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A STUDY ON THE EFFICACY OF ISLAMIC PAWN BROKING SERVICES IN FULFILLING SOCIO –ECONOMIC NEEDS: A CASE OF TWO CITIES-KUANTAN AND KUALA TERENGGANU IN MALAYSIA

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Abstract

In this paper we aim to examine the effectiveness of Al-Rahnu (Islamic pawn broking) services in fulfilling and enhancing socio-economic needs of its users as an alternative source of managing short term cash flow problem. To achieve our objectives we conducted a survey in two cities of Malaysia: Kuantan and Kuala Terengganu in the states of Pahang and Terengganu respectively. A sample of 128 users of Ar-Rahnu services were used to collect data through distributing a semi-structured questionnaire. The results were analyzed via the cross tabulation using excel spreadsheets. The findings from this study revealed that the community, especially the Malay ethnicity found Al-Rahnu services effective in fulfilling their needs of getting access to small

short term loans with fast and hassle freeway and hence making them loyal to Al-Rahnu services. This implies that the Ar-rahnu services are well accepted as a better mean to ease short term financial difficulties and hence able to empower socio-economic needs of the people. The fulfillment of needs are derived from two main components of Al-Rahnu survey questions i.e. the loan tenure and the loan sufficiency.

Keywords

Al-Rahn, Islamic pawn broking, socio-economy, loan tenure, loan sufficiency, Malaysia

1. Introduction

Pawn broking services in Malaysia began before 1811 and were introduced by the Chinese merchants. This business continued to flourish, especially after the discovery of tin mining in Larut in the 19th century. Other ethnic groups such as Malays and Indians rarely own pawn shops. In 1871, licensed pawn shops were introduced by the British Colonial of Pawn Shops Ordinance 1871 (Abdul Razak, 2011). In 1983 a new atmosphere of pawn broking was created with the inclusion of Shari'ah regulation in the finance sector in Malaysia, which gave birth to Islamic pawn broking.

Al-Rahn means a pledge or a security related to a loan. Under the Shari'ah, *Al-Rahn* means possessing a guarantee (Bashir et al., 2012). *Al-Rahn* also refers to an arrangement whereby a valuable asset is placed as collateral for debt. The collateral may be disposed in the event of default (Bashir et al., 2012). Pricing is very important under the *Al-Rahn* scheme as it usually serves the less economically privileged group of people. The cost of borrowing cash in an Islamic pawn broking system is relatively cheaper compared to the conventional pawn broking system. The cost of borrowing in the *Al-Rahn* in Malaysia is the lowest when compared to the conventional pawn broking scheme (Cheong & Sinnakkannu, 2012). When compared between Bank Rakyat versus conventional pawn broking they found that the annual cost of borrowing in the *Al-Rahn* Bank Rakyat scheme is about half the cost of the conventional pawn broking scheme. By comparing the annual cost of borrowing in *Al-Rahn* Bank Islam and Kedai *Al-Rahn* Kelantan they again found that the annual cost of borrowings are still about half the cost of conventional pawn broking schemes. Collateral is also the other important element of the Islamic pawn broking system. Islamic pawn brokers only accept gold or gold jewelry as

collateral as opposed to the conventional pawn brokers who accepted other valuables such as Rolex watches, gemstones and diamonds etc.

The main reason why the Islamic pawn brokers accept only gold is to eliminate the element of *gharar* i.e. the uncertainty. According to the Institute of Islamic Banking and Insurance (2015), *Gharar* is forbidden by the Qur'an, which explicitly forbids trades that are considered to have excessive risk due to uncertainty. To an untrained valuer the value of collaterals such as watches, gemstones and diamonds etc. might differ widely. These items need to be evaluated by trained personals. Gold on the other hand, has a standard price which fluctuates according to the international gold market price. The price of gold or gold jewellery is therefore standard and this eliminates the element of *gharar*.

