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An Over view of Islamic micro finance

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Abstract

This paper will u give an overview about Islamic microfinance and will establish a relation between Islamic microfinance and Islamic banking. As we all know there has been plenty of papers published on Islamic micro finance and its importance and its assumed role in eradication of poverty but there is less focus on relationship between Islamic micro finance and Islamic banking as they are often seem as separate entity but they are actually two side of same coin as there was always a special concern for poor's in Islam and concept of micro finance already exists in it long before it was actually developed in some form. so this paper will relate these two things.

Introduction

First we need to know what microfinance is , it is the banking services given to poor and self-employed peoples with the aim to eradicate poverty microfinance schemes are proven successful in many countries addressing problem of poverty (sheikh et. al,2021) , Islamic microfinance a missing compound in Islamic banking, microfinance scheme or products are different than usual product offered by bank as they are specially designed for poor and medium entrepreneurs so the poverty can be eradicated some of the products offered by microfinance institution are microloans ,microsaving and micro insurance. Micro loans are loans without collateral provided to low income household and low or medium entrepreneur. Second is micro saving it is basically a saving account but with no minimum limit and third is micro insurance it is also same as insurance but with lower premium. Now we need to know about Islamic banking well in islam ribba(interset) is a major sin both giving and taking in any form but financial service are also required like other peoples to promote business and satisfy other needs so to tackle that problem a new form of banking system was made using principles of holy Quran ,sunna(Doing of prophet Muhammad pbuh) and sharia. Islamic banking gives products and services which are free from ribba(interest). In islamic banking there already exist many products that can prove beneficial for poor peoples and low or middle class entrepreneurs so, when we talk about Islamic microfinance we use products that already exist in islamic banking . some products of Islamic banking that can be used as microfinance products are gardahasna , musharakah and muradha etc. Gard hasna is one of main product of

Islamic banking in gard hasna a person is provided with loan without interest and without any collectoral only on the basic of goodwill of the person and even agreed time is also extended. Second one is musharakah in this bank provide loan to a person who want to start business without any interest on profit & loss partnership i,e if the business generate profit a certain percentage of it is to be given to bank and if incurs losses than bank has to bear a certain amount of its loss and finally murabaha where bank buys a certain product required by the customer with certain of its own margin and the customer is require to pay it over a period of time. These are examples of some products provided by Islamic bank that can be used for microfinance purposes these products have many advantages over traditional microfinance products like gard hasna is best example of that as with no interest and collectoral it can prove very helpful and also in musharakh business man don't need to worry about interest on loan as he only have to pay when he earns profit and only a certain percentage of it and during loss doesn't have to bear all of it this can help to promote new startups and can help to eradicate poverty from its very roots. This paper will clear the concept of Islamic microfinance.

