectives of the Study.

The study will delve into the meaning and concept of Mudarabah, its features, types, and conditions guiding its operation, rights and limitations of the parties concerned. It will also look at the advantages of Mudarabah and how it can be used to practically and gainfully empower the people.

Definition of Mudarabah.

Muhammad Nejatullah Siddiqi (2005), defines Mudarabah as a contract in which one party; the owner (Rabbul-Mal) provides capital while the other party (Darib) provides labour and effort on the basis of a profit sharing in some pre-determined proportions.

According to Muhammad Sharif Chaudhry (2003), this type of contract i.e Mudarabah is also referred to as Qirad and Muqaradah in Islamic jurisprudence.

Research Questions.

This study will attempt to answer the following questions which have been asked to serve as guides and focus for the research:

1. What is the effect of interest on the economic life of the people?
2. What is responsible for high rate of unemployment in any society?
3. What factors are responsible for the richness of few individuals?
4. What is the attitude of the rich towards industrialization?
5. Which one brings more income, interests on savings or profits made on business transactions?

Certain assumptions have been made which have been put in null hypotheses form:

1. Interest is not responsible for idleness of money and people in our society.
2. Interest does not have significant influence on unemployment and lack of jobs in any society.
3. Interest is not a responsible phenomenon for circulation of wealth among a few individuals.
4. Interest has no causal effect on inflation and hike in prices of commodities.
5. There is no significant higher income return on business transactions as on interest.

Islamic Concept of Mudarabah.

Mudarabah has its legal backings from Sha'ria as stipulated in the Qur'an, Sunnah and the practice of Sahabah.

*He knows that there may be some among
you in ill-health, others traveling through
the land, seeking of Allah's bounty, yet*

others fighting in Allah's cause. (Al-Qur'an, An Nissai 4: 101).

Ibn Kathir explains this verse to cover those who may have legal excuses not to observe obligatory prayers like the sick, traveler in search of lawful livelihood and those involved in jihad. (Ibn Kathir Vol.4 p.439). He sees traveling through the earth for bounty of Allah as making Mudarabah permissible because it involves *Amil* i.e. another party to travel far and wide in the cause of investing capital which is tantamount to seeking the bounty of Allah and lawful livelihood.

Also, Abdullahi Ibn Abbas was reported to have narrated that his father Al-Abbas Ibn AbdulMuttalib used to give his money to other persons by way of Mudarabah under certain conditions that the *Amil* i.e other party should not travel by sea with the capital of Mudarabah, not to cross any valley and not to buy animal with it, otherwise he will be personally liable for whatever happened to the capital. These conditions were brought to the Holy Prophet who approved them. (Al-Kasani Vol.6 p7a).

Imam Malik also narrated that the third Khalifah Uthman bn Affan gave his money on the basis of Qirad contract to share the profit between him and other contracting party. (Imam Maliki, Muwatta p.312).

The Holy Prophet in the early part of his life acted as an agent in Mudarabah contract with an investment provided by Khadijah. This practice Islam later approved with some modifications. Islam supports the involvement of one who has the knowledge of business acumen but lacks money to go into partnership with one who has money. The basic requirements for Mudarabah are knowledge and trustworthiness. One who is to do business with the money should have the knowledge of business which he is embarking on and honest should be the watch-word if the contract must survive to share profits.

Features of Mudarabah.

Traits, beliefs, understandings and activities which characterize Mudarabah are:

- (a) Non-transfer of stock to another person: The manager cannot give out the stock to another person without the approval of the proprietor.
- (b) Loaning of Stock to another: The manager is not allowed to loan or lend the stock to other people. The manager alone is to trade with the stock with the sole aim of making profit for partnership sharing.
- (c) Manager's bound: the manager has certain restrictions imposed on him by the proprietor in this type of contract and under no circumstances can he deviate from any of them. Some of these restrictions can be in terms of time, locality, duration, and set of buyers or sellers as the case may be.
- (d) Under Mudarabah, investment is the sole responsibility of the *rabbu-ul-mal* while the duty of the manager is to find a way of manning the money in a lucrative business to generate profit for the two of them.
- (e) Another feature of Mudarabah is that, it is the manager who is solely responsible for the management of the business while the investor is not involved.
- (f) Where there is profit, the two parties involved will share it according to laid down agreement. On the contrary, where there is loss, the investor bears the loss alone and the manager also loses his labour and all the efforts put in.
- (g) In Mudarabah, the manager owns practically nothing as the asset is owned by the investor. The only thing a manager could have is a share in the profit.

