

Making a Dent on Poverty

Islamic Microfinance Principles, Products, Models & Institutions



International Seminar on MF & Financial Inclusion

16th March 2016

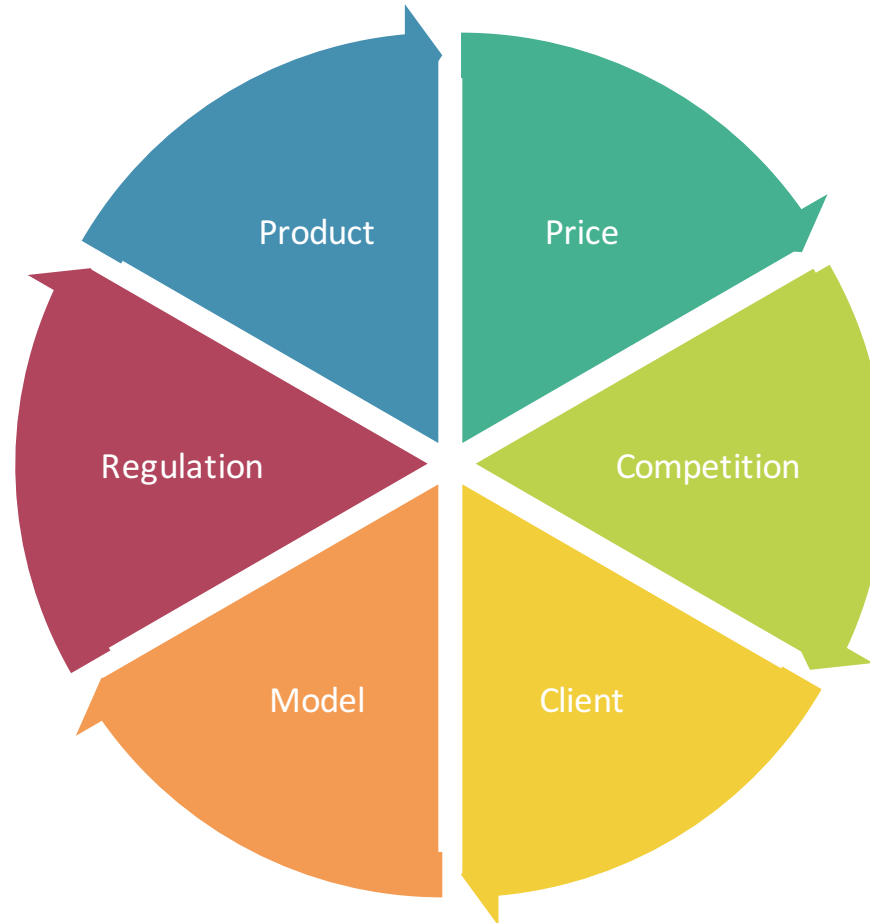
Key Principles of Microfinance

Search for better options must continue.

1. Poor need a range of financial services, beyond micro-credit
2. Microfinance must pay for itself. It is about building permanent financial institutions.
3. Competition will drive down abnormal profits if any; price ceilings choke off supply and hurt poor people.
4. Microcredit is not always the answer, especially for the destitute.
5. Donor funds should complement private capital, should not compete with it; should be used for capacity building of MFIs.
6. Government should have no role as a direct provider; should be an enabler.

Issues in Microfinance: Six Clusters

Microfinance has lost its moral compass. Microfinance institutions (MFIs) have increasingly focused on financial performance and have neglected, in some cases abandoned, their declared social mission of poverty reduction and empowerment. - David Hulme and Mathilde Maitrot



Product

Like alcohol, a debt boom tends to induce euphoria. Borrowing has been the answer to all economic troubles in the past 25 years. Now debt itself has become the problem
– Philip Coggan

Microfinance products:

- Credit-based
- One-size-fits-all
- Hidden costs

Price

I believe the microfinance industry needs to stake out a clear position that we do not make excessive profits.. that we do not charge usurious rates to the poor. To me, responsible practice means we restrain ourselves and make no more than moderate profits – Chuck Waterfield

Cost-plus pricing involves combining:

- operational costs & risk-premium
- cost of funds

How high is too high?