Review the literature

Islamic micro finance and Islamic banking have many elements comman and microfinance could be considered one of part of Islamic banking(by abdul Rahim) Islamic financial principles and microfinance are two major elements in the fast growing Islamic finance industry. Islamic financial principles do not only relate to financial need of the poor but also the social principles in caring for the less fortunate. Even though Islamic microfinance is at its infancy stage, but by providing financial products which comply with the Islamic financial principles would encourage the acceptance by the Muslims toward the financial aid provided by the microfinance institutions and also fulfil the demands among the Muslim clients.(shaheen mansoori) Many features in Islamic micro finance like cost benefits ,collectrol free etc has attracted many non muslim clients too(dr irfan ahmad sheikh) Islamic microfinance insititution often charges high fees which is considered often interest by borrowers. The weak role of IMFI's spirituality in society can be seen from the preference of the Muslim community in choosing financial services based on economic factors (low interest rate, less collateral, loan amount) and non-economic factors (service quality, ease, speed, proximity and loan officer profile) rather than religious factors (Masyita & Ahmed, 2013). A number of studies (Hadisumarto & Ismail, 2010; Mardhatillah & Rulindo, 2008; Riwajanti, 2014; Waspodo, 2008) highlighted that for the holistic goal of poverty alleviation and the development of IMFI's client performance, spiritual development is demanded in IMFI. This spiritual development is carried out through the internalization of Islamic moral values in the consciousness of the entrepreneur (akhlaq) to build honesty, discipline, passion, perseverance, patience, piety, social responsibility and awakening consciousness or to turn bad into good manner. Islamic microfinance is combining the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor especially for those who think that interest is prohibition in Islam (Dusuki, 2008). The prohibition of interest in Islam provides the microfinance industry with an opportunity to offer financial services to the poor mainly through a new emphasis on profit-generating activities in Islamic microfinance (Shirazi and Khan, 2009). Microfinance is often approached idealistically, as it is designed to help the poor. This is, of course, a commendable objective, but one that is often difficult to achieve given the complexities of poverty alleviation. In reality there are often social rather than simply financial factors determining poverty. The problem is not primarily a finance gap but rather due to the lack of knowledge and social discriminations that persists from generation to generation. In other words, the problem is not solely the supply of finance, but rather on the demand side. However, making shar¥cah compliant finance available for legitimate business activity that is perceived as úalŒl, together with technical assistance, may encourage poor Muslims to think about how they can make better use of their God given talents.5 The core concept to impart is that of khilŒfah (vicegerency), and righteous management of resources in terms of being aware of the responsibility to the Creator. The aim should be to reach the stage of mu‹ma'innah (a righteous state) by pleasing Allah, including serving fellow believers and by being economically productive(rodey Wilson). Islamic microfinance (IMFI) has become one of the important financial instrument in the Islamic world to alleviate poverty by providing microfinance services to the poor and even to the poorest .This is possible for Islamic microfinance because it combines two of the fastest-growing sector, namely microfinance and Islamic finance. Microfinance provides financial access for the poor while Islamic finance providing Islamic moral values that care about the lives of the poor (Besse Wediawati, Rike Setiawati). Some studies suggest that due some distinctive feature Islamic microfinance institutions can perform better than conventional microfinance institutions .The Islamic teaching provided to Islamic microfinance improves solidarity and rsocial between MFI and client which make them better debtors as it repayment is the part of faith(Ahmed 2002). There is an argument that spiritual commitment combined with practical support can be more effective in improving the lives of the poor than mere technical help can do (Tripp, 1999). In Islamic finance, the concern over poverty reduction via microfinance initiative is of relevance to Islamic banks. As business entities are established within the ambit of Shariah, Islamic banks are expected to be guided by Islamic economic objectives, among others, to ensure that wealth is fairly circulated among as many hands as possible without causing any harm to those who acquire it lawfully (Tahir ibn Ashur & Tahir El Mesawi, 2006). This could be done by enabling the low income earners to have easy access to micro finance. As financial institutions, IMFIs cannot avoid from getting problems related to risk. It is an inherent element and integral part of financial services in general and of microfinance in particular and indeed, profits are in part the reward for successful risk taking in business. On the other hand, excessive and poorly managed risk can lead to losses and thus endanger the safety and soundness of microfinance institutions and safety of microfinance institution's depositors. Consequently, microfinance institutions may fail to meet their social and financial objectives. This implies that proactive risk management is essential for long term sustainability of MFIs (National Bank of Ethiopia 2010). . Islamic economics is a young discipline and still in the process of development, therefore, it is not surprise that Islamic microfinance institutions (IMFIs) have not fully developed yet. Steps have been made towards the establishment and development of IMFIs, but there is a great room for improvement. MFIs are seen as a new approach to fight poverty and bring about development.(Edib Smolo). Islamic microfinance institutions operate by applying the values of Islamic teachings. These values include monotheism, the application of Shariah maqashid, prohibition of usury, upholding justice, eliminating injustice, and eliminating elements of gambling in financial transactions. The existing contracts at Islamic microfinance institutions consist of buying and selling based contracts (bai' al-murabahah), business cooperation-based contracts (al-musharakah, al-mudharabah), lease- based contracts (al-ijarah), and loan contracts, pure without interest (qardh-hasan).