An Integrated Approach to Islamic Microfinance for Poverty Alleviation in Bangladesh

Abdullahil Mamun, Mohammad Rahim Uddin and Mohammad Tauhidul Islam

To cite this article: Mamun, A., Uddin, M. R., & Islam, M. T. (2017). An Integrated Approach to Islamic Microfinance for Poverty Alleviation in Bangladesh. ÜNİVERSİTEPARK Bülten, 6(1), 33-44.

To link to this article: http://dx.doi.org/10.22521/unibulletin.2017.61.3

Abdullahil Mamun, International Islamic University Chittagong, Bangladesh. (e-mail: ahm.economics@gmail.com)

Mohammad Rahim Uddin, International Islamic University Chittagong, Bangladesh. (e-mail: mructg@gmail.com)

Mohammad Tauhidul Islam, International Islamic University Chittagong, Bangladesh. (e-mail: islamtauhidul202@gmail.com)
Abstract

The study critically examines the state of the Islamic Microfinance sector of Bangladesh to find its role in addressing poverty. The study constitutes linkage between Islamic Microfinance and Poverty Alleviation. It is a desk-based and library-oriented research relying on secondary data, structured on research objectives. Islamic microfinance organizations have not yet developed to the expected level in Bangladesh and thus Muslim citizens are compelled to borrow from conventional interest-based lending sources, but many underprivileged and small-scale entrepreneurs feel unable to access funding due to their religious ideology. Islamic concern for the disadvantaged makes it crucial to ensure Islamic microfinance services include their participation in the production process. Due to a lack of Islamic microfinance institutions in Bangladesh, the integration of Islamic microfinance with NGOs, NPOs (non-profit organizations), Zakah, Waqf, and capacity-building institutions to facilitate small-scale financial services to the poor can internalize them into the market mechanism and thereby work as a powerful tool for poverty eradication. This study proposes a new framework that directly addresses Islamic Microfinance and Poverty alleviation in Bangladesh.

Keywords: Microfinance, NGOs, NPOs, Zakah, Waqf, Poverty Alleviation.

DOI: 10.22521/unibulletin.2017.61.3
Introduction

Despite tremendous success in poverty reduction in Bangladesh, a significant proportion of the population is still suffering from poverty either in absolute or in relative form and thus remains a matter of great concern considering the social and economic costs of poverty (Mamun, 2013). Those who are thwarted in attaining desired social and economic goals legally often seek to obtain them through illegal means (Odumosu, 1999), and thus poverty is a major impediment to attaining social and economic stability in a country like Bangladesh. There are many microfinance organizations (NGOs) in Bangladesh trying to develop the poor and vulnerable by providing microloans with or without the requirement for collateral or mortgage; however, various studies have reported that these microloans do not alleviate poverty (Matin, Sulaiman, & Rabbani, 2008). Honohon (2007) found that in the 56 member countries of the Islamic Development Bank (IDB), only 28% of the adult population uses formal (or semiformal) financial intermediaries for deposit accounts or borrowing. This percentage includes the non-Muslim population living in these countries. Even when financial services are available, some Muslims view conventional products as incompatible with Islamic law and thereby 72% of people living in Muslim-majority countries do not use formal financial services (Honohon, 2007).

To mitigate poverty, different policies and programs have been attempted in recent decades, but poverty still persists extensively. Despite this, a few countries have made some progress in reducing poverty, and there is now an emerging consensus that many development programs aimed at poverty reduction have not achieved their intended results in many parts of the world. A large number of NGOs and Islamic Microfinance institutions (MFIs) provide collateral-free credit to the poor, but their investment risks are high, so in turn they charge a high rate of interest, which is detrimental to helping the poor change their fate. Besides this, most people in Muslim countries do not use conventional interest-based financial services as they are prohibited in Islam (Karim, Tarazi, & Reille, 2008). Therefore, reliable programs and strategies are needed to effectively mitigate poverty.

