**Unlocking Vistas of Islamic Microfinance in India - A Model for Poverty Reduction**

Muhammad Nauman Khan\*!

Mohammed Ziaur Rehman+

**Abstract**

India’s achievement of the Millennium Development Goals (MDG) of halving the population of poor by 2015 as well as achieving a broad based economic growth hinges on successful poverty alleviation strategies. With the Sachar report having already served as an eye-opener to the harsh reality about the status of Muslims in Indian society, the impoverished conditions of the Muslims will undermine the chances of India meeting its MDG targets. Islamic microfinance has the potent to reduce poverty among the Muslim populace in India. Islamic microfinance establishments are based on Shariah tenents. As majority of Muslim populace yearn for Islamic products over conventional microfinance products on account of religious injunctions against paying interest, the Islamic microfinance products are forceful to take care for the less privileged in tandem to deliver financial access to the poor.

This paper presents the channels that can be applied to finance the Muslim clients. The paper encompasses the distinctions between Islamic and conventional microfinance, primarily focusing on the conceptual framework of the Islamic Microfinance Institutions (IMFIs).It also manifests the sources, through which Islamic microfinance institutions can spawn funds, the paper concludes that IMFIs, can proffer various programs that shall not only lead to poverty alleviation but also be instrumental for the economic development of the Indian economy.

**Keywords:**

Microfinance, Islamic Microfinance, Entrepreneurship, Poverty Alleviation

\*Lecturer, Department of Finance, College of Business Administration, King Saud University, Riyadh, Saudi Arabia [mnauman83@gmail.com](mailto:mnauman83@gmail.com) ; [nkhan1@ksu.edu.sa](mailto:nkhan1@ksu.edu.sa)

! PhD Research Fellow, Institute of Islamic Banking and Finance, International Islamic University, Malaysia.

+Assistant Professor, Department of Finance, College of Business Administration, King Saud University, Riyadh, Saudi Arabia [ziacommerce@gmail.com](mailto:ziacommerce@gmail.com)

**Introduction**

Poverty is a major problem and every government is trying to combat against it. Poverty is also one of the main problems in Muslim majority countries. The Islamic World encompasses fifty six Islamic countries with over 1.6 Billion people all around the world (Pew Research center, 2011). Except some countries of Middle East and the South East Asia, there are high and rising poverty levels in both rural and urban regions of most Islamic countries. Eradication of extreme poverty and hunger is the first goal among eight Millennium Development Goals (MDGs) of the United Nations Millennium Declaration (MD) 2000. Three targets of this goal are to be achieved by 2015 by the signatory countries. These targets include: (a) halving the number of people whose income is less than $1 a day, (b) achieving full and productive employment and decent work for all, including women and young people and (c) reducing the number of people who suffer from hunger by half (MDGs, 2000).

In the developing countries, nearly 3billion poor people lack access to the basic financial services needed to help them manage their precarious lives (CGAP, 2009). Around 1.7 billion people are hand to mouth and living lives below the poverty line. Amongst them 44 percent are residing in Muslim countries and this factor highlights the need of Islamic microfinance in an effective way. An estimated 72 percent of people living in Muslim-majority countries do not use formal financial services (Honohon 2007). Even when financial services are available, some people view conventional products as incompatible with the financial principles set forth in Islamic law. While conventional microfinance products have been successful in Muslim majority countries, these products do not fulfill the needs of all Muslim clients.

The Sachar Committee Report (SCR, 2006) outlines that Muslims across most parts of India, as a community are deeply impoverished and suffer from huge illiteracy, a high drop-out rate, depleting asset base, below average work participation and lack of stable and secure employment. Their deplorable situation is further compounded by their limited access to government schemes and programmes, poor credit flow from public banks and other financial institutions and meagre share in public employment. As a follow up exercise, the United Progressive Alliance (UPA) government at the Centre had introduced a series of ameliorative measures especially educational and financial to address the development deficits faced by Muslims, in particular, and religious minorities at large. Measures such as Multi Sectoral Development Programme, scholarship schemes for pre-matric, post-matric and technical education, enhanced credit flows to minorities through public sector banks, strengthening National Minorities’ Development and Finance Corporation, Madarsa Modernisation Scheme, Prime Minister’s 15 Point Programme were initiated. In quantifiable terms, the above mentioned schemes have fallen short of meeting the laudable aims with which they were launched.