In Malaysia, the first Islamic pawn broking institution named *Muassasah Gadaian Islam Terengganu* (MGIT), was set up by the Terengganu State Islamic Affairs and Malay Customs, in January 1992 (Majlis, 2012; Abdul Razed, 2004). The establishment of MGIT is to provide immediate financing to assist individuals in overcoming cash flow needs, thereby eliminating the element of interest or *riba*, which is forbidden in the Islamic term (Majlis, 2012, Abdul Razak, 2004). In the Holy Qur'an usury or interest is forbidden as in Surah An-Nisa verse 161:

"...And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And we have prepared for the disbelievers among them a painful punishment."

The introduction of Islamic pawn broking in Malaysia is seen as a new micro credit instrument (Mohd Ali, 2005) providing cash loan for the lower income group when a need arises for additional cash or for small businesses, which usually have limited capital or working capital. Pawn broking also provides a fast and hassle free method of obtaining cash for immediate needs and also benefits those people who are excluded from the mainstream financial system due to lack of collateral. Since people go to *Al-Rahn* for quick and short term loan, they expect the process to be fast and hassle free. When compared to a bank personal loan, a customer has to produce related documents such as certified copies of identity cards, salary slips, bank statements, tax forms and business registration for businessmen. There are banks that require the loaner to have a minimum salary before they are qualified for a loan. And on top of that banks may or may not require a personal guarantor depending on the loan scheme offered (May bank,

2015).

Ever since the introduction of Islamic pawn broking the demand for it increases continuously. Unlike the conventional pawnbrokers where businesses were mainly family operated, the *Al-Rahn* business seems to develop through corporate entities. After Majlis Agama Islam Dan Adat Melayu (MAIDAM) had taken the first step in January 1992 to start Islamic pawn broking, this was soon followed by Permodalan Kelantan Berhad in March 1992 and then by Bank Kerjasama Rakyat Malaysia in 1993 (Abdul Razak 2011). In 2010, there were 133 branches of Bank Kerjasama Rakyat Malaysia offering this scheme throughout Malaysia which increased to 144 as of the middle of 2015. Yippee had also launched 59 counters of *Al-Rahn* scheme through Yippee cooperatives. The next financial institutions to enter Islamic pawn broking was EON Bank (August 2002) and Bank Pertanian Malaysia (Agro Bank) in 2002. Other financial institutions that provide the *Al-Rahn* scheme include Hong Leong Bank Bhd, Pos Malaysia, Bank Muamalat Bhd, Bank Islam Malaysia Bhd, RHB bank, Habib Jewels etc. Currently there are 461 pawnshops throughout the country providing financial services to low income as well as middle income earners to assist easing their short term financial difficulties. In the neighboring countries, Thailand operated *Al-Rahn* through the Pattani Islamic Cooperative Limited (Koperasi Islam Pattani Berhad) in 1987, Brunei through Bank Islam Brunei Berhad, and Indonesia through Perum Pegadaian with the cooperation of Bank Muamalat Indonesia in 2003 (Abdul Razak 2011).

This paper aims to examine the effectiveness of *Al-Rahn* in meeting the socio-economic needs of its customers. We exclusively focused on two cities in Malaysia namely Kuantan in Pahang and Kuala Terengganu in Terengganu. The primary criteria to examine the effectiveness of *Ar-rahnu's* ability to fulfill its customer's socio-economic needs were based on the question of the sufficiency of cash obtained and borrowing period of the transactions among borrowers. The questionnaire is also designed to seek information from borrowers for reasons they use the *Al-Rahn* service and their inclination towards using similar services in the future. In addition, the paper also took into consideration the respondents profile such as race, age, gender, occupation and income.