(Pupun Saepul Rohman a,b, Bayu Arie Fianto b,*, Syed Alamdar Ali Shah b, Umar Nawaz Kayani c,. Islamic microfinance is the application of Islamic values to promote social justice for all and to achieve economic development with building human capability as centre of attention. Hence, the content of moral and value aspect, emphasizes on the human side and communities responsibility, is likely to be more effective and comprehensive in poverty alleviation.(nur indah riwajanti). In comparison between Islamic microfinance and the conventional counterpart, both have similarities in terms of focused on economic development and social objective, aim to achieve a better life for whole people, support additional income, promote entrepreneurship, encourage risk sharing, believe that the poor should get involved in entrepreneurship activities Also, both are expected to rely on providing wider access to the poor, be a sustainable institution which can achieve "market based for profit approach", supported by efficient system and transparency reporting, with the focus on capacity building, combine with integration between microfinance and official financial system However, the main difference is Islamic approach emphasizes on important points of provision of financing and non-financing services to improve microenterprises, transparency, understanding and cooperation (Obaidullah, 2008b: 10).Some of the main difference between Islamic microfinance and conventional microfinance other than the above mentioned and interest are : conventional microfinance has only one category of poores while in Islamic microfinance has two categories deeply poor who do not need loan but require social safety net and zakat and those who are moderately poor who can became better if provided with loan. Target peoples for conventional microfinance it is poor and women but for islamic microfinance it is poorest families. Source of fund for conventional microfinance are external funds and saving of clients but for islamic microfinance it is external sources, saving of clients as well as islamic charity fund(zakat).when default occur i,e failure in payment of loans covential microfinance deals with giving threat, uses groups for pressuring them while islamic microfinance more ethical approach but sometimes may also uses groups. Given specific characters derived from Quran and hadiths (saying of Prophet),Islamic microfinance is provision of financial and non financial services based on islamic values with aim to promote justice for all. Considering that islam prefers community activities (Quran,5:2),islamic principles shape the nature of microfinance institutions as they operates under a group based appoarch and joint liability. It can therefore, be argued that the above characteristics seem to cover almost all aspects required by poor. However, attention should be given to the implementation of the spirit of Islamic microfinance so that it is not just an empty theory ; as the gap between the spirit and implementation is rather obvious.(Nur Indah Riwajanti). some weaknesses and problems found in certain location in terms of insufficient regulation and limited assets (Seibel, 2005). The role of microfinance in fulfilling social and development requirements is essential. Asutay (2010: 29) argues that, as part of the whole financial system, IBF has a unique character and it should apply the Islamic values contained in the Islamic Moral Economy (IME). The intention of the IBF should be to achieve both economic and social objectives, and these social objectives cannot be separated from IBF due to its obligation to implement the IME, to achieve "human-centered economic development" (Asutay, 2010: 29). On the other hand, the criticism that IBF is operating in an environment similar to conventional banking and failing to realise its social responsibility cannot be ignored (Asutay, 2010: 25). However, as the objective function of microfinance - to act as a development tool through capacity-building - is aligned with Islamic values, Asutay (2010: 29) suggests that the most suitable method of implementing IME in IBF is by conducting social banking and Islamic microfinance (IMF). Therefore, IMF is considered as a fundamental part of IME and IBF due to its ability to implement the values of IME in reality, hence bringing the idea of development into existence. In rationalising Islamic version of microfinance, it should be noted that the values and principles determine and essentialise the need to develop Islamic microfinance. In addition, conventional microfinance has been criticised because it is likely to charge its clients high interest rates; this is known as the debt-based approach, as they are dragged into debt (Asutay, 2010: 26). Islamic finance, hence, offers a moral approach through a profit and loss-sharing approach in the form of musharakah and mudarabah modes of financing (Asutay, 2010: 26) to prevent individual borrowers to be dragged into further debt. As IMF is based on asset-based approach as opposed to a debt-based approach, it is more appropriate for the needs of microenterprises since their profits from their businesses can be hard to predict. The providers of Islamic microfinance in micro level can be categorised as: (i) informal (individual such as friends, relatives, neighbours, moneylenders, saving collectors, pawnbroker, traders, processors and input suppliers and group (ROSCAs), (ii) member based-organisation, (iii) NGO, and (iv) formal institution (Obaidullah and Khan, 2008c: 23-24). The operation of individual informal sector should follow shariah rules; only repay the original amount of loan (qard hasan), fee based (ujrat), shariah compliant pawn brokering (al-rahn) (Obaidullah and Khan, 2008c: 23). There are some disadvantages of this sector, such as: very high-priced, inflexible, high risk, less apparent, at risk to fail because of corruption, mismanagement and environmental catastrophes (Obaidullah and Khan, 2008c: 24). While member based organisation might include village bank, self-help groups (SHG), credit union, and finance cooperatives, Islamic NGO might include zakah and sadaqah (charity) based organisation with deeper social objective. Islamic banks fall under category of formal institution, having the most potential to provide inclusive financial system.