The pervasiveness of caste, ethnic and religion based social exclusion in India has left specific sections of Indian population suffering from chronic poverty, illiteracy, ill-health and higher mortality rates. The impoverished conditions of the Muslims will undermine the chances of India meeting its MDG targets.For alleviating poverty from the society, governments use different strategies. One of the prominent strategies for reducing poverty is the use of microfinance.

Inspite of the very fact, that the great progress have been made in providing microfinance in last three decades for uplifting economic conditions of the poor but the developments are far from achieving targets. For the poor Indian Muslim populace in India, access of general public to the financial services is very low, despite the availability of these services owning to religious reasons.

This paper explains the differences between Islamic and conventional microfinance, cardinally focusing on the conceptual framework of the Islamic microfinance Institutions (IMFIs). This paper provides in detail, the modes that can be applied to finance the micro customers. Further, it educates about the contemporary outreach of Islamic microfinance. It also explains as how Islamic microfinance institutions can generate funds.

**Microfinance**

Microfinance is an effective and essential tool for poverty alleviation and reduction through providing financial services to destitute, poor or low income group, giving them a chance to break their vicious circle of poverty and contribute in economic development. Microfinance include services such as credit, savings, venture equity, insurance and remittance on a micro scale to those people who have limited financial means and traditionally considered non-bankable, mainly because they lack the guarantees that can protect a financial institution against a loss risk(Segardo, 2005). Good microfinance programs are characterized by:

• Small, usually short-term loans and secured savings products.

• Streamlined, simplified borrower and investment appraisal.

• Quick disbursement of repeat loans after timely repayment.

•Above-market interest rates to cover the high transactions costs inherent in microfinance.

• High repayment rates.

• Convenient location and timing of services (Fruman and Goldberg 1997).

During the 1980s and 1990s, all around the world microfinance programs were modified and thereby improved the lending methodologies and motivated the conventional wisdom to lend the poor due to many reasons. In fact among all development interventions, microfinance as a strategy becomes unique because it combines monolithic outreach, far reaching social and economic impact and financial sustainability among development interventions (CGAP, 2004).

The World Bank now estimates that in the developing countries, more than 7000 MFIs are providing services to 16 million poor people. The MFIs world-wide total cash turnover is US$2.5 billion and the potential for new growth is awesome. The Microcredit Summit estimates that US$21.6 billion is needed to provide microfinance to 100 million of the world's poorest families. Other estimates tell us that worldwide, there are 13 million microcredit borrowers, with US$ 7 billion in outstanding loans and generating repayment rates of 97 percent, growing at a rate of 30 percent annually. Despite all this, less than 18 percent of the world’s poorest households have access to financial services (Grameen Foundation, 2007).

In line with worldwide trends, microfinance in India emerged as an effort to reach out to the un-banked, lower income segments of the population. In the early 1960s, India realized the high welfare costs that resulted from the financial exclusion of low income segments, then predominantly dwelling in the country's rural areas. Identifying access to credit as an integral component of its development plan, the government initiated focused initiatives to rectify the imperfections in rural credit markets. Until the late 1960s, the credit delivery system in rural India was largely dominated by the cooperative segment. The period between 1960 and 1990, referred to as the “social banking” phase, saw a series of measures, nationalization of private commercial banks, expansion of rural branch networks, extension of subsidized credit, establishment of Regional Rural Banks (RRBs) and the establishment of apex institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small scale Industries Development Board of India (SIDBI).

After 1990, India witnessed the second phase of initiatives in rural credit delivery. It is during this period that “microfinance,” as it is understood today, first emerged on the Indian development scene. NABARD initiated the Self Help Group (SHG) - Bank Linkage program, which links informal women's groups to formal banks. This concept held great appeal for non-government organizations (NGOs) working with the poor, prompting many of them to collaborate with NABARD in the program.

In 2000, the third phase in the development of Indian microfinance began, marked by further changes in policies, operating formats and stakeholder orientations in the financial services space. In the current decade, India witnessed a surge in its economic growth, a result of the reforms initiated in the early 1990s. Exhibit One cover the evolution of Microfinance in India from 1960s till date.