- International evidence
- Some suggested fair-pricing mechanisms

Competition

Over-indebtedness, through formal or informal loan-taking, is the result of a two-party decision (the borrower and the lender)... however, it is the MFIs who should be held accountable for monitoring levels of indebtedness to protect their clients. – David Hulme

Increase in supply of microfinance

- Competition does not drive down profits
- Loan officers resort to aggressive marketing
- Poor now have multiple loans
- Short-term profit maximization
- *Caveat emptor* (buyer beware)
- Loan officers routinely harass clients (asset confiscation, public humiliation etc)

Client

The typical poor clients juggle their loans as long as they can. As long as the juggling continues, the profits (for MFI) keep rolling in. And the lenders keep pushing more loans on clients they *know* are already juggling multiple loans – Chuck Waterfield

Microfinance clients:

- Vulnerable in the face of unmet needs
- Low level of skill
- Low financial literacy
- Vulnerable to debt-addiction

Model

Greed is good. “Even philanthropy aimed at alleviating poverty can be profitable” – Forbes, 2007; Forbes 2011 and NYT 2010*

Not-for-Profits – Mutuals - Corporations

Diminished role of Philanthropy

- Exclude grants and donations from financial equation
- Only for capacity building
- Unsustainable and erratic nature

Regulation

The horse is out of the stable, we have no option but to let it run, and to tut-tut or add cautions on the side – Malcolm Harper

Microfinance regulation:

- Self-regulation or self-interested regulation
- Caps on prices/ returns
- Poor governance – insider transaction; compensation; human rights abuses (collection)
- Bail-outs favor small elite

Does Islamic Microfinance Offer Hope?

Search for better options must continue.

1. Do Islamic MFIs offer superior products?
2. Do Islamic MFIs offer financing at affordable prices?
3. Do Islamic microfinance provide healthy competition to their conventional counterparts?
4. Do Islamic MFIs better serve the destitute?
5. Why and how should philanthropy and voluntarism be integrated with Islamic MF?
6. How should Islamic MFIs be regulated and governed?

1

Product

Complex? Simple? Value-adding?



Do Islamic MFIs offer superior products?

- ❖ Freedom from contractual complexity
- ❖ A wider range of products: grant-based, credit-based, lease-based and partnership-based
- ❖ Sector-specific products: agriculture, manufacturing, trade, housing
- ❖ Usually packaged with skill-enhancement, procurement, market and business development services (smart factor)

Example: Wasil, Bank Khartoum Agri-finance

1

Product

Complex? Simple? Value-adding?



Diverse Product Offering by Wasil Pakistan

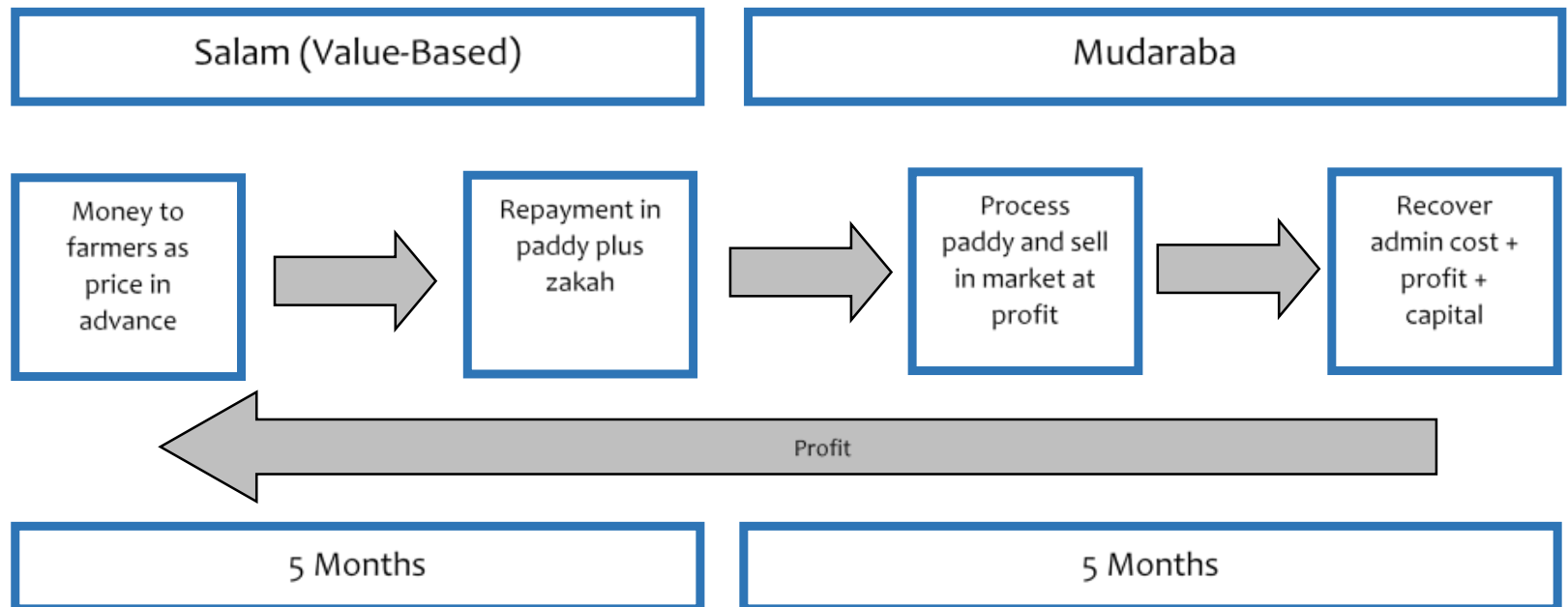
Mode	Target Beneficiary
Zakat, Sadqat	Destitute unable to work
Qard e Hassan	Poorest of the poor with ability to work
Murabaha	Micro level traders, street hawkers, Small shopkeepers
Salam	Small Farmers up to 5 acre land holding
Istisna	Micro manufacturers in different sectors
Ijara	Farmers without land holding (Rental Land)
Diminishing Musharaka	Micro entrepreneur in need of assets
Master Salam (Ijara + Salam)	Farmers in need of land plus money for cultivation