Muslim countries inherit very strong Islamic institutions of Zakah (a form of alms-giving treated in Islam as a religious obligation or tax), Sadaqah (voluntary charitable giving), and Waqf (an inalienable charitable endowment), or fighting against poverty. Early Islamic history demonstrates these charitable institutions to be very effective in taking care of the population’s needy in Muslim societies. During the time of Umar bin al Khattab (13-22H) and Umar bin Abdul Aziz (99-101H), Zakah was properly distributed and poverty was eliminated during their rule. However, due to the lack of poor recipients at that time Zakah collected in some regions could not be disbursed (Ahmed, 2008).

Though Zakah is obligatory to all Muslims who have nisab (the minimum amount that a Muslim must have before being obliged to give) amount of wealth, today the collection and distribution rate of Zakah is much lower in many Muslim countries. Besides, there is often a lack of proper authority to collect and distribute these funds. In Muslim countries it is estimated that the potential Zakah collection, if mobilized properly, could reach between 1.8% to 4.3% of annual GDP (Kahf, 1989). However, the potential for Zakah collection and its utilization for effective poverty alleviation still remains untouched.

IDB member countries like Malaysia, Saudi Arabia, Libya, Pakistan, Yemen, and Sudan have introduced a system of Zakah, whereas other countries have not done so as it is considered a private affair. It is a known fact that Muslims are paying their Zakah to the poor.
and to different charitable institutions; however, these transaction are not passing through proper channels, without any planning, and not managed as part of any strategy. The institution of Waqf and Sadaqah are of the same scenario. Therefore, the existing system itself is working against organized poverty alleviation. On the other hand, Islamic microfinance institutions are found to be an efficient instrument in addressing poverty, but their sizes are small and ineffectual when compared to the severity of the problem. Hence, it is necessary to broaden the frontier of Islamic microfinance institutions, primarily through their integration with the mainstream microfinance establishment. At the same time, more efficient accumulation of a Zakah fund, Waqf and Sadaqah and their mobilization through an appropriate channel will help address the desired eradication of poverty.

The study is presented in six sections. Delineating the objectives and methodology in this first section, followed by a review of previous studies to provide a theoretical framework for the study. Section three discusses the Islamic microfinance scenario of Bangladesh in terms of its performance and regulation. Issues hindering the scaling up of Islamic microfinance in Bangladesh are given in Section four. The fifth section offers an integrated approach to Islamic microfinancing in order to adopt the Islamic value of alleviating poverty. The final section summarizes conclusions.

Islamic Microfinance is a concept gaining worldwide attention as a Sharia-compliant alternative, which provides the poorer population with access to low cost basic financial services. It has created a conduit between the two rapidly growing sectors of microfinance and Islamic finance. Hence it has the potential to combine Islamic values and principles with the power of microfinance to provide the poor with accessible financial services.

Being Sharia-compliant, Islamic finance strictly prohibits payment or receipt of any fixed interest (riba). Islamic finance institutions earn their profits in three major areas: trading, leasing, and direct financing based on profit-loss sharing (PLS) contracts. Islamic Microfinance Institutions (MFIs) also abide by these rules. While conventional microfinance institutions claim a return from borrowers at a prefixed rate on their lending, Islamic microfinance offers major products like Murabaha (cost plus markup sale contract), Musharaka and Mudarabah (profit and loss sharing), Ijarah (leasing contract typically used for financing equipment), and Takaful (mutual insurance contributed to by participants).

One of the main problems of traditional microfinancing is its reliance on interest, which is contradictory to the teachings of Islam. On the contrary, Islamic Microfinance is a sector that has great expansion potential. Muslims often use conventional financial products, but various surveys show that if they had the choice they would use Sharia-compliant financial products, where available. Islamic financial principles not only serve the need of the Islamic value imbued poor, but also contribute to socioeconomic development by ensuring their participation in the market mechanism. Underprivileged Muslims may be more encouraged to accept Islamic microfinance products which comply with the Islamic financial principles.