**Exhibit One**

**Evolution of Microfinance in India (1960s to Today)**

|  |  |  |
| --- | --- | --- |
| 1960s - 1980s | 1990s | 2000 |
| Phase 1: Social Banking  • Nationalization of private commercial banks  • Expansion of rural branch network  •Extension of subsidized credit  •Establishment of Rural Regional Banks  •Establishment of apex institutions such as National Bank for Agriculture and Rural Development and Small Industries Development Bank of India | Phase 2:  Financial Systems Approach  • Peer-pressure  • SHG - Bank Linkage  • Establishment of MFIs, typically of non-profit origins | Phase 3: Financial Inclusion  • NGO-MFIs and SHGs gaining more legitimacy  •MFIs emerging as strategic partners to diverse entities interested in the low-income segments  •Consumer Finance emerged as high growth area  •Increased policy regulation  •Increasing commercialization |

Source: Intellecap(2012),“The Changing Face of Indian Microfinance- Inverting-the-Pyramid,P.12

The studies have revealed that the conventional microfinance products have been valued by Muslim, but these products do not recognize the religious canons of Muslim populaces. Muslims constitute 13.4 percent of India’s total population. In absolute terms, their population in India is second only to that of Muslims in Indonesia. According to current estimates and research, India’s Muslim population is close to 175 million. Sixty percent of the community’s population is below 25 years of age and over 35 percent of the community’s total population lives in urban areas, thus making Muslims one of India’s youngest and most urbanized communities. Economically, the Muslim community is not much dependent on agriculture which is the mainstay of a major part (65 percent) of India’s population. Many prominent studies and reports have shown that Muslim participation in the financial system of the country is minimal. A report dated November 2006 by a committee headed by Justice Rajender Sachar (i.e. Sachar Committee Report) has reported that almost 50 percent of the community’s population is excluded from the formal financial sector.

The Islamic microfinance has the potential to rope in sizeable people, as majority of populace yearn for Islamic products over conventional microfinance products on account of religious injunctions against paying interest. In recent years, some microfinance institutions (MFIs) have stepped in to service low-income Muslim clients who demand products consistent with Islamic financial principles—leading to the emergence of Islamic microfinance as a new market niche.

Combining the Islamic social principle of caring for the less fortunate with microfinance’s power to provide financial access to the poor, it has the potential to reach out to millions more people. Islamic Microfinance products and Institutions shall help the majority of poor people in the financial system and shall assist in achieving Millennium Development Goal. Currently all around the world, the majority of Microfinance Providers (MFPs) offer interest based finances. Creditors demand for any increase on capital over and above the principal in lieu of time, as a condition for extending credit, is riba or interest, which is strictly prohibited in Islamic Shariah.

Islamic microfinance similarly provide services such as credit, savings, venture equity, insurance and remittance on a micro scale through the use of Islamic financial instruments within the precincts of *shariah*. Microfinance and Islamic finance have much in common. Islam emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole. In this light, many elements of microfinance are consistent with the broader goals of Islamic finance. Both advocate financial inclusion, entrepreneurship and risk sharing and believe that the poor should take part in such activities. Both focus on developmental and social goals. Both involve participation by the poor. (Dhumale and Sapcanin, 1998).Conventional Microfinance especially micro credit is not appropriate for a chronically poor and destitute. Islamic Microfinance has the ability to address the two important segment of society - Destitute “Economically Inactive” and Economically Active”. Mission based Islamic Microfinance firstly provides basic needs such as, food, shelter and guaranteed employment to destitute. Such safety nets may be funded through charity – *Zakah, Waqf, QardHasan* etc. (Obaidullah, 2008a).

Normally these individuals do not possess entrepreneurial and technical skills needed for wealth creation. Mission Based on Islamic Microfinance provide them appropriate training for making them economically active. As Islam permits for profit, trade and wealth creation, market based on Islamic microfinance provide services, such as, micro credit, micro saving, micro equity, micro remittance and micro *takaful* to poor and economically active individuals. Normally the modes of finance that IMFI uses are *BaiMuajjal-Murabaha, Ijara, Bai Salam, BaiIstisna, BaiIstijar*, and Equity based modes are *Musharka* and *mudarba* (Obaidullah, 2008b).

