

# Fintech Rich Hybrid Islamic Micro-Finance



SALMAN AHMED SHAIKH  
PHD ECONOMICS  
NATIONAL UNIVERSITY OF MALAYSIA

**World Islamic Finance Forum (WIFF 2018)**  
**19-20 – March 2018**



# Presentation Outline



- Introduction
- Structure of Fintech Rich Hybrid Islamic Micro-Finance
- Funding for the Program
- Financing Services under FRHIMF
- The Differentiation from Other Programs
- Conclusion

# Introduction



- **2 billion** people do not use **formal financial services** and more than **50 percent of adults** in the poorest households are **unbanked** (World Bank).
- In OIC countries, most poor people are in **Nigeria**, followed by **Bangladesh, Pakistan** and **Indonesia**. In all these 4 OIC member states, the **poor population exceeds 20 million**.
- In Bangladesh, Pakistan, Nigeria and Indonesia, the microfinance client base exceeds **1 million**. Nevertheless, apart from Bangladesh, the **outreach gap** is **more than 90% in Pakistan, Nigeria and Indonesia**.
- The scale of Islamic microfinance still remains minuscule and there is a need for **scaling up operations, increasing efficiency, enhancing product range, and non-financial and technical support**.

# Islamic Microfinance in Pakistan

- Islamic microfinance share in 2016:
  - Active borrowers 15%.
  - Loan portfolio 7%.
- Some operators include:
  - Akhuwat
  - Wasil Foundation
  - Kashf Foundation
  - Naymet Trust
  - Muslim Aid Pakistan
  - Islamic Relief Pakistan
  - Kawish Welfare Trust
  - Esaar Foundation.

## Overall Microfinance Outreach

Key Indicators - Province wise	Sindh	Punjab	Balochistan	KPK
Offices – Fixed	651	2,284	17	107
Offices – Mobile	26	14	2	-
Active Borrowers	904,892	3,449,902	5,577	97,239
Potential Microfinance Market	2,400,000	12,600,000	500,000	500,000
Penetration Rate (%)	37.7%	27.4%	1.1%	1.9%

## Overall Microfinance Sector

Key Indicators	2010	2011	2012	2013	2014	2015	2016
Number of Borrowers (million)	1.6	1.7	2.0	2.4	2.8	3.8	4.6
Gross Loan Portfolio (bln Rs.)	20.2	24.8	33.1	46.6	61.1	92.9	136.9
Active Women Borrowers	0.8	0.9	1.3	1.4	1.6	2.1	2.5
Branches	1,405	1,550	1,460	1,606	1,747	2,960	3,220

# Introduction



- **Shari'ah compliance** is the most significant value proposition for Islamic finance.
- For Muslims who want to comply with Islamic injunctions, conventional banking and microfinance is not a usable option.
- In **Afghanistan, Morocco, Iraq, Niger** and **Djibouti**, the percentage of adult population with no bank accounts for religious reasons stands at 33.6%, 26.8%, 25.6%, 23.6% and 22.8%, respectively.

# Introduction



- Potential and Impact of Islamic Microfinance.
  - Maazullah and Bedi (2017): Users of Islamic microfinance credit services in Pakistan experienced a significant increase in working capital and in business profits.
  - Mahmood *et al.* (2017): Users of Islamic microfinance credit products experienced a rise in monthly income, expenditures on food, education and health and ownership of household assets.
  - Riwajanti and Asutay (2015): Average annual value of sales, net income, business expenditure, household expenditure, and employment increased significantly following receipt of loans.

# Fintech and Islamic Microfinance



- The key is to achieve 3 goals: **Scale, Sustainability and Outreach** in innovative ways.
- Fintech provides a useful tool to achieve these goals. Nonetheless, of more than \$50 billion in Fintech investment globally since 2010, only 1% has gone to the Middle East and North Africa (Source: Accenture).
- In Islamic tradition, innovation is not disruptive, but is taken as an opportunity. Modern-day cheques and corporations have Islamic imprints as established by Koehler (2014).
- For Islamic finance, **Real-time transactions, on-site offer and acceptance online, constructive possession through computerized transfers** can quickly manage the transfer of ownership and funds to execute Islamic transactions without hassle.

# Structure of Fintech Rich Hybrid Islamic Micro-Finance (FRHIMF)



- Fintech Rich Hybrid Islamic Micro-Finance (FRHIMF) is a specialized and comprehensive microfinance program which includes financial services, such as **micro-credit, micro-Takaful and micro-savings**.
- It is also blended with **non-financial support** in the form of **on-credit purchase of grocery and household items** as well as **training and awareness camps for health and education**.
- It targets **skills enhancement, financial literacy, computing literacy** and increasing the **business acumen** of clients.
- The financial services using **Qard-e-Hasan, Murabaha** and **Ijarah** provide finance for working capital needs and income generating assets acquisition.