Another distinguishing feature of Islamic microfinancing is risk sharing. As interest is prohibited, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits. And finally, conventional microfinance treats money as capital though there is no guarantee of its use in any productive activity. But Islam disregards treating money as "potential" capital; that is, it becomes actual capital only when it joins hands with other resources to
undertake a productive activity. Islam recognizes the time value of money, but only when it acts as capital, not when it is "potential" capital.

Figure 1 provides a clearer definition of Islamic microfinance in comparison with its conventional counterpart. Both in terms of sources of funds and financing, the area of Islamic microfinance is broader than conventional microfinance in the sense that the sources of funds in Islamic microfinance are much wider as it includes Zakah, Sadaqah, and Waqf as sources of funds along with conventional sources. Besides, Islamic microfinance serves the ultra-poor in addition to the poor, which are served through conventional microfinancing.

Figure 1. Sources of funds and its utilization: Comparison between IMF and CMF

In Bangladesh, Islamic microfinancing is at its infancy. Conventional MFIs have limited access in low-income Muslim communities because of two major reasons: they prefer to adopt Islamic law compliant microfinance, but mostly due to collateral problems. As conventional microfinance does not serve many of the poverty stricken who live by Islamic values, the need for Islamic microfinancing prevalent. With this simple backdrop, the objectives of this study are as follows:

- To conduct a critical evaluation of the microfinancing in Bangladesh, from both the traditional and Islamic perspective.
- To identify the obstacles for Islamic microfinancing practices in Bangladesh.
- To examine the ways to integrate Islamic microfinancing in Bangladesh in order to alleviate poverty.

This study is a desk-based and library-oriented research. It relies on various sources of secondary data that are annual reports of the Microcredit Regulatory Authority, Bangladesh Statistical Survey, Bangladesh Bureau of Statistics, and annual reports of different scheduled banks in order to critically examine the Islamic microfinance scenario in Bangladesh. The research consults with relevant books, journals, working papers, web articles etc., upon which a brief literature review gives a theoretical framework to the study. The study has been structured in light of the stated research objectives.

Literature Review

Adam Smith’s (1776) famous book, ‘The Wealth of Nations’, stated that ‘money makes money’ and thus injected the idea of microfinance in the literature of economics. If you have a little money it is often easy to make more money. Microfinance has received far-reaching recognition as a strategy for poverty alleviation and for economic empowerment, particularly in rural areas with a poorer population. Providing the poor with small amounts of credit at reasonable interest rates provides them with the opportunity to set up their own small-scale businesses (Mahmood, Fatima, Khan, & Qamar, 2015; Morduch & Haley, 2002). The problem faced by the poor is accessing funding due to lack of collateral upon which traditional microfinance institutions in Bangladesh rely, with a few exceptions.
Undoubtedly, microfinance is a good tool for poverty alleviation, but on many occasions the result is in fact the opposite (Durrani, Usman, Malik, & Shafiq, 2011). The main reason behind the negative result is the shortage of time, forcing clients to shut their business on many occasions which ultimately causes loss of time and money from the pockets of borrowers and thereby pushing them deeper into poverty.

There are many MFIs in Bangladesh such as BRAC, Grameen Bank, PKSF, ASA, and they are successful in terms of member numbers, the amount of loan disbursements and savings, and the innovation of their products (Khalily, Imam, & Khan, 2000). But the majority Muslim population largely do not benefit due to their discomfort with riba (interest) and there is a lack of Islamic MFIs in Bangladesh. However, being interest-free and social goal driven, the efficiency of Islamic microfinance in fighting poverty has been reported in a number of international studies. As the principles of conventional microfinance are not conducive with Islamic social norms, most people prefer Islamic microfinancing over its conventional counterpart (Durrani et al., 2011). Muslim demand for microfinance products based on Sharia compliance has contributed to the emergence of Islamic microfinance and it has the potential to expand financing to unprecedented levels throughout the Muslim world (Karim et al., 2008). As 90% of the population of Bangladesh is Muslim, the nation of Bangladesh can benefit from Islamic MFIs. Islamic microfinance gives the investor a chance to become involved in worthwhile projects which could essentially play a significant role in targeting poverty and alleviating it in many countries worldwide. IM primarily relies upon the provision of financial services to the poor or developing regions which are subject to certain conditions laid down by Islamic jurisprudence (Dhaoui, 2015).