2. Literature Review

There are few studies which discussed the development and trend of pawnshop in Malaysia both in conventional and Islamic pawnshop. Selama & Abdul Gafar (2006) in their working paper discussed the development of pawnshops: conventional vs. Islamic in Malaysia in details. They have listed several factors or beneficial aspects behind gaining the popularity of the pawnshops among users relative to the formal financial institutions in Malaysia. Few of the main factors they identified are the easy, quick and hassle free way of obtaining short term loans. As far as Islamic pawn broking is concerned, quick, hassle free, interest free, and transparency in dealings are the main factors. Some studies have found that the Islamic pawn broking services in Malaysia as an alternative to the conventional pawnshop getting more popularity even among the non-Muslims (e.g., Payal b. & Jothee S., 2008; Hanudin, A. & Chong, R 2011, etc). Maamor *et al.* (2006) in their studies explained how the *Al-Rahn* as an Islamic pawn broking scheme is important to Muslim societies. According to Abdul Razak (2011), *Al-Rahn* is important because it provides financial relief for lower income groups and small business that have been excluded from the mainstream financial system. Since *Al-Rahn* is known for lending small amount of loan, in this study, we are interested to know whether the amount given out is sufficient to the borrower. Otherwise this would lead for the user to go to another lender for additional loans.

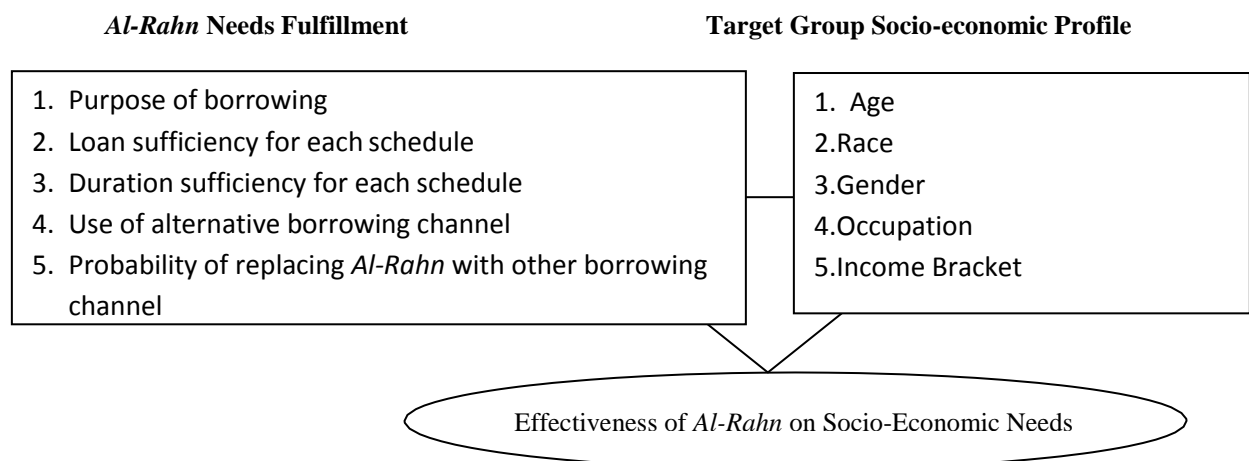
Al-Rahn is also known for giving short term loan. Banks and other financial institutions on the other hand, prefer a medium to long term loan. May bank Islamic Personal Financing-i (MIPF-I) have a tenure length of 2-6 years whereas CIMB Xpress Cash Financing-i has tenure length of at least 6 months to 5 years. We want to know whether this short tenure period of loan is sufficient for the borrowers. According to Abdul Razak (2011), Islamic pawn broking institutions in Malaysia agreed that in establishing the Islamic pawn broking business the interest of the public regardless of the purpose of getting the loan should be taken into consideration. Our study will look into the category of the reasons for obtaining the loan whether for personal or business purposes.

Generally, customer satisfaction level and service quality of *Al-Rahn* services is high which is another indicator why the *Al-rahnu* is gaining rapid popularity (Othman *et al.* 2012). According to Caruana *et al* (2014), customer satisfaction and corporate reputation have both been studied as antecedents of customer loyalty. They found that the effect of corporate

reputation on customer loyalty is completely mediated by customer satisfaction. Our study showed that repeated business is high that is a positive indicator of good customer services provided by *Al-Rahn* institutions.