The Legal Termination of Mudarabah.

Mudarabah contract or agreement can be terminated by either of the partners at any time. In case there are more than two parties, the contract may be continued in favour of the remaining partners. The sale of goods and their conversion to cash becomes obligatory before termination of the contract according to Hanafi jurists. Also, the contracting partners are to be aware of the termination.

The Maliki jurists are of the opinion that any partner can terminate the contract at any time provided that certain goods that are unsold or a certain act of business initiated must be completed before the termination takes place. In line with the Shafii jurists, Imam Ghazali expressed that "Mudarabah is a valid contract subject to termination by either of the two partners involved in concluding the contract". (Ahmad, vol. p235).

Ibn Qadama says of Hambali School that "Mudarabah is one of those valid contracts which expire by one of the partners terminating it." (Al-Mugni, vol.5 p133).

Mudarabah contract can be made for a fixed period. At the expiration of this period, the contract automatically lapses without a new decision taken. Islamic jurists agree that the right to initiate a fixed term contract will hold

subject to the right of termination. This nullifies the right of any party to terminate the contract at any time earlier than the expiration of the fixed term. Usmani, (2009).

While Hanafi, Hambali and the Shafii jurists see the contract of Mudarabah for a fixed period as legitimate, the Maliki jurists perceive the specification of a time period as annulling the agreement.

In the words of Ibn Qadama, "setting a time period is valid for mudarabah." (Al-Mugni, vol, p185).

To Imam Ghazali, 'the capital owner always has the right to forbid the working partner from purchasing more goods. Hence a certain period can be fixed in advance for this purpose. But the working partner cannot be stopped from selling his goods and therefore no time limit can be fixed for it. (Al-Ghazali, vol.1, p 222). This boils down to the fact that the goods must have been sold before terminating the contract. The period of sale should equally be considered before fixing the time or period of contract.

On the account of death, Mudarabah contract terminates but it may be continued if there are other persons remaining alive. However, if the capital is in form of merchandise, the agent has a right to sell it off so that it takes the form of cash.

Al-Dardir (Maliki) states that

*"And if a man dies in possession of
some goods taken or mudarabah then,
if the same goods are found in his inheritance,
they will be taken back. If they are not found
intact, some other assets of similar value
or the value of the goods given shall be
taken from his inheritance." (Al-Dardir, vol.2, p136)
in the case of a capital-owner dying,
his heir has a right to demand the sale of the
goods, and if the wealth is in form of cash,
he has a right to renew the contract."*
(Al-Ghazali, Vol. 1, p.225)

Mudarabah is an institution through which money and skill in trading are combined to generate profit. It is an alternative to the practice of Riba, which is unlawful to Islam. It promotes business and commercial transactions. It creates avenues for generating employment opportunities and helps to reduce unemployment in our societies.

Through Mudarabah the rich one who has capital but does not have time is able to invest his money instead of putting it in banks to generate interest or usury. It equally affords the professionals who lack money to be able to put his knowledge and skill into practice. It promotes mutual relationship between the two parties and helps foster unity and mutual trust among the Muslim ummah. It provides incentives for high participation in the contract as the parties will be looking towards sharing some profits in the nearest future.

A survey conducted among 220 participants with the findings obtained proves Mudarabah to be a worthy practical measure of physically and financially empowering the people.

Purpose of the study.