Integrating Zakah with other Islamic institutions, Meisami and Hasanzadeh (2012) shows the distinctiveness of the model in reducing the challenges of interest-bearing microfinance institutes as well as poverty. Ahmed (2002) focuses on finding the most suitable Islamic financial means to be used in the Islamic microfinance provision. He argues analytically that asset-based Islamic trade contracts (like Murabaha) are more fruitful for inclusion in Islamic microfinancing.

Therefore, it is not possible to reach a many hardcore poor through traditional microfinancing, partly because of its limitations in achieving social goals as previously mentioned and partly because of being a country of Muslim majority, most of its population avoid interest-bearing contracts upon which most traditional microfinance institutions operate. On the other hand, the efficacy of Islamic microfinance organizations in addressing social problems makes it imperative to integrate such a system into the economy of Bangladesh.

**Islamic Microfinance in Bangladesh: Performance and Regulation**

Bangladesh has leading microcredit programs. A large number of NGOs are involved in providing collateral-free credit and have been able to alleviate poverty of millions of poor households through generations of self-employment over the last few decades. Microfinance programs in Bangladesh gained pace after the establishment of the Microcredit Regulatory Authority in 2006. Currently, microcredit programs in Bangladesh are implemented by NGOs, Grameen Bank, state-owned commercial banks, private commercial banks, and specialized programs of some ministries of the Bangladeshi government. In the microfinance sector as of June 2014, the total loan outstanding is around BDT 403 billion (including Grameen Bank, 10 government projects, and Commercial Banks) and savings...
stand at BDT 237 billion. The total number of clients in this sector is 33.73 million (including 8.62 million with Grameen Bank) that has accelerated the overall economic development of the country (Microcredit Regulatory Authority [MRA], 2014).

The development of microfinance in Bangladesh in recent years is summarized in Table 1. However, the limitation of Table 1 is that it shows the state of aggregate microfinance Bangladesh, without providing segregated data on the development of Islamic microfinance distinctly. The MRA lacks the machinery to regulate and supervise the Islamic microfinance institutions apart from the conventional microfinance institutions. In other words, the existing Islamic microfinance institutions of Bangladesh are regulated by the same framework followed for conventional microfinance institutions. As the source of funding and frontier of service of Islamic microfinance is quite different from the conventional offering, the absence of a distinct regulatory framework for Islamic microfinance is working as an impediment to their growth and development. This is powerfully reflected in the list of licensed microfinance institutions in Bangladesh, with only two Islamic microfinance institutions (observed by name) out of 689 as of December 27, 2016. Most academic literature on Islamic microfinance progress in Bangladesh address the Rural Development Scheme (RDS), the microfinance program of Islami Bank Bangladesh Limited (IBBL).

### Table 1. Development of microfinance in Bangladesh

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Licensed NGO-MFIs</td>
<td>516</td>
<td>576</td>
<td>590</td>
<td>649</td>
<td>676</td>
<td>697</td>
</tr>
<tr>
<td>No of Branches</td>
<td>17,252</td>
<td>18,066</td>
<td>17,977</td>
<td>14,674</td>
<td>14,730</td>
<td>15,609</td>
</tr>
<tr>
<td>No. of Employees</td>
<td>109,597</td>
<td>111,828</td>
<td>108,654</td>
<td>110,734</td>
<td>109,628</td>
<td>110,781</td>
</tr>
<tr>
<td>No. of Clients (million)</td>
<td>25.28</td>
<td>26.08</td>
<td>24.64</td>
<td>24.6</td>
<td>25.11</td>
<td>26.00</td>
</tr>
<tr>
<td>No. of borrowers (million)</td>
<td>19.21</td>
<td>20.65</td>
<td>19.31</td>
<td>19.27</td>
<td>19.42</td>
<td>20.35</td>
</tr>
</tbody>
</table>

Source: MRA-MIS Database (Microcredit Regulatory Authority [MRA], 2015).

