ISLAMIC MICROFINANCE: MOVING BEYOND FINANCIAL INCLUSION

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Abstract

The current situation of high unemployment and the widening whole of the disadvantaged people in Muslims countries have awakened the need for proper access to microfinance. Currently, poor and low income people in Muslim countries have little access to either conventional or Islamic microfinance. This article is an attempt to investigate to what extend Islamic microfinance can best help in alleviating poverty in Muslim communities. The results showed that conventional microfinance concentrates on the low-income group. However, it excluded the destitute people from microcredit and other related activities such as saving and skills improvement both financially and socially. Furthermore, the result indicates that Islamic microfinance is moving beyond conventional counterpart to provide effective social and financial inclusion simultaneously. This is done through Islamic social tools such as Sadaqah, waqf, and Zakah, which is to be given directly to the extremely poor either in cash or in kind to satisfy their basic needs before granting them microcredit.Thus, these results are a good motivation to those who provide microfinance in these countries to improve the social and financial inclusions of the disadvantaged people. Hence, this can be achieved by adopting Islamic microcredit.

Keywords: Islamic micro financing, Zakat, Waqf, Social inclusion, financial inclusion

Introduction

Many rural areas are disadvantaged in Muslim countries particularly in central Asia, sub-sahara Africa, and MENA region. They have no proper access to the formal lending and to conventional or Islamic financing. Moreover, the lending institutions are not even well-spread enough to reach out to the needy. Private and foreign banks that seek to maximize their profits are concentrating only on the urban cities. Poor projects are left only to public banks because of the high risk that is associated with lending to the poor or micro producers. Given the rate of high poverty among these low income groups and the unavailability of collateralization mechanism, lending to this group is normally associated with greater risk as reflected in the banks' high non-performing loans in some countries like Morocco.

Because majority of people in Muslim countries are Muslim by birth, Islamic Microfinance is one way to meet the financial needs of these people. However, this will enable them to achieve better financial inclusions even for the non-Muslim poorest minority living among them. Islamic microfinance can provide small loans for the poor people or people with good expertise without any start-up capital. Unlike conventional microfinance, Islamic microfinance generated its vision from Islamic worldview. Therefore, it grants finance to the needy for self-employment based on maqasid al-sharaiah.

Islam always encourages self-employment rather than just donating money and food to the needy for consumptions. However, providing tools for production to poor people is better than the donation of consumable charity (hadith). The poor people who are self-employed will be empowered to care for themselves and their families. Furthermore, the World Bank declared the microfinance as a means of inequality and poverty eradication. Islam has more means of eradicating income inequality such as zakat and sadaquah which is given directly to the needy to solve their urgent needs. Hence, Islamic microfinance targets the very poor people who are capable of working in the production of goods or services. Consequently, while zakat and sadaquah should be paid only to specific people, Islamic microfinance is not.

Islamic microfinance can be used to mitigate the negative impact of the high unemployment rate among the youth in Muslim countries. Evidence has shown that the rate of unemployment is skyrocketing in the world among the adult and youth at same time in most Muslim countries. Islamic microfinance can be used as a quick response, targeted to finance small entrepreneurship such as Small and Medium-sized Enterprises (SMEs). Hence, Islamic microfinance can be used effectively to overcome the problem of hyper unemployment and the challenges facing SMEs in accessing suitable finance in Muslim countries. As the case of other Muslims countries, the Sudanese experience showed that Islamic microfinance has a positive impact on income generating activities. In addition, Islamic microfinance used to finance graduate students as a part of the unemployed youth sector in Sudan.

Despite the positive impact of Islamic microfinance in many Muslim countries, the borrowers are still dominated by the traditional sectors. Unfortunately, most of these sectors faced more challenges in most Muslims countries. These challenges include but are not limited to the basic infrastructures, financial infrastructures, and far and unreachable markets.

These challenges have negatively impacted the accessibility of Islamic microfinance by raising the cost of finance in many Muslim countries.