**Difference between Islamic Microfinance and Conventional Microfinance:**

The differences between Islamic MFIs and conventional MFIs are summarized in exhibit One

Exhibit One

|  |  |  |
| --- | --- | --- |
| Characteristic | Conventional MFI | Islamic MFI |
| Liabilities  (Sources of Funds) | External funds client savings | External funds client savings  Islamic Charitable Sources |
| Assets  (Mode of Financing) | Interest based | Islamic Financial Instruments |
| Financing the Poorest | Poorest are left out | Poorest can included by  integrating zakah with  micro financing |
| Funds transfer | Cash given | Good transferred |
| Deductions at  inception of contract | Part of the funds  deducted at inception | No deductions at inception |
| Target group | Women | Family |
| Objective of targeting Women | Empowerment of women | Ease of availability |
| Loan liability | Recipient | Recipient & spouse |
| Work incentive of employees | Monetary | Monetary and religious |
| Dealing with Default | Group/center pressure  and threats | Group/center/spouse  guarantee, and Islamic  ethics |
| Business risk | Mainly the client | Often shared |
| Loan transaction | Straight loan | Often transaction linked |
| Admin costs | Significant | More significant |
| Staff time | Significant | More significant |
| Social impact | Secular | Religious |

Source: Adapted from Ahmed (2002), "Financing Microenterprise: An analytical study of Islamic Microfinance Institutions," Islamic Economic Studies, Vol. 9, No. 2

**Emergence of Islamic Microfinance**

As Islamic banks are established and operate within the scope of *Shariah* (Islamic law), they are expected to be guided by an Islamic economic objectives (*Maqasid ul Shariah*) and ensure that wealth is not concentrated in few hands. It must be fairly circulated among the hands of a large number without badly effecting to those who acquired it legitimately (Ashur, 2006). Islamic finance industry is the fastest growing industry in last 30 years with double digit annual growth rate (Iqbal and Molyneux,2005).While the estimate of the exact volume of Islamic finance industry vary yet there are about more than 300 Islamic banking and finance institutions in 70 countries with investments worth 500 billion to 800 billion dollars(Arekat, 2006). It will also attract the 40 to 50 percent of the total savings of the 1.6 billion Muslims population worldwide by 2015 to 2017 (Alam, 2006). In recent studies, IFSB estimates that global Islamic finance industry’s assets which include Islamic banking, takaful, Islamic funds and sukuk to grow US$1.6 trillion in 2012 and will be US$4 trillion by 2020 (Omar, 2011). A further US$200 billion to $300 billion is managed by the Islamic banking branches and subsidiaries of international banks in the world’s major financial centers such as New York, London, Paris, Geneva and Tokyo (Banker Middle East, 2003). This is a clear recognition of the viability of Islamic financial industry and its steady significance in today’s banking worldwide.

Today’s formal Islamic Microfinance institutions are the recent development of applying Islamic finance principles in microfinance. Conventional Microfinance products do not fulfill the needs of many Muslim clients. They may be deterrent from participating in interest based Microfinance Program as *Riba* is forbidden in Islam. Even the religiously moderate clients may also prefer *Shariah* based products.

*Table one* throws light on the Islamic microfinance institutions by the country. It is revealed that Bangladesh has the largest Islamic microcredit outreach, with over 100,000 clients and two active institutions. However, Bangladesh is also the country where conventional microfinance products have the largest outreach of nearly 8 million borrowers and Islamic microfinance represents only 1 percent of its microfinance market. In all Muslim countries, Islamic microfinance still accounts for a very small portion of the country’s total microfinance outreach. For example, in Syria and Indonesia, Islamic financing instruments comprised only 3 percent and 2 percent, respectively of outstanding microfinance loans in 2006. In addition, the average outreach of the 126 institutions covered by the CGAP survey is only 2,400 clients (and none has more than 50,000 clients).

*Table two* covers the data on Islamic Microfinance Institutions by Type. Table illustrates that Islamic microfinance come through a number of organizational structures. Among the institutions that offer Islamic microfinance products, Non-Government Organizations (NGOs) are the dominant players in reaching the largest number of clients, with just 14 institutions reaching 42 percent of clients. Commercial banks (represented by only two institutions: Yemen’s Tadhamon Islamic Bank and Bangladesh’s Islamic Bank Bangladesh Limited) have the second largest outreach with over 87,000 clients. Interestingly, 105 Sharia-compliant rural banks in Indonesia account for 25 percent of total clients, but represent a sizeable share of 62 percent of the outstanding loan portfolio on account of their significantly higher average loan size and focus on small and microenterprise financing.