The overall growth of microfinance programs among different sources is shown in Table 2. Clearly, microfinance institutions are playing the leading role in the microfinance sector of Bangladesh, and the steady growth of microfinance programs has an important impact on the enhancement of macroeconomic growth. But Table 2 displays only a partial picture of the true contribution of microfinance to the economic growth of Bangladesh as it only includes microfinance programs of the Top 10 MFIs. Moreover, the contribution of Islamic microfinance is completely set aside from the table. However, the progress of Islamic microfinance is not satisfactory as, despite having a good potential considering its sources and funding uses, the cumulative disbursement of Islami Bank Bangladesh Limited (IBBL) up to December 2016 under its Rural Development Scheme (RDS) was only US$ 20,492.57 million which was the maximum among all private commercial banks in Bangladesh registering the highest recovery rate of 99.54%. Institutionally the development of Islamic microfinance is confined to IBBL’s RDS programs, and accordingly, most of the studies conducted to evaluate the growth and development of Islamic microfinance in Bangladesh employ the data of the IBBL’s RDS programs. In view of the limited access of conventional microfinance to certain low income communities, those lacking collateral and specifically in Muslim communities those in search of Islamic-compliant microfinance, undoubtedly Islamic microfinance in Bangladesh is operating far below its potential.
Persistent increase in microfinance programs of ministries, banks and NGOs prove its importance for poverty alleviation. But, unfortunately the role of Islamic Microfinance institutions are left ignored as business opportunities are not provided, nor is the recognition of their contribution. The Rural Development Scheme (RDS) introduced in 1995 and the Urban Poor Development Scheme (UPDS) launched in 2012 remain the leading Islamic microfinance schemes since their launch. Apart from NGOs and Grameen Bank, who are particularly engaged in microcredit distribution, the microfinance programs of ministries and scheduled banks followed a downward revision one or more times over the last few years, while the growth of RDS (see Figure 2) since its inception maintains a persistent growth which reveals the potential of Islamic microfinance in checking poverty. Considering the appeal of Islamic microfinance, it is high time to take the initiative of its mainstreaming and remove the barriers against which it is striving.