Islamic microfinance tools

Mudarabah

It is a type of Islamic banking technique which can be used for microfinance purpose(Abdul rahimm 2012).In mudarabah a bank provides capital to an entrepreneur for doing business and the profit generated from business will shared by both Islamic bank and entrepreneur on pre determined ratio but the loss will only be beared by the capital provider .Here the capital provider is known as (rab –ul-maal) and the receiver mudarib .The mudarib as full controle over capital and rab ul maal can only monitor the mudarib that how he is using the capital but cannot actually interfere in the business operation. There are broadly five types of mudarabah I.e. single tier and two tier. In single tier there are only two person involved i.e. capital provider (rab –ul-maal) and receiver mudarib . However, in two tier mudarabh their are three persons involved the capital provider (raab –ul-maal) , intermediate mudarib and final mudarib. Here capital providers or raab-ul-maal is government or zakat funds which is than given to intermediate mudarib (Islamic bank or Islamic microfinance institution) who are given task to provide the capital to a suitable entrepreneur i.e. final mudarib .There are also two more types on the basis on degree of freedom to mudarib namely mudarabh muqayyadah and mudarabh mutlaqah as we already discussed earlier mudarib has a lot freedom in term of use of capital but in mudarabah muqayyadah rab-ul-maal has right to decide where mudarib can invest capital or which business he can do from it and in mudarabah mutlaqah mudarib is free to decide where to use it. Well mudarib should be given right where to use it as at the end of the day he has to use it and supposedly increase it. Fifth type is muza'ah it is a type of mudarabhah where Islamic bank finances a farmer or orchard owner at the time of harvest the produce is divided in raab –ul-maal and mudarib at pre-determined ratio. Let's take a example of a man namely ahmed who wants to start a shop he got the expertise's but not capital than he goes to the Islamic microfinance institution they will examine him to see if he is able to do it or will take a guarantor than will provide him money making him mudarib and IMF institution as raab-ul-maal it is clearly the mudarabah mutlaqh as mudarib is deciding where to invest the money .They decided to share the profit at 20:80 ratio i.e. when the business generates profit it will be divided into two parts 20% and

80% where 20% will be given to rab-ul-maal i.e. bank or IMF and 80% to the mudarib i.e. ahmad apart from giving principle amount but if incurs losses will be totally beared by rab-ul-maal.

Advantages

- IT is less dangerous for a person to get the mudarabah as it doesn't pull him in debt trap.
- It can also prove very profitable for banks as if the business generates a lot of profit they will make a large sum of money too.

Disadvantages

- Banks are at very high rish as there are neither collectrol nor guaranteed interest.
- Mudarib has to pay large part of his profits to the bank which can even get higher than interst on traditional loans.