**IMFI Operations**

For achieving the goal of poverty alleviation, Islamic Approach uses the blend of Mission-based modes and Market-based modes. Mission-based modes are used normally for providing social safety net to destitute or the extremely poor. *Zakah, Sadaqa, Waqf* and *Qard-e-Hassan* are used as Mission-Based modes. Market-Based Modes are used for wealth creation and economic empowerment primarily through *Musharka, Mudarba,Murabaha, Ijarahas* Market Based modes.

**Mission Based Not for Profit Modes:**

In Islamic approach *Zakah, Waqf* and *Qard-e-hasan* are used as Mission-based not for profit modes.

**1-Zakah:**

Zakah is the specific share of a man’s wealth, nominated by Allah SWT that he has to give every year to those persons who are entitled to receive it. In the first phase, the basic needs of poorest of the poor can be fulfilled on top priority through *Zakah*. In the subsequent phase, the destitute may be made economically active through skill development programs and vocational trainings and their cost can be borne with *zakah*. After providing trainings, *zakah* funds may also be utilized to start a new micro-enterprise either in the form of interest free loans (*qardhasan*), providing raw material on profit basis (*Murabaha*) or making investment on profit or loss sharing (*Musharkah*).

**2-Waqf**

*A waqf* (plural awqaf) is an inalienable religious endowment in [Islamic law](http://en.wikipedia.org/wiki/Sharia). The *waqf* is created by giving away an asset that has the feature of perpetuity on a permanent basis. Therefore, *waqf* typically applies to non-perishable properties whose benefits can be extracted without consuming the property itself (Obaidullah, 2008b). For example, if a building is given as a *Waqf*, the rent of that building can be used for the charity, while the building is held intact as the original investment. *Waqf* is a form of continuous charity (*sadaqahjariyah*) and the rewards for this type of charity continue even after the donor's death for as long as people continue to benefit from the *Waqf*.

*Waqf* mostly involves devoting a land or building for religious or charitable purposes. However, some scholars also permit *waqf* of books, agricultural machinery, livestock, shares, stocks and even cash. This is deemed acceptable under the condition that the physical asset itself is not depleted with flow of benefits from such assets (Kahf,2003).

**3. Qard-e-Hasan**

*Qard-e-Hasan* means benevolent loan, beneficial loan, gratuitous loan, beautiful loan or interest free loan etc. Umer Chapra (1995) has given the definition of *qard al hasan* as *"Qard al-hasan* is a loan which is returned at the end of the agreed period without any interest or share in the profit or loss of the business".  Thus, *qard hasan* is a kind of benevolent loan that is granted to the poor for a fixed period of time. The borrower of the loan is required to pay only original principal amount of loan without any extra payment of profit or interest.

**Profit Based Modes**

Poor who are financially active may be provided financing in the form of profit based modes so that they can generate handsome income and spend a contented life. Profit based financing is very important for the IMFIs and for the whole financial system sustainability and development.

Islam restricts interest based conventional loans but it allows equity based, trade based and rental based credit facilities in which ownership of the commodities is transferred or use of physical asset in the productivity of business and in return payments will made in future period of time. It reduces the chances of unproductive utilization of resources as in the case of the conventional finance. These Profit based modes include *Musharakah*, *Mudarbah, Murabaha, Ijarah, Murabaha, Bai-muajjal, Ijara, Bai-salam, Bai-istisna and Bai-istijrar* etc*.*

**1-Musharkah:**

The root of the word "*Musharakah*" in Arabic is [*Shirkah*](http://www.meezanbank.com/AjaxFunction.aspx?id=352&width=250)*,* which means being a partner. Under Islamic jurisprudence, *Musharakah* means a joint venture formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution. Each partner has a right to participate in management, has full access to accounting, financial and business information and his consent is necessary for raising of capital from any new partner. (Usmani, 2002). If the Bank provides capital, the same conditions will apply. By using *Musharakah,* the IMFI and client creates a true joint venture partnership where capital, land and labour are provided by both parties to form a business. The profits are then shared in proportion to predetermined agreed ratio but any losses are born in proportion to the capital contribution. Instead of high risk for IMFI, it is an ideal alternative for the interest based financing with far reaching effects on both production and distribution.