# Structure of Fintech Rich Hybrid Islamic Micro-Finance (FRHIMF)



- The key feature of the program is the **use of Fintech in both supply side and demand side operations** and processes.
- This ensures **transparency, effective monitoring and reducing transaction costs** and helps towards achieving **scale, sustainability** and **outreach** more efficiently than in a brick and mortar model.
- The incentive structure in different services encourages participation of clients in the program for the long term.
- It decreases their chances of wilful default or complacency in work.
- The incentives are dynamic in the sense that higher benefits accrue to clients who repeatedly repay the instalment on time.

# Structure of Fintech Rich Hybrid Islamic Micro-Finance (FRHIMF)



- The overall financing structure enables the clients to **obtain finance for productive enterprise as well as assistance for meeting life's other needs and contingencies.**
- This approach enhances the trust level and **engenders long-lasting relationships** whereby, the **successful clients become change agents** themselves through their subsequent financial and volunteering contribution.
- FRHIMF is suitable to be launched in small homogenous communities in suburban and rural areas in developing Muslim countries where banks usually do not reach.
- The scheme has strong **potential for reaching scale through its E-crowdfunding platform, efficient operations, use of Fintech and multiple mediums of engagements both on the supply side as well as on the demand side.**

# Structure of Fintech Rich Hybrid Islamic Micro-Finance (FRHIMF)



- FRHIMF is a comprehensive microfinance scheme which **fulfils both financial and social intermediation** towards the improvement of economic, social and quality of life indicators of the clients.
- It provides **financial as well as non-financial assistance**. Non-financial assistance **ensures emergency support, skills upgradation, community involvement, loyalty** and permanent relationship.
- The scheme engages both the financial donors as well as people who want to contribute with time.
- The program provides financing products to enhance incomes through financing income generating assets for the client.

# Structure of the Program

Supply Side		Demand Side
Financial Funding & Contributions		
External	Social contributions via E-Crowdfunding to place Zakat, Sadqah and Waqf funds to IMFI.	Such contributions are used to provide Sadqah and Qard-e-Hasan to the needy clients.
	Social impact investing via E-Crowdfunding platform.	Proceeds are pooled and then used to provide sale and lease based Islamic financing.
Internal	Micro-savings using E-Wallet. Profit sharing ratio higher for micro-savers.	Clients open remunerative accounts and access money via E-wallet.
Non-Financial Contributions & Services		
Individuals	Micro-volunteering in training programs by students and professionals.	Volunteers provide training, vocational skills and business facilitation in the form of record keeping and basic calculations.
Institutions	Subsidized services from accredited schools, hospitals and retail stores.	Clients enjoy access to subsidized services only by spending through E-Wallet so as to incentivize its use.
	Micro-Takaful for health risks and accidents.	Clients with minimum E-Wallet balance get Micro-takaful. Higher savings ensure Micro-Takaful and higher profit share.
	E-Wallets / Debit Card issued by banks.	E-Wallets issued by banks are accessible through smartphones and smart cards.

# Financial Funding and Contributions



- In the proposed FRHIMF, the **funding comes from external and internal sources**.
- At the formation stage, most funding is expected to come from external sources. In order to pool greater funds and to provide wide participation, the contributions are sought from the public with a minimum contribution amount set at Rs 1,000 only.
- **The contributors can have social and/or commercial motive partly or entirely.** Those who have entirely social or religious motive contribute without requiring the return of their contributions and any profits.
- Such contributions are used by the FRHIMF institution to offer non-commercial assistance in the form of Sadqah and Qard-e-Hasan depending on the nature and seriousness of need.

# Financial Funding and Contributions



- However, impact investors have at least a partial commercial motive.
- Their contributions are used to provide commercial financing products using credit and lease based Islamic modes of financing.
- Such commercial financing can only be provided to those who are not ultra-poor and who have some financial capacity, skills and business acumen to repay their commitments.
- **The FRHIMF institution not just targets bankable clients, but also aim for social mobility** through its financial and non-financial schemes.
- The resources pooled through E-Crowdfunding are used to provide financing to the clients using **Murabaha, Salam** and **Ijarah**. The profits are distributed among the impact investors and the micro-savings clients based on the pre-agreed profit sharing ratio.