The purpose of this study is to attract the attention of individuals, Banks and financial institutions to adopting practical implementation of Mudarabah as a measure to providing jobs for the people and empowering them financially. It is also to challenge these individuals and Banks to allocate funds for Mudarabah for the Mudarabah project to run along with funds allocated to loans based on interests with a view to comparing which one brings more profits between the two within a specified period. It is also to ascertain which one actually contributes meaningfully to the social and economic life of the people within the society and which one guarantees wider circulation of wealth among the citizenry.

Research Methodology.

The study focussed on the use of Mudarabah as a way of practically gainfully employing members of the society using Malaysia as a centre study. Malaysia has been selected because a number of Islamic financial institutions exist here. Aside, these institutions attempt to champion the course of Islamic products among which Mudarabah is one. Some Banks which have western origin also opened up Islamic Windows to attract Muslims because of the majority of the Muslim populace in Malaysia which is about 52% of the total Malaysian population.

Location and Sample.

The research was carried out in two institutions in Malaysia, University Sains Islam Malaysia and the Institut Perguruan Kampus Raja, Melewar, Seremban Malaysia which is a Teachers Training Institute. The researcher chose these two institutions for convenience and because of easy access to administration of questionnaires. These institutions have enough number of academic and administrative staff who are believed to have good background that would be required for the study.

Method of Data Collection.

The researcher obtained data through the use of questionnaires and documentary review.

The questionnaire was divided into two sections; the first section (A) was meant for the collection of the participants demographic data which ranged from age range, qualification, gender, length of year graduated, whether employed or not and whether in government service or private employment.

The second section consisted of section (B) which had twenty-five questions to get responses from the randomly selected participants. The questionnaire contained closed ended questions which had five multiple choice options based on five likert scale: SA- Strongly Agree to SD- Strongly Disagree. Points were ascribed to the choices assigning 5 points to Strongly Agree, 4 points to Agree, 3 points to Partially Agree, 2 points to Disagree and 1 point to Strongly Disagree. The SPSS 15.0 version was used to run the analysis of the data collected from the questionnaires.

In addition, two theoretical documentary cases were reviewed to x-ray how Mudarabah could be practically applied to empower the individual members of the society.

Population and participants.

Two hundred and twenty (220) persons were involved in the study, this number included postgraduate students, lecturers and admin staff members who work at different capacities and sectors in the two institutions. Total population of participants involved at USIM was 100 while 120 was involved at IPG. Some students assisted in the administration of questionnaire at USIM while a colleague, a PhD student at USIM but who is a lecturer at IPG assisted in the administration of questionnaire at the IPG Kampus.

Results of Findings.

Frequency of data collected.

Out of the 220 persons involved in the study, the demographic data revealed that 83 (37.7 %) were males and 137 (62.3 %) were females. This only gave information that females were in higher percentage among those involved in the study. Ninety (90) people (40.9 %) were civil servants, 10 people (4.5 %) were self employed, while 120, (54.5%) fell under others. If we go by this data, it shows that only 4.5% were in private business, the status of 54.5% could not be determined, this the researcher interpreted as not having employment. This study shows that even though the government is trying in providing jobs for the people, there is no doubt that government cannot do it all alone, more so, not every citizen will be in government employment, hence, there is the need to make provision for how small scale individuals can thrive through the use of Mudarabah.

Those who graduated within the past five years were 141 (64.1%), out of which only 19 (13.4%) of this figure were in government employment. If we go by this figure, a high percentage of graduates involved in this study could probably be engaged in Mudarabah investments initiated by individuals and Islamic financial institutions.

For the age range of respondents 181 (82.3%) fell between 18 - 27 years, 13 (5.9%) fell between 28 – 37 years, 6 (2.7%) fell between 38 – 47 years while others fell between 48 – 67 years. On qualification, majority were first degree holders, 104 in number (47.3%). The percentage of participants between the age range of 18 – 27 years is high, more than fifty percent of the participants were first degree holders. This justifies that the participants were within employable age and they possess basic certificate suitable for employment opportunities. (Appendix a). Cronbach's alpha reliability statistics puts the result summary at .89 while the plot and histogram charts also give a normal distribution indicating that the responses from respondents were well skewed.