**2-Mudarbah:**

*"Mudarabah*" is a special kind of partnership where IMFI gives financial capital or money and the entrepreneur provides human capital or services in a commercial enterprise. (Usmani, 2002).The financial investment comes from IMFI, named as "*rabb-ul-mal*", while the management of the business provides professional, managerial and technical expertise for initiating and operating the business. It is an exclusive responsibility of the entrepreneur, called as "*mudarib*". The profit of the undertaking is shared on an agreed percentage between the two parties, but in case of financial loss, capital provider will bear all loss and entrepreneur will lose its services.

**3-Murabaha:**

Murabahah is a particular kind of sale where the seller expressly mentions the cost of the sold commodity and sells it to another person by adding some profit thereon (Usmani, 2002). Thus, *Murabaha* is not a loan given on interest; it is a sale of goods for cash/deferred price. *Murabaha* is most popular product among the Islamic Microfinance Institutions (IMFI) due to its relatively simplicity and easy to operate.

In *Bai' Murabahah*, IMFI purchases the product on behalf of a client and resell it to the client on cost-plus-profit basis. Under this arrangement, the IMFI discloses its cost and profit margin to the client. In other words, rather than just advancing hard cash to the borrower, as conventional microfinance banks operate, the IMFI will buy the goods from a third party and sell those goods to the customer on agreed price.

**4-Ijarah:**

*"Ijarah*" is a term of Islamic *fiqh*. Lexically, it means 'to give something on rent'. It is an important product that is used by IMFI to finance clients. IMFI acts as lessor and allows its clients to use assets for a specific time period that act as Lessee in return of some predetermined rentals. The rentals are structured in a way that cover the cost of the asset and provide a fair return to IMFI. The IMFI after recovering its cost and fair return may simply donate the asset or sell the asset at a nominal price to its client. (Usmani, 2002).

In *Ijarah*, IMFI remain the owner of the assets throughout the *ijarah* period while client enjoy the benefits of the assets. All kinds of income-generating equipments or physical assets, such as, tools and machines to manufacture commodities, Cars, rickshaws and boats to transport people can be financed through this mode for the poor.

**5-Salam:**

*Salam* is payment in advance with delaying the receipt of the purchased item. (Usmani, 2002). Salam is an effective mode of financing for small farmers, traders and artisans. Farmers or artisans need short term loans to finance their household expenses and production process like purchasing raw material etc. Under *salam* agreement, IMFI make spot payment to the client against purchase of product, which is under the process of production. It fulfills their present needs and at a pre-agreed future date, they deliver the merchandize to the IMFI. The IMFI sells the products in the market at market price. The amount paid by IMFI to clients is lower than the selling price of the products in the market and difference is the profit of IMFI. It is necessary that the price, quality, quantity, time, place and mode of delivery should be clear in *salam* agreement, leaving no ambiguity leading to dispute (Obaidullah, 2008a). IMFI can hire any third party for the collective marketing of products that they purchase from their client**.**

**6-Istisna:**

*Istisna*' is a contract to develop or manufacture. Under *Istisna* agreement, a buyer orders a seller or contractor to manufacture an item according to the specification in the purchase contract to be delivered on a certain future date. The manufacturer uses his own material to manufacture the required item. Price must be fixed with consent of all parties involved. The buyer makes payment of price in parts over the agreed time period or in full at the end of the time period. In an *istisna*, the seller and the manufacturer or developer may be different entities (Usmani, 2002).

IMFI uses Istisna’ to finance the construction of apartments or building on behalf of its clients. IMFI hires the services of a third party through a parallel *istisna* arrangement. For example, if the client seeks financing for the construction of a shop, the IMFI may undertake to construct the shop on the basis of an *Istisna*. If the client does not own the land and wants to purchase that too, the IMFI can provide him with a constructed shop on a specified piece of land. The IMFI does not have to construct the shop by itself. It can either enter into a parallel *Istisna*’ with a third party or hire the services of a contractor (other than the client). It must calculate its cost and fix the price of *Istisna*’ with its client that allows him to make a reasonable profit over its cost. The payment of installments by the client may start right from the day when the contract of *Istisna*’ is signed by the parties. In order to secure the payment of installments, the title deeds of the shop or land, or any other property of the client may be kept by the financier as a security until the last installment is paid by the client. The IMFI will be responsible to strictly conform to the specifications of shop.

