



THE ROLE OF ISLAMIC MICROFINANCE IN POVERTY ALLEVIATION IN BANGLADESH: A COMPARISON BETWEEN ISLAMIC AND CONVENTIONAL MICROFINANCE SYSTEM

Md. Rizwan Hassan

Associate Professor, Department of Business Administration

International Islamic University, Chittagong, Bangladesh

hassan.rizwan@gmail.com

Abstract

Microfinance has evolved as an economic development approach in developing countries. The pioneering role of Bangladesh in micro financing system has drawn world attention. This approach has been recently critically analyzed by scholars as having overlapping loan problems among the borrowers. In this paper, we have discussed Islamic microfinance as an alternative financial instrument of conventional microfinance. The role of Islamic microfinance in poverty reduction and employment creation has been examined in this study. To make a clear conceptual understanding, we use the example of Islamic Bank Bangladesh investment scheme. Conventional microfinance is based on interest, where the extremely poor are usually left out for being beneficiaries but Islamic microfinance are based on non-interest-bearing financial instruments with a priority of justice and moral values and encourages profit and risk sharing. The study found that Islamic microfinance programs provide opportunities for employment and generate income for poor people, particularly those who live in rural areas.

Keywords: Microfinance, Islamic Microfinance, Conventional Microfinance, Poverty Alleviation, Bangladesh

INTRODUCTION

The world attention has been earned in the microfinance system of Bangladesh for having the prestige of pioneering role in microfinance. The enormous size and famous institutions, replication of the model worldwide make the issue more significant to the researchers (Alamgir, Hassan & Dewan, 2011). Microfinance has developed an economic approach to benefit low income people. Bangladesh has the historic position in the development of the concept of microfinance. Grameen Bank, BRAC, and other institutions including Islamic microfinance system have paved the way of continuous economic development in the country (Yuge, 2011). The effects of microfinance are many, i.e., reduction of poverty is the most important aspect of microfinance system. Moreover, it takes care for social welfare, basic education, health services, water and sanitation programs, family planning, nutrition, economic programming, enhancing people's capability to take risks etc (Morduch and Haley, 2002).

A plenty of studies, show the beneficial activities of microfinance. It focuses on the instruments like small savings, insurance, remittance services etc. under the poor people. The micro credit programs go ahead in Bangladesh with the strategy of assisting the poor. It not only emphasizes on financial needs but also other social and institutional issues such as women empowerment, bringing rural poor in an institutional framework, reducing the dependency on informal money lenders (Alamgir, Hassan and Dewan, 2011). Another research is also describing the same importance that is microfinance institutions (MFIs) mainly aims at women development programs and alleviation of poverty from the society. Although social welfare is one of the issues of micro financing, it reconciles some financial goals as well, earning profit and ensure sustainability. On the other hand, Islamic microfinance is to serve the poor people by giving credit at low cost. It is growing progressively particularly in the poor countries in the world. It has been considered as an efficient instrument to encourage entrepreneurship and gives preference to create small to medium enterprises. The user of Islamic microfinance is mainly Indonesia, Bangladesh and Afghanistan consisting 80 percent of global demand (Abdelkader & salem, 2013). In this paper, we have tried to represent the issue of Islamic Microfinance (IMF) as a financial strategy for poverty alleviation. First we have tried to define IMF and after that make understand some basic differences between conventional micro financing system and Islamic micro financing system. At present several researches show that conventional micro finance creates over loan to the poor people. On the other hand, an issue has been already addressed by researchers like "Does microfinance really help the poor." (e.g Morduch, 1998). As it always promises for working against poverty, how can the aim be reached in case of burden of interest of conventional micro finance. As a result, alternative financial instrument of conventional microfinance, it has been emphasized on the role of Islamic micro finance system

as a special tool of poverty reduction and creation of employment. To make understand, we describe about the investment schemes of Islamic Bank Bangladesh as an example.

CONCEPTUAL FRAMEWORK OF ISLAMIC MICRO FINANCE

Islamic microfinance is a combination of two rapidly growing sectors: microfinance and Islamic finance. Islamic finance is based on Sharia, there is strict prohibition of paying or receiving any fixed, interest (riba). Therefore, Islamic microfinance institutions operate on the basis of profit. It is a credible alternative allowing financial service to the poor population at a lower cost. Following the rules of Islamic banking system, Islamic microfinance has three basic areas: trading, leasing and direct financing in profit loss sharing contracts (Abdelkader & Salem, 2013). It is also considered as an efficient instrument to encourage entrepreneurship and creation of small to medium enterprises (Admed, 2002).