Other challenges facing Islamic micro-finance in Muslim countries is high cost and the riskiness of financing poor borrowers. This stems from the small size of their finances, the remote residential areas of the poor from the urban cities, and their uncollateralized risk. Thus, the projects executed by the poor are always of small scale in nature and they always lived in very remote and even some times, primitive areas in Muslims countries. In addition, Muslims countries only recently recognized the essentiality of microfinance as a tool of empowering low income group, reducing the problem of unemployment, and elevating poverty. Also, the weakness of the Islamic microfinance infrastructures includes the limited spread of Islamic financial institutions and the relevant financial regulations, and the unavailability of popular Islamic micro finance agencies or effective program in these countries.

While extreme poverty is a global phenomenon which is not limited to the Muslim countries, the structured finance, right choices of financing programs, and the policies to alleviate it, is very essential and urgent. This is because although the World Bank planned to end extreme poverty by the end of 2030, some evidence showed that people in the poorest regions of rural Africa can even lift themselves out of extreme poverty in just five years. Thus, this can become a reality if proper means and tools of microfinance exist. This paper attempts to move beyond traditional microfinance to Structured Islamic microfinance by sector and places and even by professions. Thus, this will facilitate the particular needs of the poorest people based on their diversity. Also, Structured Islamic microfinance by diversity might represent the right intervention for achieving better financial inclusion among the poorest in Muslim communities.

The Readiness of Islamic Microfinance

Islamic Microfinance is very effective and essential for creating hope not only for the poor and those above the poverty line as shown by the traditional microfinance, but also for the extremely poor in the community. However, Muslims who are extremely poor remained excluded through traditional microfinance for several reasons. They were excluded voluntarily due to the practices of the interest rate by conventional lending institutions which considered riba which is forbidden in Islam. Similarly, it can be excluded non-voluntarily due to inability to repay back the loan plus the interest rate accrued to it. Thus, Islamic microfinance can easily overcome these challenges due to its wide scope to cover various diversity of customer whether based on their expertise or sectorial dimension. This is in addition to its supported tools such as zakat, waqf, and sadaqah.

Abdulrahman (2007) investigated Islamic microfinance as a missing component in Islamic banking. His investigation revealed that despite the main objectives of microfinance, poverty alleviation and enabling the poor to be empowered in line with the principles of Islamic values has not been addressed reasonably by Islamic banks.

Saad Norma (2011) investigated various income generating activities financed through microfinance institutions in Malaysia. The study used survey to indemnify which activity is viable to the microfinance institution and in generating high income. While the study identified some high income generating activities, it was discovered that the microfinance receiver lack the proper skills. Salwana et al. (2013) showed that traditional microfinance has failed to satisfy the Muslims communities because of its shift from poverty to focus on profit oriented business. In addition to that, conventional microfinance loan being granted based on interest rate (riba from an Islamic point of view) is not tailored to the Muslims beliefs.

Clemens and Gabriel (2013) investigated the new transparency in Development Economics: Lessons from the Millennium Villages Controversy. They found that there is a weakness in the claims of the World Bank to end extreme poverty by the year 2030. Furthermore, they added that the claim of the success of ending poverty might depend on the right programs and policies.

The above studies showed some shorting comings on conventional microfinance which raised the hope of whether Islamic microfinance can take a lead at least among Muslim communities. Therefore, this leads us to investigate and test the readiness of Islamic microfinance in Muslims countries.

The current situation showed that most Muslim countries political and economic unrest, occurs particularly in Arab countries, such as Egypt, Tunisia, Morocco, Libya, Sudan, Jordan, Syria, Iraq, Lebanon, and Yemen. These political instability leads to unfavorable microfinance environment particularly among foreign investors. In addition to that, most Muslim countries or communities area are affected by the drawback of the civil war or natural disasters. This sometime becomes a strong barrier to reach the disadvantaged people let alone to eradicate their extreme poverty.

Given the high rate of unemployment among the youth and adults in Muslims countries, the huge demand to access finance far beyond the available supply is given by the existence of microfinance providers. In addition to that, most of the microfinance providers are non-profit organizations which are characterized with limited capacity and weak management. However, these negative characteristics have either limited their ability to reach the poor who are scattered in the vast rural areas, or to have enough coverage for them to achieve better financial and social inclusion.

Despite the high liquidity of the Islamic banking system, it was not converted into microfinance services to shrink the wide gap between the demand and the shortage of supply in many Muslims countries. Furthermore, these might be due to political instability and the lack of confidence and coordination between microfinance institutions and the Islamic banking sector as a result of political and economic stability.