. My opnion on mudarabah is that it can a prove very profitable deal for banks as we had already discussed earlier mudarib has to pay principle amount and also a certain percentage of profit that they have already agreed upon for an agreed time which can earn them a lot more than they had earned if they have given it as traditional loan but at the same time they are at a very high risk of losing the capital while as mudarib is at very safe position but he may also had to pay a much larger amount than traditional loan. So, in this way they sacrifices something and gain something in mudarabah whether it may be chance of earing or high safety.

Musharakah

It is a technique or scheme used by Islamic banking now also used in Islamic microfinance where capital is provided to the entrepreneur on the basis of partnership it is like mudarabah but a better version of it as in musharakah, (irfan et al., 2017) both the profits and also losses are distributed among both of them on pre agreed ratio which is just fair as like profits losses should be also shared as it is partnership .Musharakah has mainly three type musharakah mutanqish where capital is provided to a entrepreneur and he has to pay both principle amount and a share in profit which they already agree on but as he pays loan the share of profit given to bank is also decreased till a point that all profit is kept by entrepreneur. Also there is musharakah musaqat which is a musharakah service provided to industrial sector and also musharakah muzara'ah which is a musharakh service provided to agriculture sector but mostly orchard keepers where harvest is divided among both bank and entrepreneurs on pre-determined bases.lets take a example of barakat a small scale entrepreneur or a shopkeeper who is already running a shop but wants to open a another shop but he does not have the required capital but he got both the skill and experience to do it then he goes to a Islamic bank or (irfan et al., 2018) a Islamic microfinance institution where he gets the required capital in the form of partnership bases or musharakah that even in musharakah mutanquish where he agreed on repaying the whole capital in installment by giving 10% every year of the whole capital and 50% of the profit but every year when he pays the installment he has to pay 5% less but if he incurres losses he has to pay 50% of the losses i.e. the amount he has loosed of the total capital.

Advantages

- There is a chance that bank will earn more profit than it would had if he had given it as traditional loan as he receives both principle amount and also a part of profit for certain period of time.
- Those who take loan are at very safe position as they have to pay just a certain percentage if they incures losses.

Disadvantages

- Bank is at very high risk of losing whole capital as they will paid only a certain percentage.
- Those who take loan may have to pay more than what they might have to pay if they have taken traditional loan.

Murabahah

Mubarabah is a technique or scheme used in Islamic banking now also used by Islamic microfinance institutions (irfan at al., 2020). In murabahah a financial institution buys an asset or an equipment and then sell it to an entrepreneur on a higher price than they have purchased it on installment basis. One might think what is the difference between murabahah and normal emi or installment payment well in traditional emi a certain interest is to be paid by the customer let say 10% and he failed to pay it interest will be increased by 10% on the increased value i.e. cost plus 10% interest than if he fails more 10% interest will be applied on it this is how interest is applied on interest but in murabahah if payment failure occurs only a little penalty may be applied which is also highly unlikely. In murabahah the asset is delivered to the customer and he can use it but the ownership will be held by bank until all payment is done. In murabahah principle of sharia are to be followed like:1)It is to be confirmed that the asset is not to be used for harm things. 2) Good must be present at the time of sale.3) Goods must have a commercial use.4) Bank will hold ownership until all payments are done. Another difference between murabahah and traditional emi is that murabahah can only purchase and resell those product which have commercial use i.e. for business but not for personal use. Let's take example of Salem a shopkeeper who want to purchase a portable ice cream or softy maker for his shop but didn't have capital so, he approaches a Islamic bank or a Islamic microfinance institution where he gets a murabahah and he is told that they will purchase the required equipment with the specification he told them for about 25000 dollars and will sell him to about 30000 dollar on a monthly installment of 2500 dollar but he fails to pay it he have to pay penalty of 200 dollar and if he successfully pays it he will get ownership of the product but he can continuously use it during the time being he also have to sigh the memorandum or a contract for it

Iljarah

It a type of technique or scheme used by Islamic bank now also by Islamic microfinance institutions in which bank will purchase a product and then give it on lease or rent to a person mainly for business purposes where he pays a pre-determined rent on particular intervals of time(Irfan at el., 2018). Bank will also monitor the use of product to see if that it is used for a halal or permissible work according to Islam bank will retain its ownership. In a type of iljarah after a certain installment are paid entrepreneur will gets its possession when he pays a pre–determined amount of money is paid which of course will include their own profit. The responsibility of asset is of the user .A contract is signed by the lease as a proof that he agrees to all the conditions.