Zakah and Sadgah are the most important instruments of charity in Islamic sharia. These instruments are also helpful for alleviation poverty. Rules of sharia are fairly clear about who are capable to give charity and who can benefit from Zakah. So Islamic MFIs can mobilize resources through accepting savings deposits or obtaining funds (Abdelkader and Salem, 2013). Kustin (2015) explained the concept of Islamic microfinance in a more terminologically. He discussed that Islamic microfinance is a financial technique for increasing overall market share of Islamic banking and finance by folding untapped population into formal financial activity. It is according to the direction of Sharia (Islamic Law) and establishes viable Sukuk (bonds), Takaful (Insurance). There is also participation of Sharia based stock exchange which expands the profile of Islamic microfinance through partnership and funding strategies permits people to meet their liquidity preferences. In this market, there is a secured access for the poor and establish Islamic banking finance industry. All of these economic activities are motivated and run by maintaining Al-Quran and Sunnah (the practices, teaching and path of the prophet Mohammed).

Islamic banking and finance institutions (IBFIS) report 2013 explores “ how the promise of Islamic microfinance lies in its unique benefits in terms of user experience, poverty alleviation related outcomes and product innovation, and access to poor clients who need liquidity but may be reluctant to engage with non -Islamic finance” (Kustin,2015).

METHODOLOGY

The present study applies the qualitative, conceptual, and descriptive research methods. The paper reviews existing research on the concepts of microfinance and Islamic finance. It is based on secondary sources from the existing literature and online platforms. It evaluates the

investment schemes from an Islamic bank in Bangladesh, called Islamic Bank Bangladesh Limited (IBBL). It attributes the practical application of an Islamic bank to how it performs for the micro-finance system to contribute alleviate poverty.

FINDINGS AND DISCUSSION

Financial products of Islamic Microfinance

A number of financial instruments are making business in the modern Islamic financing system. According to Dhaoui (2015) the instruments used are discussed below:

1. Participatory profits-loss sharing (PLS) modes, such as mudaraba and musharaka;
2. Sale based modes, such as murabaha;
3. Lease based modes or ijara;
4. Benevolent loans or qard-hassan with service charge only.

Islamic Vs Conventional Microfinance System

Ahmed (2002) has described precisely between Islamic and conventional microfinance system. First he described about the sources of these two financing system. Conventional MFIs come from foreign donors, multilateral and national agencies, government, central banks, savings of clients etc. On the other hand, the sources of Islamic MFIs come from spiritual groups, Islamic humanitarian sources, client savings, international benefactors, national organizations, the private sector, etc.

Secondly, conventional MFIs are based on interest, where the extremely poor are usually left out of the financing model but Islamic MFIs are based on non-interest-bearing financial instruments. As integrating Zakah as an instrument of financing, the extreme poor are benefited from the Islamic MFIs.

In conventional MFIs, there is a deduction at the inception of the contract. While the funds are deducted from the principal in case of conventional banking, there is no deduction in case of Islamic MFIs. In addition, the social development programs available for conventional MFIs are secular, ethical and social development. Islamic MFIs contain the social development program, including behavior, ethics, and social values.

According to Kustin (2015), in Islamic microfinance does not use the system of conventional banking. It typically uses “financing” instead of “loan”. It is fully based on Sharia compliance. Where a loan contains interest, but Islamic microfinance offers business on sales or partnership. However, different IMF approaches vary according to country, sensitivity of religion practice, corporate culture and local language. On the other hand, conventional microfinance overwhelmingly deals with women empowerment initiatives; however, Islamic

microfinance does not mandatorily finance just women, but rather it provides finance to need-based clients. For example, Islamic Bank Bangladesh Limited has launched Islamic microfinance programs, not only giving importance to women's economic achievement but also with a motive to help the poor and helpless from the end. The contention on this matter is that Islam encourages the ideas of family empowerment in order to involve men and women in fulfilling their respective duties in pursuing the social and economic well-being of every family member. In fact, Islamic ideals and values are at conflict with women's exclusive approach to traditional microbusiness growth and poverty alleviation. However, women might be exploited in these conventional micro financing programs instead of being empowered. It might be happened that women take the loan, and the loan related liability can be served by male members or their loan might be not utilized by the male members in the family. Therefore, the merit argument on Islamic micro finance is that it not only makes way of financial success for a woman but also her family members (Kustin, 2015).

Islamic Microfinance in Bangladesh

Islamic microfinance products have been introduced in a few countries. Indonesia, Bangladesh and Afghanistan are the top three countries to demand Islamic microfinance products containing 80 percent of total world demand (Abdelkader and Salem, 2013). Islamic microfinance institutions (MFIs) have a better performance than conventional MFIs in Bangladesh. There might be brought this issue as Bangladesh has varieties of conventional micro finance institutions why people should interest in Islamic MFIs. The importances of launching Islamic microfinance in Bangladesh are in several folds, the most of the reasons behind this issue base on religious factors and poverty alleviation.

Bangladesh is officially a muslim country, and it is the third largest muslim country in the world where more than 90 percent population belong to the muslim faith. Following the rule of Sharia, the prohibition of riba basically is encouraged people to take Islamic MFIs as a financial strategy.