Table 2. Micro-Credit Programs in Bangladesh** (in US$ million)*

<table>
<thead>
<tr>
<th>Source</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disb.</td>
<td>1734.40</td>
<td>1796.97</td>
<td>1738.07</td>
<td>2021.75</td>
<td>2204.87</td>
<td>2212.10</td>
</tr>
<tr>
<td>Rec.</td>
<td>1565.12</td>
<td>1753.97</td>
<td>1632.85</td>
<td>1964.64</td>
<td>2319.74</td>
<td>2125.77</td>
</tr>
<tr>
<td>% Rec.</td>
<td>90.24</td>
<td>97.60</td>
<td>93.94</td>
<td>97.17</td>
<td>105.20</td>
<td>96.10</td>
</tr>
<tr>
<td>Schedule Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disb.</td>
<td>254.91</td>
<td>194.21</td>
<td>303.37</td>
<td>295.15</td>
<td>323.03</td>
<td>501.68</td>
</tr>
<tr>
<td>Rec.</td>
<td>201.31</td>
<td>187.88</td>
<td>300.38</td>
<td>294.36</td>
<td>316.76</td>
<td>646.09</td>
</tr>
<tr>
<td>% Rec.</td>
<td>78.97</td>
<td>96.74</td>
<td>99.01</td>
<td>98.73</td>
<td>98.06</td>
<td>128.78</td>
</tr>
<tr>
<td>Grameen Bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disb.</td>
<td>1107.53</td>
<td>1302.56</td>
<td>1464.65</td>
<td>1528.47</td>
<td>1637.25</td>
<td>1780.80</td>
</tr>
<tr>
<td>Rec.</td>
<td>971.08</td>
<td>1173.62</td>
<td>1361.53</td>
<td>1476.63</td>
<td>1589.30</td>
<td>1735.17</td>
</tr>
<tr>
<td>% Rec.</td>
<td>97.20</td>
<td>96.89</td>
<td>99.01</td>
<td>99.73</td>
<td>100.00</td>
<td>97.44</td>
</tr>
<tr>
<td>Main NGOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disb.</td>
<td>13967.41</td>
<td>2707.75</td>
<td>3068.98</td>
<td>3655.41</td>
<td>4240.69</td>
<td>5414.58</td>
</tr>
<tr>
<td>Rec.</td>
<td>12763.95</td>
<td>2414.17</td>
<td>2906.74</td>
<td>3286.74</td>
<td>3816.64</td>
<td>4419.12</td>
</tr>
<tr>
<td>% Rec.</td>
<td>91.38</td>
<td>89.15</td>
<td>94.71</td>
<td>89.91</td>
<td>90.00</td>
<td>81.62</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disb.</td>
<td>15468.33</td>
<td>4362.43</td>
<td>4985.48</td>
<td>5638.50</td>
<td>6358.15</td>
<td>9909.16</td>
</tr>
<tr>
<td>Rec.</td>
<td>14049.91</td>
<td>3896.83</td>
<td>4705.07</td>
<td>5197.52</td>
<td>5860.86</td>
<td>8926.15</td>
</tr>
<tr>
<td>% Rec.</td>
<td>90.83</td>
<td>89.32</td>
<td>94.37</td>
<td>92.17</td>
<td>92.17</td>
<td>90.08</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance (various issues).
** Up to December 2015 *At current exchange rate

Figure 2. Rural Development Scheme (RDS) of IBBL (IBBL, 2015)
Factors Hindering the Scaling-up of Islamic Microfinance in Bangladesh

Conventional financial systems focus primarily on the economic and financial aspects of transactions, whereas the Islamic system places equal emphasis on the ethical, moral, social, and religious dimensions, to enhance equality and fairness for the good of society as a whole. The Islamic financial system is founded on the absolute prohibition of the payment or receipt of any predetermined, guaranteed rate of return, and thus closes the door to the concept of interest (riba). Owing to the prohibition of riba, Islamic microfinance is expected to be consistent in ensuring allocation efficiency as investment alternatives are strictly selected based on their productivity and the expected rate of return.

Of the 180 million population of Bangladesh, more than 45 million still suffer under extreme poverty (Ministry of Finance, 2015). MFIs or banks providing products complying with Sharia law reach only 100,000 active borrowers compared to the 22 million active borrowers reached by NGOs and conventional commercial banks including Grameen Bank, BRAC, and ASA, all of which are providing conventional products. Clearly a good number of the extreme poverty-stricken are still beyond reach through the existing microfinance operation. Despite the potential of Islamic microfinance to expand at unprecedented levels throughout the country, the industry is suffering from the authentication problem that it can provide financial services that meet the needs of the poor on a larger scale. There are several obstacles that are currently hindering the upscaling of Islamic microfinance in Bangladesh, which are as follows.