Other might be related to the inexistence of the legal and regulation framework that might organize the relationship between partners in Islamic microfinance. Thus, this represents one of the essential challenges related to the weakness of Islamic financial infrastructures facing Islamic microcredit in Muslims countries. Many Muslims countries have not yet activated the Islamic social financial inclusion tools effectively. However, such tools include zakat, sadqah, gard al-hassan, and waqf in their economical system which is very essential in achieving financial inclusion. In addition to that, the limitation on Islamic banking system is in terms of its wide-spread over the country to reach out to the poor masses. They are either yet to be introduced in some countries such as Morocco. Also, they have limited involvement in micro lending such as in Egypt, Tunisia, Jordan, Lebanon, Syria, and other African and Central Asia countries.

Most of the Microfinance institutions in Muslims countries depend majorly on conventional financial providers. They are either interest-based commercial banks or non-governmental microcredit institutions with strong Western flavor. Given the specificity of Muslim nation, these conventional institutions have limited impact on social and financial inclusion on Muslims' low-income communities. Hence, they aid in eradicating poverty in Muslims territories.

Unlike Islamic finance, conventional microfinance addressed financial inclusion in isolation from the social inclusion, while Islamic finance addresses both simultaneously. Despite the recent phenomena of the growing microfinance institutions, most Muslim countries have very low financial inclusion. This is because previous evidences showed that two-third of the populations in Arab world and Sub-Saharan Africa are financially unreached. While just over 10% of adults in most Arab countries have loan accounts with banks, micro-entrepreneurs have more difficulties to have access to finances. Moreover, most of the microfinance providers if not all, are located in the urban cities. Also, the low-income group in Muslims countries resides in the rural areas.

Islamic Microfinance Providers

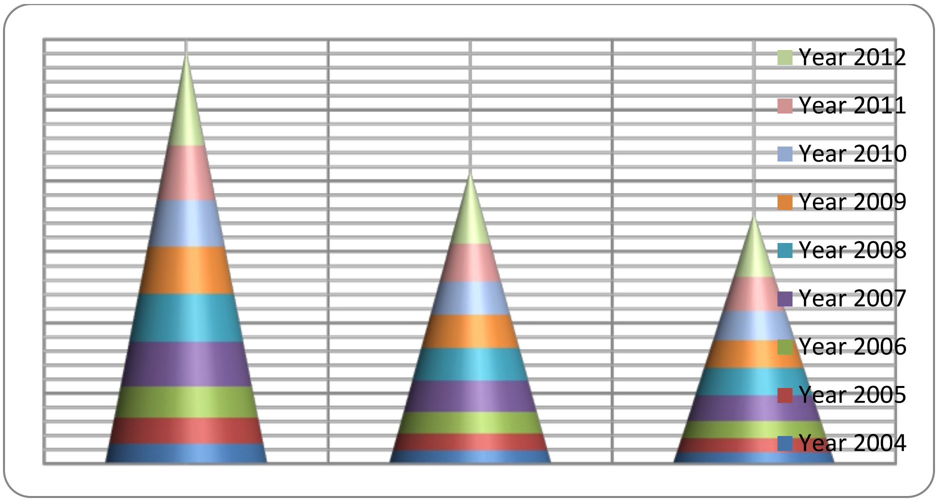
Despite the huge demand for Islamic microfinance among Muslims communities due to the high rate of unemployment and poverty, Islamic microfinance do not keep peace with upraising demand. While millions of poor people were covered by the conventional microfinance, only few thousands have been reached by the Islamic microfinance in Bangladesh. The situation is not much different in GCC countries and even in North Africa Arab countries. However, recent report showed that the current Sharia compliant microfinance providers covers only one million out of 650 million Muslims living on less than $2 a day[27]. Given the considerable growth, Islamic banks might be the potential microfinance providers in Muslims countries.

One of the main reasons is the lack of clear policies and regulations for Islamic microfinance providers to carry on their duties in the essential developmental sector. Therefore, one of the essential financial lending institutions is banks. Banks varies in Muslim countries either in terms of the development or the outreach. Few countries have well-developed Islamic banking system such as Sudan, Iran, Pakistan, Malaysia, and GCC. However, majority of the banks particularly in North Africa, Sub-Sahara, and Central Asia still needs more efforts to introduce Islamic financial system or to attract more Islamic financial institutions from the neighborhoods to invest in them.