According to the statistics of Bangladesh in 2025, 28 percent of the population living below the poverty line, and more than 9.35 percent live in extreme poverty. The paper of Banihani (2012) depicted that there is a high rural- urban economic disparity in Bangladesh, and the incremental growth is associated with insufficient and poor education, health, and sanitation facilities. The Islamic financing system aims to help extremely poor people through charity. That is why people who are suffering from extreme poverty can get certain benefits from Islamic microfinance.

In Bangladesh is a traditional agricultural system where about 60 percent people live in rural areas. Although more than 44 percent labor force is dependent directly on agriculture. The human resources have not been utilized properly due to lack of education, per capita income, facilities for vocational training, and access to land. But women's employment in the readymade garments sector has brought the potential of human resources in Bangladesh. The government of Bangladesh has given priority on rural poor women and youth to the development agendas. On the other hand, a broad-based approach has been emphasized for poverty alleviation and macroeconomic stability. Besides the role of government agencies, NGOs and private sectors have been also included in this development agenda. Where micro finance especially Islamic MFIs stands for aiming at equity based economy (Banihani, 2012).

Dhaoui (2015) described how Islamic microfinance in Bangladesh works and how much it contributes in poverty alleviation in Bangladesh. As Bangladesh is a muslim major country, here a lot of Islamic financing institutions prevail like Islamic Bank Bangladesh, Social and Investment Bank Bangladesh, Al- Fallah and Rescue etc. These institutions basically are using deferred-payment sales (baymuajjal) mode of financing. They are facing always a competition with the conventional types of institutions like Grameen Bank and BRAC. On the basis of several research paper Dhaoui found that Islamic microfinance institutions are performing quite well than their conventional counterparts. But the Islamic micro finance system has not yet get popularity globally as Grameen Bank and BRAC have pioneered models of micro finance across the world. He also argued that although Grameen Bank makes the business according to interest based portfolio, it is quite different from conventional interest- based system. For example, Grameen bank is very soft with borrowers it does not claim any financial mortgage from the borrower, which is absent in case of conventional banking system. Researcher pointed out that the Grameen Bank's departure from the conventional one might very close to Islamic ideals.

Now we can point out the activities are conducted by Islamic micro finance in Bangladesh. Islamic Bank Bangladesh investment scheme has been evaluated as for an example. The investment schemes are as follows:

1. **Small Business Investment Scheme:** It helps to educate unemployed young generation both in rural and urban areas. After getting proper education and training facilities, they can either enter into the job market or become self-employed. The most important scheme of this sector is that providing investment to small business entrepreneurs. It is very important for the poor people in Bangladesh as they can start a business within this credit and expand the business in future, if people are active and trustworthiness.

2. **Agricultural Implement Investment Scheme:** It is also beneficial for the poor farmers in Bangladesh because a huge number of people are dependent on agriculture and they are also living below the poverty line. This schemes provides money to buy agricultural instruments like power tillers, power pumps, shallow tube wells, thresher machines etc. on easy terms to unemployed rural youths for self-employment.
3. **Women Entrepreneurs Investment Schemes:** There are some important programs for creating women entrepreneurship. It provides assistance on potential unemployed women to involve them in production process. As women from developing countries are used to making business in households, Islamic Bank invests money on the small business can be conducted by women in the households. For example the cottage artifacts in Bangladesh is very popular all over the world. On the other hand, there are also programs to uplift of socio-economic condition of women by diversifying investment portfolio.
4. **Rural Development Scheme:** Islamic micro finance has introduced rural development scheme by understanding the issue of huge rural-urban disparity in Bangladesh. The aim of this scheme is to generate employment and raise income to the rural people with a view to alleviating poverty. Some of the programs under this scheme are investment in farming and off- farming sectors, self-employment by taking projects for the youth entrepreneurs, utilization of rural human and natural resources, investment in rural housing, safe drinking water, sanitation etc.
5. **Integrated Development Approach:** This scheme not only focuses on micro level investment facilities but also ensures some facilities and services to integrate people under development program as well as corporates social responsibilities. Some of the well-known programs are education and training, health and medicare programs, environment protection program.
6. **The Urban poor development scheme:** Beside rural development programs Islamic Bank Bangladesh has taken several development programs for urban poor people. For example, improvement of living hood urban poor slum dwellers, improvement of the education, health, sanitation status of poor people especially children and women.

CONCLUSION

Bangladesh has already gained the prestige of pioneering micro finance system. If micro finance does not covers all it's roles and sometimes fails to poverty alleviation, Islamic microfinance should be treated as an effective alternative for people. By giving the impoverished access to microcredit, microfinance organizations have developed to reduce poverty. Islamic

microfinance developed as a substitute for conventional microfinance as it relies on interest, while Islamic microfinance encourages profit and risk sharing. According to the report, Islamic microfinance programs help the impoverished, especially those who reside in rural regions, find work and make money. Islamic microfinance is an interest-free method that improves participants' lifestyles and lowers poverty levels. Therefore, the researchers need to focus on Islamic microfinance to raise people's financial status and lower the poverty rate in Bangladesh. Further research should be given importance by researchers on this issue.

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