# Financial Funding and Contributions



- The internal source of funding comes from micro-savings by the clients.
- The amount in micro-saving accounts can further be used to provide financing to other clients.
- **The micro-savers share 1.5x times their capital contribution share, while the impact investors share residual profits.**
- E.g., if micro-savers together contribute 20% to the asset pool from which financing is provided, then 70% of the actual profits will be shared by the external impact investors who contribute through E-Crowdfunding platform and 30% of the actual profits will be shared by the micro-savers.
- **This incentivizes micro-savings by the clients.** It will also enable the impact investors to achieve ‘impact’ by motivating higher savings.

# Profits Sharing Illustration



- Total Profits Rs 100,000.
- Total Capital Contribution Rs 500,000.
- Impact Investors Capital Contribution Ratio (CCR) 80%.
- Micro-savers Capital Contribution Ratio (CCR) 20%.
- Profit for Micro-savers (Rs 30,000) 1.5x CCR.
- Profit for Impact Investors (Rs 70,000).
  - RoI (Overall) 20%.
  - RoI (Impact Investors) 17.5%.
  - RoI (micro-Savers) 30%.

# Use of Social Savings in Skills Enhancement



- In FRHIMF, social savings which require no repayment and profits are used to establish training and business support centres. The list below mentions the priority segments for which training is provided.
- Carpentry.
- Welding.
- Stitching.
- Dying.
- Cooking.
- Office Automation.
- Electrician.
- Electronics Repairing.
- Beautician & Grooming Services.
- Driving.
- Flower Making.

# Supply Side Support for Non-Financial Support



- FRHIMF also engages micro-volunteers from among the professionals, academicians and college and university students.
- A network platform ensures matching so that efficient and flexible scheduling is achieved and is spread throughout the year. The training features the following necessary modules:
  - The financial literacy program is offered for low-income and low-educated clients so that they can make financial plans and use banking services, such as ATM, Smart Cards and E-Wallet through a smartphone.
  - Basic record keeping training on a customized user-friendly accounting app in the local language.
  - Business facilitation support through educating on merchandising, accounting and marketing aspects of the businesses.
  - Imparting vocational skills for gaining self-employment.

# Supply Side Support for Non-Financial Support



- **Micro-volunteering** involves professionals offering their skills and only a few hours of their time by responding to the specific request. E.g. **Help with fundraising, training sessions or health/education camps.**
- People can participate without having to drastically alter their daily schedules or lives. This can likely increase the number of people who give time to volunteer.
- Micro-volunteers also help in arranging **educational camps** where basic numerical skills and computing skills are taught in order to ensure familiarization with record keeping and conducting transactions on smartphones and computers.
- Micro-volunteers also organize **health camps** and **impart awareness** about **basic health issues, precautionary measures to take in daily routine lives** and ways to have **proper sanitation** and **clean drinking facilities** at their homes.

# Use of Fintech in Banking Transactions



- **Clients spend money using primarily their E-Wallet** which is usable across accredited retail store chains, hospitals and educational institutions.
- E-Wallet enables the purchase of groceries and household items through E-Wallet from designated stores with a **7-day grace period** for some selected raw food items, such as flour and rice below 5 kg purchase for a single time in a month.
- These stores could offer a certain percentage of **discounts**. The vendor/store could be provided incentives by the government through no GST charge on the sale of items from such designated stores where payment is made via E-Wallet.

# Use of Fintech in Banking Transactions



- The E-Wallet / Smart Card can have silver, gold and platinum grading.
- The clients can convert silver into gold and gold into platinum after surpassing a spending limit of Rs 10,000 and Rs 50,000 respectively.
- The silver card offers 2% discount, gold card offers 4% discount and platinum card offers 7% discount.
- These discounts are only offered to the clients who purchase / spend through E-wallet / Smart Card at designated retail outlets.

# Use of Fintech in Financing Transactions



- Clients repay their dues through their E-wallet account.
- Each repayment will earn them 1 point per Rs 1,000 worth of repayment amount on-time.
- This 1% mark-up rate subsidy provides an incentive for on-time repayment.
- When 10 points are earned, Rs 100 is credited to the E-wallet account through which clients can make purchases to avail further retail discounts and future subsidies on financing services.

# Use of Fintech in Financing Transactions



- The asset purchase from the designated stores is facilitated through a software application which does **electronic scanning of the asset, offer and acceptance** and **transfer of funds** from the bank to the vendor.
- Once **the client engraves thumb impression signifying the offer and acceptance** to enter into Murabaha transaction for the specified asset, **the funds are electronically transferred from the bank to the vendor.**
- This ensures efficient processing and utilization of the credit amount only for the agreed purpose of purchasing the asset.
- Clients E-wallet account will be automatically debited after a grace period of 7 days following the due date.
- Until the grace period is over, client can pay instalment and earn reward points.