Consequently, Islamic banks represent a potential incubator for Islamic microfinance. Thus, the spread of Islamic financial institutions might be a good sign for the growth of Islamic microfinance in Muslim countries. The following diagrams show the total asset, total deposit, and total financing which was granted by Islamic banks in the three regions of Islamic Development Bank (IDBG) member countries, namely Asia, Middle East, and Africa for the last twelve years.

[27] http://www.cgap.org/news/islamic-microfinance-challenge-2013

Asia Islamic Finance Providers: Total Asset, Total Deposit, and Total Finance for the Period from 2004-2012



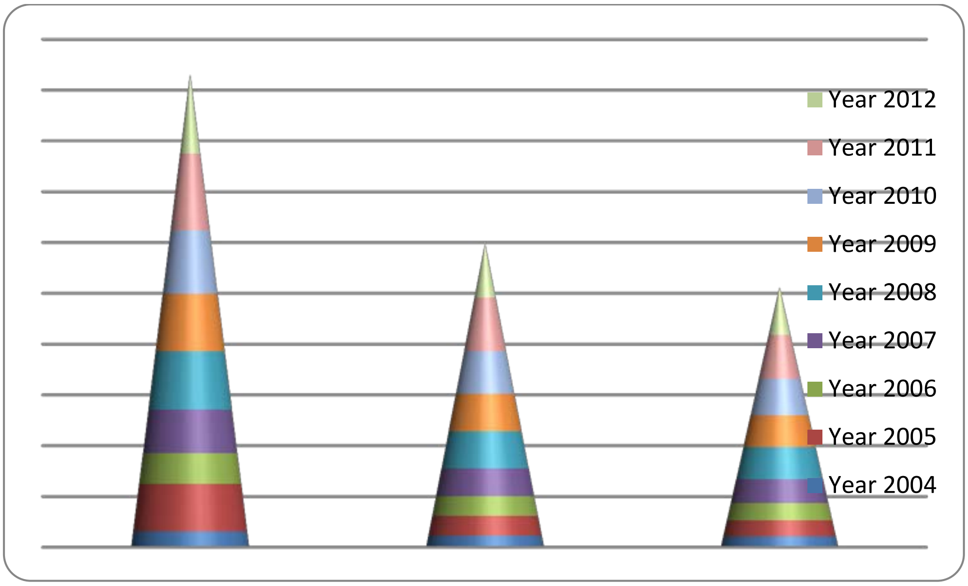
	Total Asset	Total Deposit	Total Financing
Average	324,863,750	230,478,691	196,662,656
Maximum	673,515,908	518,084,759	444,046,746
Minimum	143,540,763	444,046,746	83,013,886

Data Source - IBISonline.net; the amount - thousands USD

The above diagrams represent Islamic banks in Asia. It shows that Islamic banks in this region are growing on an average of 22.4%. Thus, this was in terms of asset that reached a total of USD673,515, 908 at the end of the year 2012 from USD 143,540,763 in the year 2004[28]. The total deposits and total finance has also grown on an average to 518,084,759 and 444,046,746 from 444,046,746 and 83,013,886 consecutively for the same period.

[28] Islamic Research and Training Institute, IBIS Database.

Middle East
Islamic Finance Providers: Total Asset, Total Deposit, and Total Finance for the Period from 2004-2012