3. Methodology

A quantitative piece of research using random sampling technique was employed. Total sample size was 128. The research/geographical scope were limited to Kuala Terengganu and Kuantan and respondents selected were patrons/customers of the *Al-Rahn* shops. Data were collected using a structured questionnaire distributed among the sample customers and also by intercepting respondents outside *Al-Rahn* shops. The questionnaire was designed to capture information to meet the objective of the study in the first and second sections, while the third section captures the respondents' demographic profile. The first section targeted respondents who have used the *Al-Rahn* services for more than once, while the second section focused on respondents who have used the *Al-Rahn* for the first time. The questions asked were: (i) purpose of using the *Al-Rahn* services, (ii) duration of utilization of the *Al-Rahn* services, (iii) sufficiency of the funds obtained, (iv) sufficiency of the duration for each schedule, (v) consideration of using other services to replace *Al-Rahn* and (vi) the possibility of using *Al-Rahn* in the future. The last section gathers respondents demographic profile i.e. race, gender, age, occupation and income. The framework of the questionnaire is as below:



4. Results and Discussions

4.1 Utilization of the *Al-Rahn* Services

A total of 128 respondents participated in this research from Kuantan and Kuala

Terengganu. 70% of the respondents said that they used *Al-Rahn* services more than once or multiple times while 30% were first time users of the *Al-Rahn* services. This suggests that for those who have used *Al-Rahn* services before they came back and used the service repeatedly for their needs.

4.2 Purpose of Using Al-Rahn Services

With respect to the purpose of borrowing through *Al-Rahn* among respondents, about 42%, which is nearly half of the respondents used *Al-Rahn* services for the purpose of obtaining capital for their business which are mainly working capital in helping to ease their cash flow. The other half of the respondents used *Al-Rahn* in period of needs. About 30% of the respondents used *Al-Rahn* to obtain cash for their daily expenses, while 11% obtained it to meet up with situations of emergency cash demand. Parents also constituted another 11% that utilized *Al-Rahn* for the settlement of children's school fees. The remaining 9% of respondents stated miscellaneous reasons for using *Al-Rahn*.

4.3 Duration of Al-Rahn Loan

The duration of *Al-Rahn* loan tenure was evaluated to verify whether the objective of *Al-Rahn* services i.e. short term borrowing or financing is actually fulfilled. The survey revealed that the most popular duration of borrowing is 6-7 months; this is about 51% of the sample collected, followed by 2-3 months duration of borrowing (22%). As a matter of fact, 90% of the transactions fell below seven months duration. Therefore, it could be concluded that *Al-Rahn* actually met its objective in terms of short term funding/borrowing.

4.4 Sufficiency of Al-Rahn Loan Duration (tenure)

Findings revealed that loan extension periods are at times required by customers. About 9.6% of the *Al-Rahn* customers responded that the loan duration is insufficient i.e. they requested for the loan period to be extended. However, the statistics show that the majority of the *Al-Rahn* customers do not require the loan period to be extended which might suggest that they are aware of the length of loan period that they require and they are able to pay it off to redeem their collateral within the 6-month periods.

4.5 Sufficiency of the Loan Amount

Regarding sufficiency of the loan amount, majority of the respondents claimed that the amount obtained from their *Al-Rahn* loan is sufficient to meet their purpose of borrowing.

However, there is a small percentage amounting to 11% who claimed that the amount is insufficient. The research included a question to obtain further information from respondents who claimed the loan amount was insufficient to their needs. The question was, “*Did you use any other services to obtain additional money to make up for the insufficiency?*” The responses were that despite the insufficiency, only 15% claimed that they used other services to get money to make up for the insufficiency.

4.6 Intention to Replacement of Al-Rahn Services with other Loan Services

In order to evaluate respondents’ loyalty towards *Al-Rahn*’s services, a question was raised as to whether they would replace *Al-Rahn* services with some other loan services in future. The findings strongly suggested that the loyalty level for *Al-Rahn* services is high. That is only 15% of the respondents claimed they will use other loans in replacement of *Al-Rahn* service. However, they do not have any particular loan service in mind that they will use in the future except for only two respondents who mentioned that they would use loan services of Bank Islam and Bank Muamalat.

4.7 Probability of Using Al-Rahn in the Future

In the previous question which showed high loyalty level towards *Al-Rahn* is further confirmed by another question posted to them on the probability of repeated use of *Al-Rahn* in the future. Only 1% claimed that they will definitely not use *Al-Rahn* services in the future, while a high percentage, 93%, showed interest in future use. This fact suggested high loyalty and repeated use of *Al-Rahn* services by those who have used this service before.