# Client Screening Form



<b>Demographic Information</b>		<b>Response</b>	
Age (in years)			
Gender		<input type="checkbox"/> Male. <input type="checkbox"/> Female.	
Household Size (in nos.)			
Number of Dependents (in nos.)			
Earning Members in Family (in nos.)			
<b>Income / Wealth Related Information</b>			
Household Monthly Income (in Rs.)			
<b>Liquid Assets</b>		<b>Historical Price</b>	<b>Market Value</b>
- Cash in Hand			
- Savings Funds (Bisee)			
- Other Receivables			
- Gold Jewellery			
- Other Jewellery			
- Other Liquid Assets			
<b>Fixed Assets</b>		<b>Historical Price</b>	<b>Market Value</b>
- TV			
- Fridge			
- Furniture			
- Motorcycle			
- Mobile Phone			
- Other Fixed Assets			
<b>Expenditure Details</b>			
Utility Bills			
- Electricity (in Rs.)			
- Gas (in Rs.)			
- Telephone (in Rs.)			
<b>Size of Dwelling (in rooms)</b>			
<b>Nature of Dwelling</b>		<input type="checkbox"/> Cemented. <input type="checkbox"/> Bricks. <input type="checkbox"/> Tin / Wood.	
<b>Income Earning Assets Owned (in nos.)</b>			

# List of Income Generating Assets



<b>Category A (Rs 3,000 – Rs 30,000)</b>	<b>Category B (Rs 30,000 – Rs 100,000)</b>
Juicer	Motorcycle
Iron	Copier
Sewing Machine	Oven
Grocery / Fruit Carrier	Livestock
Donkey Cart	Merchandise Inventory
Drilling Machine	Construction Tools
Personal Computer	Gas Stove With Cart for Popcorns
Stove	Construction of Road-Side Cabin
Potato Fries Machine	Partial Financing for CNG Rickshaw
Coal Run Stove on Cart	Blender / Chopping Machine

# Credit Disbursement Criteria and Filters



- Provide financing if:
  - Client does not own an income generating asset in Category B, and
  - Sum of household income and one-sixth of value of aggregate liquid assets is less than the product of basic income required per person times household size, and
  - Value of aggregate liquid assets is less than **Rs 20,000** and
  - Value of aggregate fixed assets is less than **Rs 50,000** and
  - Sum of the value of utility bills paid is less than **Rs 2,500** per month on average.
- Provide non-compensatory loan if:
  - Client owns an income generating asset in Category B, but requires funds for working capital, and
  - Sum of household income and one-sixth of value of aggregate liquid assets is less than the product of basic income required per person times household size, and
  - Value of aggregate liquid assets is less than **Rs 5,000** and
  - Value of aggregate fixed assets is less than **Rs 20,000** and
  - Sum of the value of utility bills paid is less than **Rs 2,500** per month on average.

# The Differentiation from Other Programs



- FRHIMF **incorporates Fintech** in both supply side as well as demand side operations.
- The use of Fintech in **E-crowdfunding** enables **wider and transparent participation**.
- The **use of software application** for **credit screening, asset scanning** and **execution of contract mechanics**, such as **offer and acceptance on-site** enables **reduction of transaction cost, paperwork, documentation, multiple monitoring** and frees human resources.
- The use of **E-volunteer program** enables to leverage the human resources and achieve **efficient scheduling of training programs, health and education camps**.

# Conclusion



- FRHIMF aims to achieve 3 goals: scale, sustainability and outreach in innovative ways.
- Use of Fintech **ensures transparency, effective monitoring and reducing transaction costs** and helps towards achieving scale, sustainability and outreach more efficiently than in a brick and mortar model.
- The incentive structure in different services **encourages participation of clients in the program for the long term**.
- The **contributions** are sought from the public using an **E-Crowdfunding platform**.
- FRHIMF also engages micro-volunteers from among the professionals, academicians and college and university students.
- A **network platform ensures matching** so that **efficient and flexible scheduling** is achieved and is spread throughout the year.

# Conclusion



- **Clients spend money** using primarily their **E-Wallet** which is usable across accredited retail store chains, hospitals and educational institutions.
- The asset purchase from the designated stores is facilitated through a software application which does electronic scanning of the asset, offer and acceptance and transfer of funds from the bank to the vendor.
- FRHIMF **fulfills** both **financial** and **social intermediation**.
- FRHIMF is suitable to be launched in small homogenous communities in suburban and rural areas in developing Muslim countries where banks usually do not reach.
- The scheme has strong potential for reaching scale through its E-crowdfunding platform, efficient operations, use of Fintech and multiple mediums of engagements both on the supply side as well as on the demand side.

Thank You  
Questions & Feedback

[islamiceconomicsproject@gmail.com](mailto:islamiceconomicsproject@gmail.com)