Gardhul hasana

It is a type of scheme used by Islamic bank now also by (sheikh irfan 2021) Islamic microfinance institutions in which a bank gives a person loan on goodwill and does not charge interest they may charge services fee. It is actually not made for banks rather for normal peoples so they can give their relatives loan and does not charge anything as they can do it because it is not their business rather just an act of kindness but when it comes to bank or Islamic microfinance institutions they have earn profit to give salaries to their employs and run things if they take service charges it will be as good as traditional loans and also for bank it is highly risky as they don't take any collateral too. It is highly disliked by banks too.

Summary

Indian Islamic Finance Islamic finance appears to be synonymous with Islamic banking to laypeople because banking is a widespread term and people are familiar with the name and fundamental operations of banks in general. Either they are self-motivated or forced to maintain their bank literacy knowledge However, research shows that Islamic funding, particularly for the poor, is not limited to banks; rather, it can range from a straightforward NGO to a full Islamic bank. Today, there are more than 500 Islamic microfinance organisations worldwide, and the majority of them are either NGOs or non-banking cooperatives. This proves beyond a shadow of a doubt that an Islamic fiancé is anything but straightforward and adaptable. Without a doubt, the fury is substantial and widespread if it is through pure banking. When seen in the context of pure Islamic finance, India is a virgin nation. It remains a pipe dream for the majority of people since mainstream banking is not permitted to conduct business directly; rather, it must act as an intermediary or financier for other entities. Additionally, this faith-based arrangement is not supported by the current legal framework. Islamic microcredit is no longer a foreign concept in the modern world; rather, it is a burgeoning market available to all communities, offering access to millions of disadvantaged people and evolving into a crucial tool for reducing poverty and a successful strategy for financial inclusion. The last ten years have seen industry growth globally.As estimated Alhuda center 2018, currently 500 institutions offer financial services based on microproducts that comply with sharia, servicing millions of male and female, Muslim and non-Muslim clients. Unexpectedly, Asian nations share a significant market. Pakistan, Bangladesh, and Indonesia share more than 80% of the customer outreach. On the other hand, despite the fact that the industry is developing, its outreach still only accounts for roughly 1% of microfinance outreach. Due to worldwide poverty, 1.2 billion people live on less than $2 a day, with 44% of them coming from Muslim-majority nations. As per estimates the industry is set to record growth rate of over 20% in by the end of year 2019. While addressing the underprivileged, it continues to criticize Islamic finance and Islamic organizations. However, due to the establishment of Islamic microfinance institutions (IMFI) in the 1980s, as well as its continued growth, expansion, and reputation According to the literature, Islamic microfinance combines microfinance with Islamic financing, potentially not only being effective to satisfy demand but caring more about the impoverished by combining Islamic social ideals (Sira et al.,2018).This being among reasons to address millions of poor towards faith based products. Despite Islamic credit programs for poor exists in different setups of countries structure no previous study has been published in relation to prospects of Islamic micro credit. Therefore the present study is an attempt to examine the future of Islamic micro credit in country, the determents of same would include awareness, motivation and attitude towards as Islamic micro credit prediction in country.

CONCLUSION

As per brief review about interest free micro finance we deduce that Islamic micro industry has roots from Islamic banking, however, the format for both streams of finance are union of the two. The growth rate of main stream banking opens new opportunities for practitioners and academician to ponder upon. The charity models are the extra benefit for micro industry which is missing component in the banking. The simplicity of products particular Qarde- hsana and mudarabah shows increasing trend at market place. it is time to work for the alternative methods for the overall growth of the economy

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