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Product

Complex? Simple? Value-adding?

Value-Based Salam Financing by Muslim Aid Sri Lanka

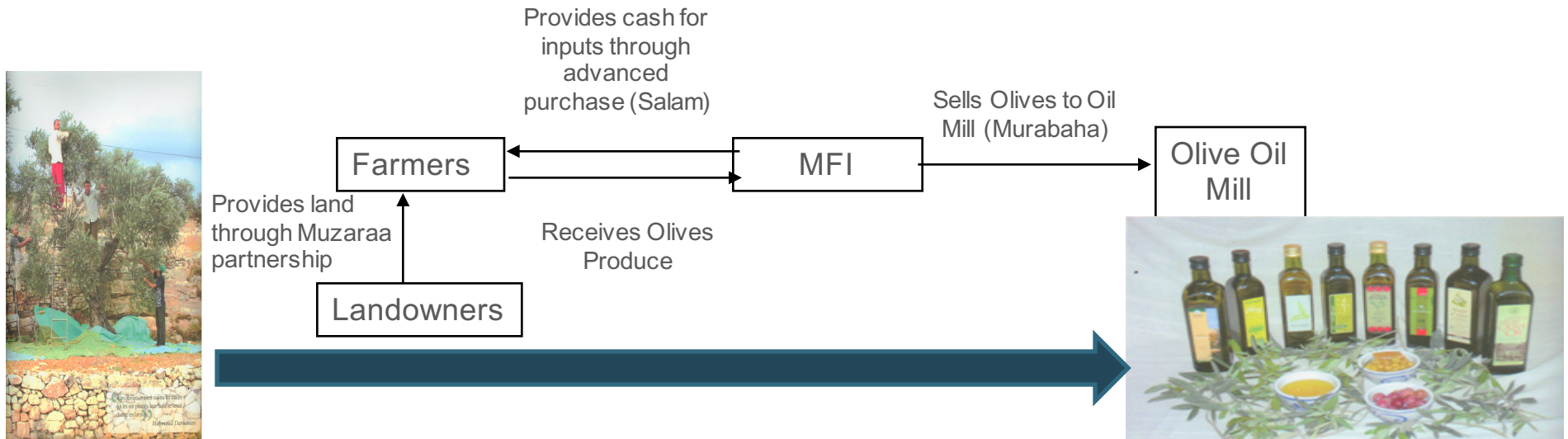


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Product

Complex? Simple? Value-adding?

Value-Chain Financing by IDB in Palestine



The Islamic MFI is involved in each step of the Olive value chain

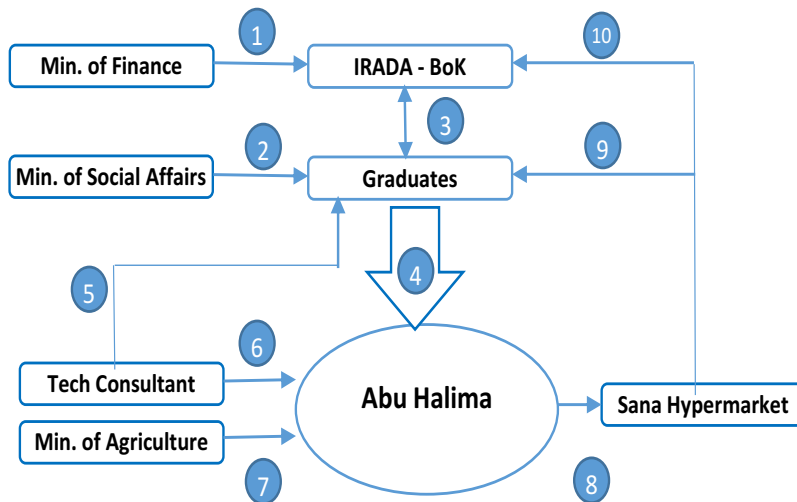
- Facilitates Muzaraa agreement between landowners and the poor farmers
- MFI will provide Salam (advance) Financing for Olive Seeds & fertilizers
- Olives Collected is sold to the Olive Oil Mill for a profit

1

Product

Complex? Simple? Value-adding?