**Sources of Funds**

Although this paper focus on IMFIs operations and its different contracts, yet it is important to describe the sources of IMFIs. While it is always a long term goal of every microfinance institution to be self-sufficient in funds generation through mobilizing its own client’s savings but examples of self sufficiency of microfinance institutions through client’s savings is not common. Normally for running its operations, CMFIs are dependent on government or NGO’s financial aid or borrow money from other institutions on lesser or subsided interest rates. IMFIs also face the same problem of shortage of funds. But fortunately for the IMFIs, there are fixed source of huge funds that are not available for the conventional counterpart. In Islam, it is obligatory for all *Sahib-ul-Nasab* Muslims to pay 2.5% *zakah* on their wealth. In every Muslim society, any governing body can collect these funds and properly channelize those funds to the destitute and the poors. It is very important that in a society the objective of *zakah* is not to make handicaps but to make entrepreneurs, so that they become economically stable and also give the *zakah* next time and get exclude from the group of zakah takers. As discussed earlier, that *Awqaf* is also an important source of funds for the IMFIs. The religious bodies that govern the system of *zakah* and *Awqaf* in a society can give funds to the IMFIs on risk sharing basis and after proper contractual arrangements IMFIs can pass on these funds to their clients on same risk sharing basis. In this way, IMFIs gets a better position to take the risk of those profitable ventures that CMFIs ignore due to the chances of losses and lose good opportunities of profit making. IMFIs can do *Musharakah* and *Mudarbah* contracts with the fund providers and can also link the same contracts with the clients.

**Application in India**

Shariah Finance or interest-free finance is novel mechanism which has the potential to boost India’s economic growth. The Prime Minister’s Economic Advisor Prof. Raghuram G. Rajan has advocated (in the Report of the committee on Financial Sector Reforms) inclusion of Interest-free finance in Indian financial system. In the past few years, Indian regulators have approved schemes with exclusive claims of Shariah compliance. The following table gives a glimpse of the important actions that Indian government and institutions have taken in the recent past.

India Inc, having sensed the momentum building up in favor of Shariah Finance, and has started looking for strategic vantage positions to exploit the niche opportunity. Many private sector players have come up with Shariah-compliant/tolerant/friendly products abroad as well as in India. A leading private sector player has created an entire vertical for distributing Shariah tolerant products. Recently a major NBFC player has entered Shariah-compliant Leasing, along with participation from a foreign player. The viability of this mode of finance is greatly dependent on government regulations which impact on this type of transactions. Transactions based on Musharaka and Mudaraba based Financing too have been practiced by various entities. They have been used to promote ventures in various fields, Musharaka type arrangements mostly take on the modern partnership organisational format as they are essentially partnerships. Ministry of Minority Affairs is keen to bring its financing arm (National Minority Development Finance Corporation) under Shariah and they are further looking at strengthening Shariah compliance of various Muslim centred activities that fall under Wakf Act.

**Conclusion**

Microfinance has become very popular in last two decades as an alternate strategy of poverty alleviation. Much research work has been done on the efficiency, sustainability and impact study of the microfinance. But Islamic microfinance is the new field of interest. The studies show that there is huge potential of IMFIs to alleviate poverty in Muslim countries in particular and from whole world in general. In this way, IMFIs approach of poverty alleviation is more comprehensive and it is robust in the asset side and the liability side as compare to its counterpart conventional MFIs. Some studies about the impact, efficiency and sustainability of IMFIs have been done by many researchers. According to them, IMFIs are performing well in many countries in terms of efficiency, profitability and sustainability. It is widely acceptable due to religious beliefs of Muslims. But these studies also manifests that still there are many problems and inefficiencies existing in IMFIs. As it is an infancy industry, it entails comprehensive studies about impact assessment of IMFIs on the livelihood of customers by covering all the important variables. Further studies regarding efficiency and sustainability should be done, so that efficient, improved and sustainable services can be provided to the customers. It is also very important, not to just rely on *Murabaha* transaction as a key mode of Islamic finance but also use other desired mode of financing like *Musharkah* and *Qard-e-Hasan* and thereby make the analysis of the performance and make contractual & legal changes according to the required situation. Furthermore IMFIs should use other sources of funds like *zakah,* charity and waqf, utilize them to meet the basic needs of destitute. In this way IMFIs can increase their outreach by providing effective and *Shariah* compliant financial services to the poor Muslims in India.