The success of Islamic microfinance largely depends on a supportive legal framework. Government recognition, support from the Central Bank and supportive commercial laws required to run Islamic MFIs and compete with conventional MFIs is completely absent in Bangladesh. Government and regulatory bodies could offer policy supporting diversified and competitive financial services for the growth and development of Islamic microfinance. The Microcredit Regulatory Authority (MRA) of Bangladesh is greatly involved in the development of conventional microfinance institutions with the necessary accompanying policy support since its inception, whereas there is no policy to support Islamic microfinance. Bangladesh Bank issued its “Guidelines for Conducting Islamic Banking” in November 2009, revising it at regular intervals to ensure a competitive environment for Islamic and conventional banks. However, there are still no guidelines or supportive policies for Islamic MFIs in order to protect them from their conventional profit-driven counterparts, and in turn for the survival of thousands of Islamic value-imbued potential borrowers.

The distinctive feature of Islamic microfinance is that it is based on the principle of risk sharing. Being interest-based, the entire risk is borne by the entrepreneur in conventional microfinance; but in Islamic microfinance, risk and uncertainty are borne by both the financier and the entrepreneur. As it is difficult to predict the operating result of enterprises with profits earned and losses incurred, and it is not just about giving guarantees to the financier with a fixed and predetermined rate of return, rather asking the entrepreneur to share the risk and uncertainty together with the bank, the risk portfolio of IMIs is higher than conventional counterpart. Additionally, Islamic MFIs are working in narrow areas and serve a small community, and so organizing small-scale financial transactions is costly. Risk management is also another crucial factor for the sustainability of Islamic MFIs. Since microfinance institutions provide security-free loans to the extreme poor, it involves an associated high level of default risk. Therefore, overall risk management for IMIs is of critical
importance. Nonetheless, in the absence of a supportive regulatory and supervisory structure, the indistinct form of risk-management tools of IMIs in Bangladesh does not equip clients with instruments to hedge against the high volatility in currency and commodities markets.

Along with the unfavorable policy support, funding is another critical issue facing the Islamic microfinance industry. Funders or donors are the biggest players in the microfinance sector. There are many funders for conventional MFIs, but Islamic microfinance is suffering from a funding deficiency. Some MFIs try to provide Sharia-compliant product and services to their clients whilst relying on loans from conventional sources as part of their liquidity management, and thereby departing from the principle of Islamic Microfinance. Several Islamic transfers like Zakah, Waqf, and Sadaqah can be a good source of Islamic microfinance. The Bangladeshi government has established institutions to collect and manage Zakah, but this is only voluntarily contributed to by Zakah payers. The majority of Zakah, Waqf, and Sadaqah are privately practiced, meaning that the fund cannot be used in an organized way to alleviate poverty. These are a few of the issues hindering the scaling-up of Islamic microfinance in Bangladesh, and there is no immediate solution even in the face of the need to integrate IMIs.

**An Integrated Approach to Islamic Microfinance for Curving Poverty**

As Islamic microfinance in Bangladesh is facing ample challenges ranging from its regulation to funding, an overnight solution is almost impossible. It is also not possible to reach the hardcore Islamic value-imbued population living in extreme poverty relying on the conventional microfinance institutions. Therefore it is time to address the demand for the integration of Islamic microfinance institutions for which a comprehensive Sharia governance framework is needed with a Sharia body awarded the appropriate power, authority and function. The following structure can provide a better understanding of the Sharia governance framework in which the MRA can appear in the role of regulatory body, being the sole authority on microcredit regulation in Bangladesh.

![Regulatory Body](image)

**Figure 3. Supportive Regulatory Framework for Islamic Microfinance**

A Sharia Supervisory Committee or council supervises the financial activities and transactions for conformance to the basic tenets and principles of Islam. On the other hand, a uniform and efficient accounting standard is at the heart of Islamic finance and which will develop client confidence about the Sharia compliance of the IMIs.