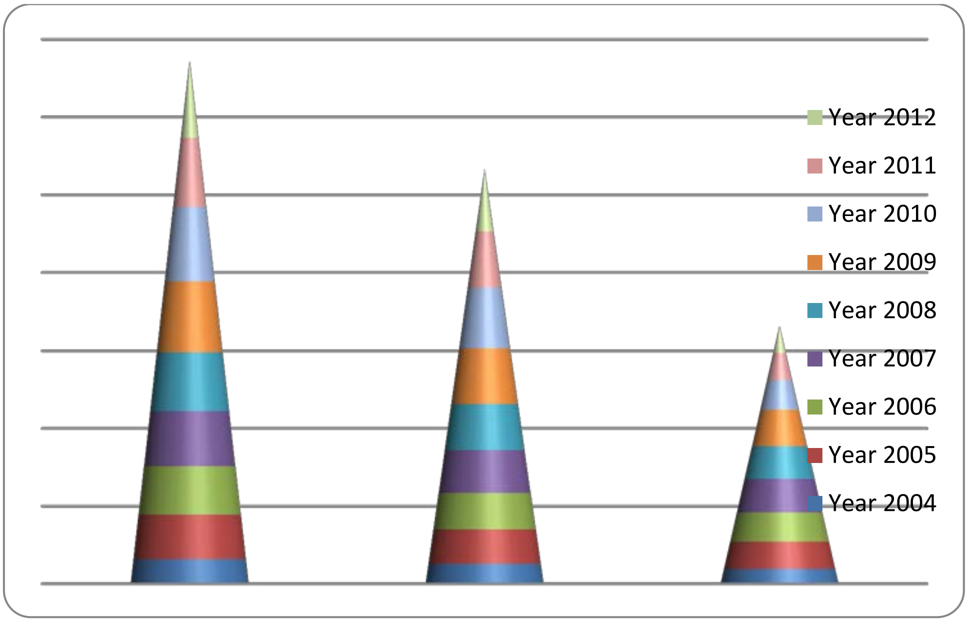
	Total Asset	Total Deposit	Total Financing
Average	207,443,172	133,162,546	114,012,232
Maximum	316,521,518	215,024,148	190,176,553
Minimum	62,520,446	46,456,957	42,454,453

Data Source - IBISonline.net; the amount - thousands USD

The above diagrams represent Islamic banks in Middle East region. It shows that Islamic banks in this region are growing on an average of 22.4%. This was in terms of asset that reached a total of 316,521,518 at the end of the year 2012 from USD 62,520,446 in the year 2004[29]. The total deposits and total finance has also grown on an average to 215,024,148 and 190,176,553 from 46,456,957 and 42454453 consecutively for the same period.

[29] Islamic Research and Training Institute, IBIS Database.

Africa Islamic Finance Providers: Total Asset, Total Deposit, and Total Finance for the Period from 2004-2012



	Total Asset	Total Deposit	Total Financing
Average	14,979,435	11,855,479	7,395,951
Maximum	20,148,622	16,122,574	9,419,695
Minimum	6,341,030	5,112,997	3,844,451

Data Source - IBISonline.net; the amount - thousands USD

The above diagrams represent Islamic banks in Africa. It shows that Islamic banks in this region are growing on an average of 22.4%. This was in terms of asset that reached a total of 20,148,622 at the end of the year 2012 from USD 6,341,030 in the year 2004[30]. The total deposits and total finance has also grown on an average to 16,122,574 and 9, 419,695 from 5,112,997 and 3,844,451 consecutively for the same period.

Generally, Islamic banks in the three regions are growing on an average of 22.4% in term of asset that reached a total of USD4,973, 864,698 000 at the end of the year 2012 from USD 212610742000 in the year 2004[31]. The total deposits and total finance has also grown on an average by 21.5% and 20.6% consecutively for the same period.

Despite the remarkable growth of Islamic banking sector in general, Muslim countries is still dominated by the conventional counterpart. For instance, while there are 54 banks in Lebanon, only four are Islamic banks.

[30] Islamic Research and Training Institute, IBIS Database.
[31] Islamic Research and Training Institute, IBIS Database.

The number of Islamic banks are even less in Muslim majority countries such as Egypt, Tunisia, and Morocco. Banks being conventional or Islamic are licensed under the supervision of the central banks to provide financial services including microfinance. In addition, Islamic banks are subject to the Sharia's advisory board at the level of the banks or at the central bank levels such as in Sudan. Consequently, only few countries such as Sudan, Yemen, and Malaysia have issued circular to stimulate Islamic banks to involve in microfinance services. The Central Bank of Sudan permits Islamic banks to use up to 12% of their reserve in granting microfinance. Moreover, beside the establishment of Islamic microfinance units, the Sudanese Central Bank has granted license to one specialized bank, which is the Sudanese Family Bank to extend microfinance based on Shariah.