Results of findings.

Results from the respondents confirm interest as a factorial variable which has significant influence on all other variables. Five null hypotheses were formulated using interest as a key factor being responsible for idleness of money and people within the society, resulting to unemployment and lack of jobs, leading to circulation of wealth among few individual, thereby causing inflation and hike in prices of commodities. Using multivariate analysis where interest is used as factorial variable, the results show interest as having 65% influence on these other variables leading to null hypotheses being rejected and assuming the alternate hypotheses. All the 25 items used have a significant P value of below .05 which establishes the fact that interest does a lot of harm and damages to the economic and social lives of the people.

This study therefore points out that to further strengthen the employment status in Malaysia and to reduce it from its present percentage of 2.08 (wiki.answer.com) to an insignificant level, the practical use of Mudarabah could be a better alternative.

Discussion of findings.

The researcher adopts the results of the Hotelling's Trace which shows that the P value of all the criterion variables was put as (.000) compared to the F value put at (22.476). This shows that the effect of interest is significant on the other identified variables (considering the significant value at 0.05) hence leading to rejecting the null hypotheses and assuming the alternate hypotheses. In this case, interest is a key factor leading to the identified problems. (Appendix b). Victoria Duff (2012) supports that interest causes rise in asset prices and cost of living. It is assumed that if the problem of interest is overcome, the other effects would further be reduced to a non-significant level.

Tests between subjects- effects also confirm interest having significant influence on unemployment, inflation, circulation of wealth among few individuals and hike in prices of commodities. (Appendix c). The study reveals that a large percentage of the population depends on interest loans before they could meet their financial commitments even in acquiring higher education. Hence, the appropriate option being suggested in this paper to overcome the problem of interest earnings in any form is to embrace the adoption of Mudarabah which if judiciously used would serve as a better alternative to interest borrowing, deposits, investments and the likes.

Discussion on documentary review.

Mudarabah has a concept of Profit sharing between the investor and the manager and is perceived as the entrepreneur by Muhammad Sharif Chaudhry (2003) in the modern industrial world. According to him, organization or enterprise plays a very significant role in the modern industrial world.

In his words, "It is the entrepreneur who employs other factors of production, remunerates them and gets maximum production with maximum cost". (Muhammad Sharif Chaudhry, 2003, p 1).

Hence, Mudarabah could thus be applied in the following ways to financially set up the people in one business or the other:

- (a) An investor goes into mudarabah investment with a taxi driver for a period of two years within which to pay back the cost of the car i.e the amount invested on the car and to share the profits after which the ownership of the vehicle is transferred to the taxi driver.

Cost of the car	= RM 50,000
Monthly return	= RM 4,500
1 st Year return	= RM 4500 x 12 = RM 54,000
2 nd Year return	
Monthly return	= RM 3000 (C - DL). Car - depreciation level.
Therefore 2 nd Year return	= RM 3000 x 12 = RM 36,000
Sale of car after 2 years	= RM 15,000 (C - f DL) car - further depr level).
Therefore, total money realized	= RM 54,000 + RM 36,000 + RM 15,000
	= RM 105,000
Therefore Remove car cost	= RM 105,000 - RM 50,000 = RM 55,000
So remove 2 nd hand value cost	= RM 55,000 - RM 15,000 = RM 40,000
Therefore profits to be divided	= RM 40,000 / 2 = RM 20,000 each
Profits each will be	= RM 20,000

So the investor will take = RM 50,000 + RM 15,000 + RM 20,000
= RM 85,000 (70 % profit made)

While the taxi driver takes = RM 20,000 + plus the car.

In this case, Mudarabah has been used to empower the taxi driver who initially did not have any amount with him to set up business. If this was not done, it would have been practically difficult for the taxi driver to raise such fund and he would have remained in perpetual poverty. Here is a practical way by which Mudarabah could be used to set up people in gainful businesses. This can be extended to as many people as possible within the society and the single amount earmarked can serve as many as possible because the fear of paying interest is not there. This can be motivating factor to make people work assiduously with utmost honesty because they know that there is no intention to put them in perpetual poverty but rather to make them independent financially within a short time.