Through integrating funds from different voluntary and involuntary sources, Islamic microfinance can overcome its funding problem. In order to bring Zakah, Sadaqah, and Waqf...
into poverty alleviation, there is a need to exert rigorous efforts and introduce policies to strengthen the collecting institutions. Channeling them into a small entrepreneurial framework using appropriate Sharia-compliant models so as to approach poverty will bring about more efficient results than seen in current practices. At present, the Zakah being collected by the government bodies in most countries is very small compared to its total amount. The majority of Zakah is paid by individuals and is not used in any productive sector; just used to serve consumption purposes. If more Zakah and Waqf fund can be collected and disbursed by the public Zakah institutions in an organized manner, it will be able to make the desired impact. One way in which governments can enhance the Zakah revenues is through the enactment of law. While laws could be passed that will give the government the right to collect Zakah from individuals and economic entities, people would also be bound to paying Zakah to the government which will create the bulk of the Zakah funds. For example, Pakistan, Saudi Arabia, and Sudan, have enacted laws that entitle them to collect Zakah on various assets, but the collections appear to be very small. In Malaysia, the government need to pass new tax laws to introduce tax credits for Zakah payments. These laws save people from double-taxation. Another aspect of increasing the Zakah revenues is to expand the Zakah base by expanding the assets on which Zakah should be paid. Contemporary Sharia scholars have to come up with resolutions that add newer assets into the preview of Zakahable assets.

Zakah organizations should have good governance structure and management procedure. Important aspects of good governance and management procedures are transparency, human resource and flexibility to introduce innovations in systems and processes, and cost efficiency in operations. After collecting Zakah, Sadaqah, Waqf effectively from the public, these funds can be disbursed to the poor by the form of collateral-free loans through Islamic Microfinance – without charging interest. At the same time, preparatory and awareness-developing activities along with supportive and motivational activities are required to develop value-oriented entrepreneurs, which are crucial for the system to succeed.

![Figure 4. Mobilization of Funds for Islamic Microfinance](image-url)
Aa with conventional banks, conventional microfinance institutions can open Islamic microfinance departments to reach out to the poor. The anomalies of conventional banks in offering services through their Islamic windows, particularly in managing funds and liquidity, may serve as a good lesson for the successful operation of Islamic microfinancing departments at traditional microfinance institutions for creating the desired impact on poverty alleviation.

**Conclusion**

The role of microfinance institutions in poverty alleviation is indispensable not only for generating employment, but also in the exploring of latent capacity of the poor. Relying on conventional microfinance institutions in a Muslim-dominant lower to middle income country like Bangladesh for tackling poverty is not a prudent choice. As Muslims try to avoid interest-based financial arrangements and are open to accept profit-sharing contacts offered by Islamic microfinance institutions, Government and regulatory bodies should step forward with the necessary policies in response to the wishes of the majority of Muslims. Moreover, owing to risk-sharing, Islamic MFIs are assumed to be more efficient in ensuring optimal allocation of resources. Conventional MFIs receive a fixed rate of interest for their involvement in the transaction and the entrepreneurs, on the other hand, receive a variable rate of return, profit or loss, and thus bear the entire investment risk, which does not pass the criteria of allocation efficiency.

Furthermore, microcredit given as cash to the receivers may not always provide an expected return as it is both small in amount and the people receiving it live hand to mouth. As a result, when borrowers receive some cash, a proportion of it is used in order to meet their daily expenses and the rest is invested for which it fails to generate expected return. In the end, the new loan is issued rescheduling the earlier one, ultimately leaving the borrower loan-dependent, which can never be self-enduring. Rather than offering simple cash transfer, IMF relies on real transfer which protects the client’s interest by protecting the value of the service received in terms of microfinance, which then turns into a much more efficient way of approaching the needs of the poor.

Poverty has many facets and therefore can be approached from many ways. While profit-driven conventional microfinance institutions fail to serve the needs of the poor in the manner to which they require, morally- and socially-driven Islamic microfinance has the ability to reach to the root cause of problems of poverty in an efficient way and thus the funding and regulations for sustainable Islamic microfinance program is a time befitting demand for fighting poverty in Bangladesh.

**Notes**

Corresponding author: ABDULLAHIL MAMUN
References