The second important microfinance providers are the non-banks institutions. Most of the non-banking microfinance providers in Muslim countries are local or international Non-governmental Organizations (NGOs). However, they provide conventional microcredit services based on interest rate apart from their other services related to their mandates. The majority of the non-banks microfinance providers adopt individual lending methodology, while only a few specializes in group lending such as women and agriculture in rural areas. One of the most important limitations of the NGOs is multidisciplinary mission intuitions under the management of the ministry of interior. Beside others, they also perform the activities of financial and social inclusion development programs. Most of these NGOs are international, and they grant their lending based on Riba. Hence, they aim to achieve multipliable goals, which weakened their performance in achieving considerable financial inclusion among Muslims communities. Other challenges faced by these non-profit organizations might be the limited capacities building and the weakness in management. In addition to that, most of them have multidisciplinary missions and concentrate on microcredit. Given the huge supply and demand mismatching, NGOS is far below the ceiling of meeting the demand of microfinance brewers.

Other non-banks microfinance providers arise in form of Funds or developmental program provided by multilateral banks such as IDB or government ministries. Also, Islamic microfinance now covers millions of extremely poor and disadvantaged people in many Muslims countries. Nevertheless, they are still far from the required level due to many constrains and challenges that will be discussed in the section below.

Islamic Microfinance: Moving Beyond Financial Inclusion

The recent evidence showed that conventional microfinance that focused on profit making has faced many challenges in Muslims countries. Profit maximization through microfinance, leads to excessive microfinance lending and eventually results in market saturation. In Bangladesh, the microfinance was growing very fast since 1990, but sharply change in direction as the market becomes saturated due to excessive lending.

Conventional microfinance lends only to the active poor and low-income group. Hence, it leaves the extremely poor and the destitute behind. However, based on conventional microfinance lending behavior, the extremely poor are often excluded financially. This is because of the high risk, since conventional microfinance seeks profit, and the extremely poor people might consume the loans. Thus by focusing in profit making out of financing the low income group and depriving the extreme poor from the small loans financing, conventional microfinance financially and socially excludes the destitute people from microcredit. However, other activities include saving and skills improvement related to microfinance as a whole. Conventional microfinance pre-conditions for granting microcredit is that the poor must be economically active and must possess entrepreneur skills. These conditions might not exist for the majority of the deprive people around the world in general and Muslim communities in particular. Therefore, for most conventional microfinance, the customers lay around the poverty line.

Islam does not differentiate between poor people based on the drown line of poverty. Thus, Islam divides poor people based on two main categories of Fuqara and Masakeen. Fuqara are the people that do not have enough substances to satisfy their basic need for one day, while Masakeen are the people that have enough substances to satisfy their basic needs for the whole year. In this case, Islamic microfinance providers might not prevent Fuqeer who is highly skilled in certain specialization, and trustful from lending him through profit sharing if the outcome of project viable. Fuqeer is also illegible in Islam for both Zakah and Sadaqah. However, this is the most effective Islamic tools for social inclusion. So Islamic gives the satisfaction of the basic needs for Fuqara and Masakeen high priority through recommended tools to be implemented by the state, institutions and even wealthy people from their wealth. This occurs whenever they fulfill certain requirement such as al-nisab in term of the Zakah and voluntary charity (Sadaqah).

Furthermore, Islamic microfinance is moving beyond conventional counterpart to provide effective social and financial inclusion simultaneously through its twin tools. Hence, credit lending and Zakah should be given directly to the extremely poor in cash or in kind to satisfy their basic needs. Islamic microfinance is expected to be more ethical that focus more in the social responsibility rather than on only profit maximization. Islamic microfinance is very ethical when it grants finance and more ethically at time of repaying the loan. Subsequently, Islam encourages not being hard on people you lend, and have a natural default for those unable to pay back the loan even if there are not Fuqara.

وَإِن كَانَ ذُو عُسْرَةٍ فَنَظِرَةٌ إِلَىٰ مَيْسَرَةٍ ۚ وَأَن تَصَدَّقُوا خَيْرٌ
لَّكُمْ ۖ إِن كُنتُمْ تَعْلَمُونَ ﴿٢٨٠﴾

And if someone is in hardship, then [let there be] postponement until [a time of] ease. But if you give [from your right as] charity, then it is better for you, if you only knew.

Evidence has shown the failure of the dominant conventional microfinance to satisfy extreme poor people in Muslim countries. In addition to the religious conservativeness, the urgent need of the extremely poor needs to be satisfied first, before moving along to production borrowing. However, these tools of satisfying the basic needs of the poor free of charge exist only on Islamic socioeconomic, through Zakah, Sadaqah and waqf. Zakah is the right of poor in the wealth of rich Muslims being companies, banks, or individuals.