Value Chain Financing by Bank al Khartoum



1. Financial partnership between Ministry of Finance and BoK
2. Nomination of agriculture graduates for the project by Ministry of Social Affairs
3. *Mudaraba* agreement between IRADA (BoK) and the micro entrepreneurs (agriculture graduates)
4. Setting up of Abu Halima greenhouses
5. Technical consultancy to micro entrepreneurs
6. Technical consultancy to greenhouse establishment and operation
7. Provision of fertilizers and other services by Ministry of Agriculture
8. Sale of vegetables output to Sana Hypermarket and others
9. Sharing of profits (40% for 5 years and 100% after that) by micro entrepreneurs
10. Sharing of profits (60%) by IRADA-BoK for 5 years

2

Price

Can price be reduced to zero?



Do Islamic MFIs offer financing at lower prices?

- ❖ Operational costs and risk-premium similar to conventional microfinance; or even higher due to additional costs of Shariah-legal compliance
- ❖ Required profit rate on qard funds is zero
- ❖ Admin costs may be reduced through institutionalized voluntarism
- ❖ Lower admin costs may be absorbed by philanthropic fund flows (zakah, sadaqa and awqaf)

Example: Akhuwat, Islami Bank Bangladesh, Iranian Qard Funds

2

Price

Can price be reduced to zero?



The Akhuwat, Pakistan

Indicators	2008-09	2009-10	2010-11	Dec. 2011	Dec. 2012
No. of loans	44577	65650	99844	125,646	230,000
Loan disbursed (Rs. million)	488	739	1157	1500	3200
Percentage of recovery	99.50	99.86	99.85	99.82	99.83
Cities	15	20	34	45	105
No. of branches	21	33	53	62	153
No. of employees	90	181	358	419	785

2

Price

Can price be reduced to zero?



The Akhuwat, Pakistan

Year	Donation from borrowers (Rs Million)	Operating Expenses (Rs Million)	Donations from borrowers as %age of OE
2008	0.021	8.3	0.25
2009	0.010	10.4	0.10
2010	6.1	17.83	34.3
2011	12.3	36.7	33.4
2012	23.9	68.2	35
2013*	29.8		

Year	No. of Loans Disbursed	Amount of Loan Disbursed (Rs. Million)	Operating Expenses (Rs. Million)	OE as %age of Loan
2008	11,388	122.45	8.29	6.75
2009	13,821	164.23	10.38	6.32
2010	21,073	251.81	17.82	7.08
2011	34,194	418.21	36.67	8.77
2012	67,683	1,137.68	68.16	5.99

3

Competition

Creativity pays



Do Islamic MFIs provide healthy competition to others?

- ❖ Space for MFIs funded by grants, not-for-profit and for-profit funds
- ❖ Fear of market distortion appears to be largely exaggerated
- ❖ Sobering impact on profit-seeking behavior is good for long-term health of the sector

Example: Rural Development Scheme of Islamic Bank Bangladesh,

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Client

Creativity pays



Does Islamic MF better serve the poor?