On the other hand, if the taxi driver did not have interest in buying that car or that he preferred another car to the one under investment, the car would be sold out and the amount of RM 15,000 will be added to the profit bringing it to RM 55,000 which should be shared 50 % equally.

i.e. $\text{RM } 55,000 / 2 = \text{RM } 27,500.$

The taxi driver will take = RM 27,500.

The investor will take = RM 27,500 + RM 50,000 + RM 15,000
= RM 92,500. (85 % profit made)

The banks and financial Islamic institutions can take positions of these investors instead of giving out loans on interests and staying idle to make money.

(b) Another Mudarabah investment is a Dry Cleaning investment :

An investor enters into mudarabah contract with a dry cleaner who wants to set up a dry cleaning business outfit which will cost a sum of Thirty Thousand Ringgit (RM 30,000) for a period of 18 months.

Amount released by the investor = RM 30,000

Monthly returns for 1st month = RM 750

2nd month = RM 1200

3rd month = RM 1700

4th month = RM 2200

5th month = RM 2000

6th month = RM 3000

7th month = RM 3500

8th month = RM 2750

9th month = RM 2850

10th month = RM 3750

11th month = RM 2450

12th month = RM 3500

13th month = RM 2850

14th month = RM 3200

15th month = RM 1900

16th month = RM 2300

17th month = RM 3500

18th month = RM 2800

Total returns for the 18 months = RM 46,200

Therefore subtract investment from return = RM 46200 – RM 30,00 = RM 16,200

After 18 months, the business was valued at = RM 12,000

Therefore the investor will take = RM 30,000 + RM 12,000 + 50 % of profit.

$$\text{Profit divided by 2} = \text{RM } 16,200 / 2 = \text{RM } 8,100$$

Therefore the Investor will take $= \text{RM } 30,000 + \text{RM } 12,000 + \text{RM } 8,100$

= RM 50,100 (67 % profit made)

While the dry cleaner will take $\frac{1}{2} \times \text{RM } 16,200 = \text{RM } 8,100$ plus the business asset.

Observations from the documentation review show a good percentage of profits made on each of the investment. The taxi investment recorded about 70% profit while the dry cleaning investment recorded 67%.

Each party involved in the business benefited, the Rabbul al mal made profits on his investment and the Mudarib also shared from the profits and at the same time became a business owner.

The percentages of profits made on each of the two businesses cannot be made in interest loan sponsored businesses, this is because, a particular percentage would have been fixed which ranges between 15% and 22% depending on individual Banks.

Looking at the mean statistics of item 23, (3.18) and standard deviation as (1.15), a good percent of the respondents seem to agree that more money would accrue from business investments than money deposited in the bank to generate interests. This again is corroborated with the observation from the document review.

Conclusion.

This study has revealed the effects of keeping money in Banks to generate interest rather than investing it on business to generate profit. This however has been observed to result in unemployment, hike in prices of commodities, few individuals abandoning virtues and perpetrating a lot of evils because they want to make ends meet. In the words of Usman, (2012), interest causes injustice among the people.

It has however been justified that if Al- Mudarabah- Islamic business financing is practically utilized, it can be a great asset to reviving grassroots participation in small scale businesses which could be used to empower the people meaningfully.

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Appendix.