4.8 Demographics Profile of Al-Rahn Customers

This section of the report focused on the demographic profile of *Al-Rahn* users in order to understand the socio-economic background of the people. The demographic data gathered are ethnicity, gender, age, education level, occupation and household income bracket.

4.8.1 Ethnicity

Analysis revealed that about 92% of the 128 respondents are Malays. However, given the population mix of the two geographical areas in this research, i.e. Kuantan which is situated in Pahang with a total Malay population of 70% (Population and Housing Census, 2010) and Kuala Terengganu which is situated in the state of Terengganu with the Malay population of 95% (Population and Housing Census, 2010) the ethnic composition of the respondents is skewed

towards the total population spread since the sampling method of this research is by random sampling.

Besides the argument above suggesting the possibility of the predominantly Malay based geographical areas where this research was conducted resulting from a high usage of *Al-Rahn* among the Malays, a discussion on ethnic awareness on Islamic pawn broking research (Apennine & Doris, 2011) in Sg. Petani, Kedah, which also has a high percentage of Malay population suggested there was no issue of unawareness of Islamic pawn broking among the Chinese which might lead to low usage of *Al-Rahn*. The research indicated that 78% of Chinese respondents were aware of Islamic pawn broking.

To further strengthen the findings of this study in relations to the ethnic composition of *Al-Rahn* customers, a study carried out by Abdul Razak (2011) revealed that among the 311 respondents from three main regions of Peninsula Malaysia (Northeast, Central and Southern) more than 90% of the respondents were Malays, where Malays show preference to Islamic pawn broking shops as opposed to conventional pawnshops..

4.8.2 Gender Mix of Al-Rahn Customers

Majority of *Al-Rahn* consumers (70%) are predominantly female. Findings further revealed that housewives constituted 25% of *Al-Rahn* customers. It is also worth to note that among the female *Al-Rahn* customers, 48% came from households where the income is RM2,000 and below. Also, around 30% of the female respondents ran their own businesses using *Al-Rahn* services. The findings in this study slightly differ from that of Abd. Hamid and Abdul Aziz (2003), which was conducted in Kelantan based on 267 respondents, showed that customers from institutional *Al-Rahn* spread equally well among male and female.

The domination of the female over the male *Al-Rahn* customers may not be unconnected with the fact that most females often use and store gold jewelries as compared to the males, whereas, it is the gold that is being used as collateral in *Al-Rahn* transactions.

4.8.3 Al-Rahn Customers' Occupations

In terms of occupation breakdown among *Al-Rahn* customers, those who run their own businesses constituted the highest percentage i.e. 37%, as compared to other varying occupations. As indicated earlier, the introduction of Islamic pawn broking in Malaysia is seen as a new micro credit instrument, as it provides financial supports for the lower income group and small business owners (Bashir *et al.*, 2012). This is an indication therefore, that the objective of establishing *Al-Rahn* is met. The second largest percentage of occupation is made up of housewives (25%), while those working in the private and government establishments constituted 18 and 14 percentages respectively.

4.8.4 Household Income Level of Al-Rahn Customers

Majority of *Al-Rahn* customers (48%) fell under the lower household income bracket of RM2000 and below. 26% of customers household income are between RM2001 to RM3000, while 25% customers household income are between RM3001 to RM4000 and above. This shows that 51% of the customers are from income bracket of RM2001 to RM4000.

4.8.5 Education Level of Al-Rahn Customers

More than half of *Al-Rahn* customers (54%) completed secondary school level of education, while 31% had tertiary education qualifications.

4.8.6 Age Bracket of Al-Rahn Customers

About 81% of *Al-Rahn* customers fell within the employable age of 19-49 years old with the majority (57%) within the 19-39 years old age bracket. The remaining 19% are those whose age fell under 18 years old. The *Al-Rahn* services provided by organizations such as Bank Rakyat, requires that a customer must be 18 years old. The overall findings of this study suggested that based on the current profile of *Al-Rahn* customers, this ar-rahnu service is able to meet their needs and requirements in terms of short term borrowings and hence enhance the socio-economic development of its customers. However, further study could be made to extend *Al-Rahn* services to other people from a more diverse background.