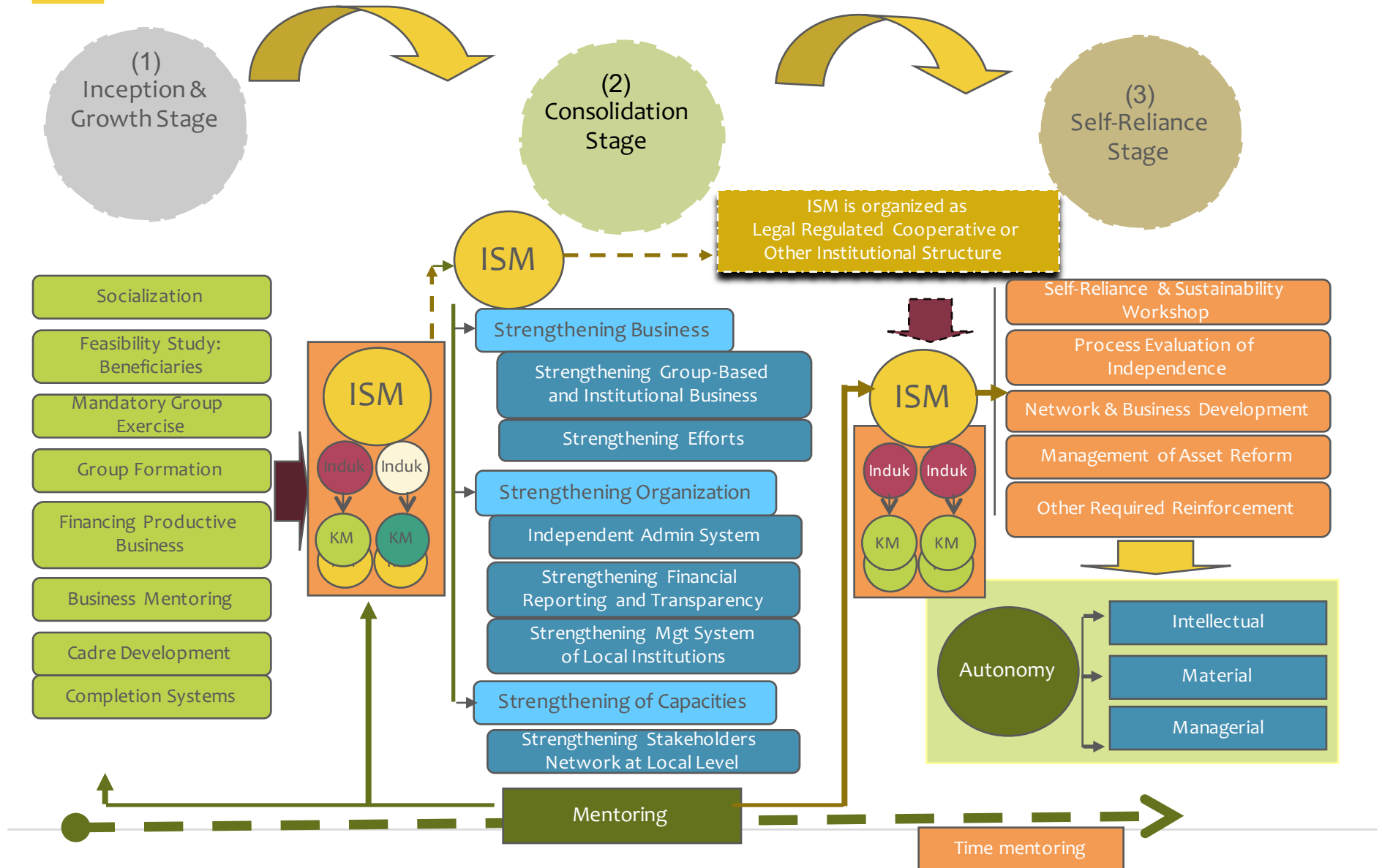
MFIs are not buyers and sellers of credit, but have a role in economic and social transformation

- ❖ Understand the needs of poor, design and offer “smart” products and services
- ❖ Involve participation of community
- ❖ Ensure cost efficiency through innovative and austere methods
- ❖ Establish endowments for provision of safety-nets, non-financial services and absorb specific elements of costs

Example: Dompot Dhuafa, Akhuwat, Islamic Bank Bangladesh, DEEP

4 Client

Masyarakat Mandiri, Dompet Duafa



5

Model

Benevolence? Profits?



How do we integrate philanthropy with MF?

- ❖ Zakat-funded community-driven-development (CDD)
- ❖ Zakat/ waqf-funded credit pool (Mustahiq-2-Muzakki)
- ❖ Zakat/ waqf-funded safety net + for-profit MF
- ❖ Zakat/ waqf-funded skill-enhancement + for-profit MF
- ❖ Zakat-funded guarantee + for-profit MF
- ❖ Waqf-funded micro-takaful + MF

Example: Dompot Dhuafa, Akhuwat, Baitul Maal Muamalat, Fae'l Khair, DEEP, Bank Khartoum

6

Regulation

Too little? Too much?



How should Islamic MFIs be regulated & governed?

- ❖ Issues in Shariah compliance while dealing with alternative sources of funds, e.g. zakat, sadaqa, waqf, qard, for-profit funds; Contractual compliance with Shariah
- ❖ Transparency, ethics and fairness in dealings – need for maqasid-driven regulatory framework
- ❖ Alternative organizational structures that must function under a well-coordinated body of laws and regulations
- ❖ Search for new solutions must continue

Example: laws of MF in Indonesia, Bangladesh

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Thank you

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