**Table One**

**Islamic Microfinance Institutions by Country**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Institution | % Female | No. of Clients | Total financing (US$) | Avg. Financing (US$) |
| Afghanistan | 4 | 22 | 53,011 | 10,347,29 | 162 |
| Bahrain | 1 | n/a | 323 | 96,565 | 299 |
| Bangladesh | 2 | 90 | 111,837 | 34,490,490 | 280 |
| Indonesia\* | 105 | 60 | 74,698 | 122,480,000 | 1,640 |
| Jordan | 1 | 80 | 1,481 | 1,619,909 | 1,094 |
| Lebanon | 1 | 50 | 26,000 | 22,500,000 | 865 |
| Mali | 1 | 12 | 2,812 | 273,298 | 97 |
| Pakistan | 1 | 40 | 6,069 | 746,904 | 123 |
| W. Bank-Gaza | 1 | 100 | 132 | 145,485 | 1,102 |
| Saudi Arabia | 1 | 86 | 7,000 | 586,667 | 84 |
| Somalia | 1 | n/a | 50 | 35,200 | 704 |
| Sudan | 3 | 65 | 9,561 | 1,891,819 | 171 |
| Syria | 1 | 45 | 2,298 | 1,838,047 | 800 |
| Yemen | 3 | 58 | 7,031 | 840,240 | 146 |
| TOTAL | 126 | 59 | 302,303 | 197,891,882 | 541 |

\*Micro and rural banks only

Source: Karmin, N, M. Tarazi and K. Reille (2008), Islamic Microfinance: An emerging market niche, Consultative Group against Poverty (CGAP): Washington, DC, p. 8.

**Table 2**

**Islamic Microfinance Institutions by Type (Globally)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | No. of Clients | | Total Financing  Outstanding | | Avg. Financing |
| Institution Type | No. of Institutions | Number | % of Total | US$ | % of Total | US$ |
| Cooperative  Village Bank (Syria)  NGO  Rural Bank (Indonesia)  NBFI  Commercial Bank | 1  1  14  105  3  2 | 6,671  2,298  125,793  74,698  4,293  87,569 | 2  1  42  25  1  29 | 926,251  1,838,047  41,421580  122,475,158  1,893,207  29,030,997 | <1  <1  21  62  <1  15 | 132  800  303  1,640  595  305 |
| TOTAL | 126 | 305,237 | 100 | 198,090,268 | 100 | 629 |

Source:Karim, Nimrah, Michael Tarazi, and Xavier Reille (2008), “Islamic microfinance: An emerging market niche," CGAP Focus Note No. 29, August, p. 9.

**Table 3**

|  |  |
| --- | --- |
| **Action** | **Year** |
| Establishment of Anand Sinha Committee under the Reserve Bank of India for studying Islamic Financial Products. | 2005 |
| Appointment of Justice Rajinder Sachar Committee to report on the Social, Economic and Educational status of the Muslim Community of India | 2005 |
| Committee led by Prof. Raghuram G. Rajan recommends Interest-free banking for financial inclusion of Muslim community in India. | 2008 |
| Government of India calls for bids in connection with reconstruction of National Minority Development Finance Corporation (NMDFC) on Shariah lines. | 2008 |
| SEBI permits India’s first Shariah tolerant Mutual Fund. | 2009 |
| SEBI permits India’s first Shariah tolerant Venture Capital Fund. | 2009 |
| Government owned general insurance company starts international re-takaful operatrions | 2009 |
| Government of the state of Kerala announces launching of a Shariah-compliant Investment company. | 2009 |

**Source:** KPMG, TASIS (2010), “India Shariah Finance Summit 2010, New Delhi”, 26-28 April,PP22

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