In the process of analysis, the first section measures the technical features of *Al-Rahn* in terms of the purpose of customers' borrowings, duration of borrowing, sufficiency of loan tenure and loan amount. It was found that *Al-Rahn* is effective in meeting socio-economic needs of customers. The survey results also show that majority of customers are repeat customers of *Al-*

Rahn i.e. they have used *Al-Rahn* before and came back again to make loans with *Al-Rahn*. At the same time, among early institutions that provided Islamic pawn broking services such as MGIT with the objective to provide immediate financing to assist individuals in overcoming cash flow needs, was also met. It is evident from the results that around half of the respondents use *Al-Rahn* as a platform to obtain capital for their businesses. At the same time, *Al-Rahn* acts as a means to reduce their burden when faced with emergencies and incidences that require extra cash.

In terms of borrowing duration, customers use *Al-Rahn* to obtain short term borrowings where the majority of customers borrowing tenure are under 7 months. However, *Al-Rahn* has the flexibility to extend the borrowing tenure in cases where customers were unable to settle their loans within the stipulated initial agreement tenure. This is definitely a feature that is most welcomed by customers.

The majority of customers also claimed that the loan amount that they obtained from *Al-Rahn* is sufficient for their needs and they do not go to other sources to get additional funds. Customers also display high loyalty towards *Al-Rahn* as most of them claimed that they will use *Al-Rahn* in the future and they do not have any intention to replace *Al-Rahn* with other services or have any other financial institutions in mind for small short term borrowings.

A further analysis of the customer profile strongly shows that *Al-Rahn* is mostly used by Malays, although there is a small percentage of Chinese who also used *Al-Rahn* services but none at all among Indians. Although this research covers areas dominated by the Malays in terms of population, previous research works on Islamic pawn broking, revealed that high level of awareness of Islamic pawn broking among the Chinese, does not influence a high use of *Al-Rahn* among them (Apennine & Doris, 2011; Skully, 2005). Similarly, *Al-Rahn* is observed to be more popular among those who are in the active working age bracket of 19-49 years old to fulfill more demanding life commitments as opposed to the younger or the older income groups.

Those who ran their own businesses show higher inclination to use *Al-Rahn* as a platform to obtain capital for their businesses. *Al-Rahn* borrowing terms which do not require any guarantor, fast or almost immediate disbursement of loans with very little documentation requirement makes *Al-Rahn* a popular financial institution among them. At the same time, the *Al-Rahn* feature which usually accepts only gold items or jewelries makes it popular among

housewives as a means to obtain cash in times of need since they have at hand, the collateral to make an *Al-Rahn* loan.

5. Conclusions

The findings from this study implies that the community, especially the Malay ethnicity found *Al-Rahn* to be able to fulfill their needs for fast and hassle free way of obtaining small short term loans, hence providing loyalty to *Al-Rahn*. The perceived limitations to this study is the geographical areas used for sampling, which are both predominantly high in Malay population and within the east coast geographical areas where *Al-Rahn* is known to be a popular source of micro financing among the population there. Hence, it will do good to conduct a similar form of study in other geographical areas in Malaysia to get a full picture of the effectiveness of *Al-Rahn* on socio-economic needs of the people. The promotional mix of advertising, public relations, sales promotions, personal selling and social media are all important instruments to be adopted in marketing *Al-Rahn* services to the general public (Mc Daniel, 2013) . According to Sam, the desired ultimate responses from the target market are the purchase of the service of *Al-Rahn*, high satisfaction with the service and favorable word of mouth among customers. He recommended that awareness and knowledge on the services of *Al-Rahn* be enhanced. Linking the target customers to *Al-Rahn* is important because there are those who feel shy to deal with *Al-Rahn*. Preference and conviction over other similar financial services will encourage more customers to doing business with *Al-Rahn* (Sam *et al.*, 2010).

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