Other factor that may cause the failure of the conventional microcredit is the interest rate-based (Riba) financing which is forbidden in Islam. Despite their extreme poverty, poor Muslims are very reluctant to take usury. In addition to that, interest-based need collateral or grantor to secure the payment of the loan is difficult for the poor as they can even afford their daily basic need. Islamic microfinance is also more appropriate than the conventional for entrepreneurship, SMEs, and extremely poor even in terms of the modalities. Based on sale or profit and risk sharing contracts, Murabahah, quart al-Hassan, Ijarah, salaam, Istisna'a and muzara'a, etc are Islamic microfinance best modalities to address the diversities needs and business nature of the poor or SMEs being Muslims or even non-Muslims. The poor requires diverse range of microfinance services that covers their wide scope of need as far as possible. Islamic microfinance is a more accurate way of micro financing to the poor since it provides various microfinance products. In addition to that, Islam would not support the idea of granting unproductive microcredit loan for the purpose of gathering more profit from Fuqara and Masakeen. Islam encourages providing tools for production to the poor which might increase their income and help them to make more money. Unlike the previous conventional microfinance provided by the NGOs, the current practices of Islamic microfinance might exceed the microcredit to the micro-saving, micro-insurance, and other non-financial micro-services such as capacity building.

Conventional microcredit is one way to be granted based on the interest taking gain and without sharing the pain with the borrower as the matter in the Islamic microfinance. Moreover, Islamic microfinance is more inclusive than the conventional microcredit that addresses the social and financial inclusion simultaneously. Islamic microcredit does not target only the low income group of people, but are more appropriate for the unemployed and skills group such as the graduate students and educated people, farmers, and alike. Hence, Islamic microcredit targets different clients with a wide scope of lending products.

Given the high unemployment rate among Muslims youth, Islamic microfinance could be the best modalities to mitigate the risk of disadvantaged graduates and other group of youth than the conventional counterpart. Islamic microcredit can be structured based on the specialization and the professionalism of the poor and the unemployed people by categories. In Sudan, microfinance is used to finance veterinary projects for the graduated universities students such as egg production and chicken rearing through partnership between family bank, Omdurman Islamic University, and the students. Islamic instruments such as Salam, Muzarah and even Istisna'a can be used to finance working capital for disadvantaged rural people in Muslims countries regardless of having income or not. Thus, this is possible since they have expertise in certain business. Also, these instrument is best fit for financing pre-shipping and post-shipping for entrepreneurship and SMEs imports and exports. Other modalities such as profit and loss sharing (Musharakah and Mudarabah) can also fit for many disadvantages of financial needs and small scale industries.

Through Zakah, Sadaqah, Waqf and Qard al-Hassan, these unemployed disadvantaged people can be socially included by providing them with the necessary needs before taking them to the next step of the microcredit. However, Islamic social intervention tools will pave the roads to effective microfinance. Thus by empowering extreme poor and disadvantaged people, Islamic microfinance is moving beyond financial inclusion to social inclusion and is preserving human dignity.

Conclusion

The current situation of high unemployment rate and the widen whole of the disadvantaged people in Muslims country have awakened the need for proper access to micro-financing. Currently, poor and low-income people in Muslim countries have little access to either conventional or Islamic microfinance. This study investigates why microfinance is facing more challenges to improve the life of the poor people in Muslims countries. Despite the existence of the Islamic banking, the evidence showed that conventional microfinance is dominated by microcredit activities in Muslim countries. Hence, more people have been deprived access to microfinance either because of the adopted interest rate by conventional microfinance providers which is forbidden in Islam for those who are more conservative, or those who are extremely poor and cannot fulfill the criteria of the conventional microfinance.

Contrary to conventional microfinance, Islamic microfinance might use Zakah, Sadaqah, Waqf, and Qard al-Hassan to make social inclusion to the disadvantaged people by providing them with the necessary needs before taking them to the next step of the microcredit. Furthermore, Islamic social intervention tools will pave the roads to an effective microfinance. Thus by empowering the extremely poor and disadvantaged people, Islamic microfinance is moving beyond financial inclusion to social inclusion and is preserving human dignity.

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