(a) Item-Total Statistics

		Cronbach's Alpha if Item Deleted	Mean	Std. Deviation
item1	I find it easy to meet my basic needs like food, clothing and shelter.	.89	4.1182	.94827
item2	Seventy percent of our people live below poverty level.	.89	3.2818	1.10319
item3	I took loan to finance my education.	.89	3.5727	1.37465
item4	Many of those who take loans find it difficult to pay back regularly.	.89	3.9773	.97664
item5	More than fifty percent of the citizens take loans to provide for their basic necessities of life.	.89	3.6636	1.09192
item6	Interests charged on money bring job benefits to the people.	.82	3.1773	1.11463
item7	I will prefer to deposit my money in the bank to generate interest than to invest it on a business.	.83	3.4227	1.09729
item8	Unemployment rate is high because people prefer to keep their money in the banks to generate interests.	.80	3.2682	1.05375
item9	Crime rate is high because many people are idle and jobless.	.81	3.7318	1.05375
item10	Interests charged on money deposited in the banks bring hardship on members of the society.	.82	3.5682	.89130
item11	There is wide gap between the rich and the low income earners.	.81	3.7545	.95742
item12	The rich ones dictate and control the prices of commodities.	.80	3.7227	.97944
item13	The rich ones prefer to keep their money in banks to generate interests rather than investing it on business.	.81	3.3545	1.10694
item14	Lucrative jobs are readily available for school leavers and university graduates.	.81	3.2591	.94659
item15	Bank policies favour the rich ones and place them at an advantage above the low income earners.	.80	3.4727	.98118
item16	Prices of commodities are reasonable and affordable to low income earners.	.84	3.3591	1.03065
item17	I come from a low income family background.	.81	3.5318	.98569
item18	Lack of available job opportunities and products result in high prices of commodities.	.80	3.5318	.93822
item19	The rich promote company shares and bank interests rather than promoting industrialization.	.88	3.4773	.99056
item20	Fear of liquidation discourages the rich from investing in businesses.	.89	3.3773	.94528
item21	I have requested for interest loan before.	.88	2.9409	1.34169
item22	I will prefer to invest my money on interests than to put it on business.	.82	3.1955	1.18706
item23	More money will accrue on interests than on business.	.87	3.1864	1.14549
item24	Money invested on interest favours one party and puts the other party at risks.	.80	3.3818	1.04669
item25	Interest loans carry some hidden charges.	.83	3.5182	1.06185

(b) Multivariate Tests(c)

Effect		Value	F	Hypothesis df	Error df	Sig.
Intercept	Pillai's Trace	.957	1123.804(a)	4.000	200.000	.000
	Wilks' Lambda	.043	1123.804(a)	4.000	200.000	.000
	Hotelling's Trace	22.476	1123.804(a)	4.000	200.000	.000
	Roy's Largest Root	22.476	1123.804(a)	4.000	200.000	.000
Interests	Pillai's Trace	.704	2.711	64.000	812.000	.000
	Wilks' Lambda	.415	3.087	64.000	785.241	.000
	Hotelling's Trace	1.139	3.532	64.000	794.000	.000
	Roy's Largest Root	.876	11.113(b)	16.000	203.000	.000

© Tests of Between-Subjects Effects

Source	Dependent Variable	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	Unemployment	39.163(a)	16	2.448	8.163	.000
	Richnessfew	37.712(b)	16	2.357	7.681	.000
	Inflation	37.349(c)	16	2.334	7.101	.000
	Higherincome	27.654(d)	16	1.728	3.032	.000
Intercept	Unemployment	884.759	1	884.759	2950.746	.000
	Richnessfew	931.387	1	931.387	3035.233	.000
	Inflation	939.570	1	939.570	2858.080	.000
	Higherincome	822.443	1	822.443	1442.887	.000
Interests	Unemployment	39.163	16	2.448	8.163	.000
	Richnessfew	37.712	16	2.357	7.681	.000
	Inflation	37.349	16	2.334	7.101	.000
	Higherincome	27.654	16	1.728	3.032	.000
Error	Unemployment	60.868	203	.300		
	Richnessfew	62.292	203	.307		
	Inflation	66.735	203	.329		
	Higherincome	115.710	203	.570		
Total	Unemployment	2693.800	220			
	Richnessfew	2814.640	220			
	Inflation	2730.920	220			
	Higherincome	2459.320	220			
Corrected Total	Unemployment	100.031	219			
	Richnessfew	100.004	219			
	Inflation	104.083	219			
	Higherincome	143.363	219			