

WORKSHOP

ON THE ECONOMICS OF ISLAMIC MICROFINANCE

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Integrated Microfinance Models for Effective Delivery and Impactful Outcomes

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Presentation Outline

- Common Microfinance Structures
- Common Challenges in Microfinance Delivery
- Required Changes in Microfinance Design and Delivery
- Islamic Microfinance Structures: Cases & Illustrations
- Designing Incentives for Effective Targeting in Hybrid Models
- Operational Structure of a Hybrid & Integrated Model
- Q&A

Common Needs of Poor Requiring Funds

- **Physiological:** Basic Food, Shelter, Clothing, Health
- **Social Life Needs:** Weddings, Childbirth, Education
- **Personal Emergencies:** Sickness, Injury, Unemployment, Funerals
- **Disasters:** Floods, Earthquakes
- **Business Needs:** Setup Cost, Asset Purchase Needs, Expansion

Challenges in Microfinance Delivery

- High transaction cost relative to loan size including screening, administrative and monitoring costs.
- Not all clients have entrepreneurial mind-set and knowledge to grow businesses.
- Loans are used to fund consumption than income generating activities.
- Conflict of interest. Lending to existing borrowers is cost effective. Poverty exit may potentially lead to loss of a customer who can be financed cheaply than the new one.
- Financial sustainability on which outreach and scale is also dependent.

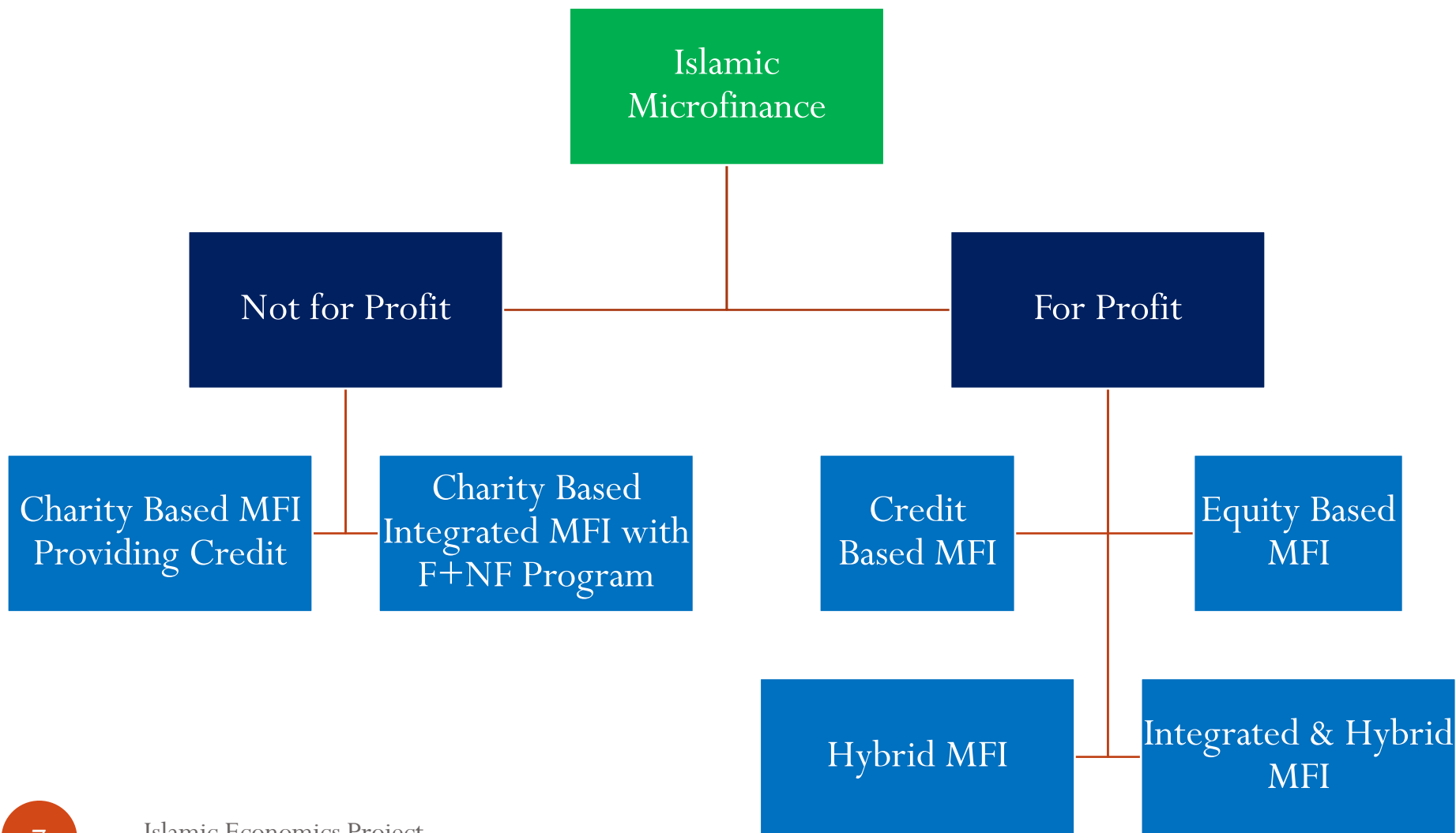
Common Microfinance Structures

- Individual Lending at High Interest Rate ($r_{\text{bank}} < r_{\text{mfi}} < r_{\text{loan shark}}$).
- Group Lending at High Interest Rate ($r_{\text{bank}} < r_{\text{mfi}} < r_{\text{loan shark}}$).
- Rotating Credit and Savings Association.
 - Pooling money and providing peer-to-peer lending on rotation basis.
- Credit Unions
 - Owned by and for participants to provide limited banking services.
 - Work on non-profit basis.
 - Tax exemptions

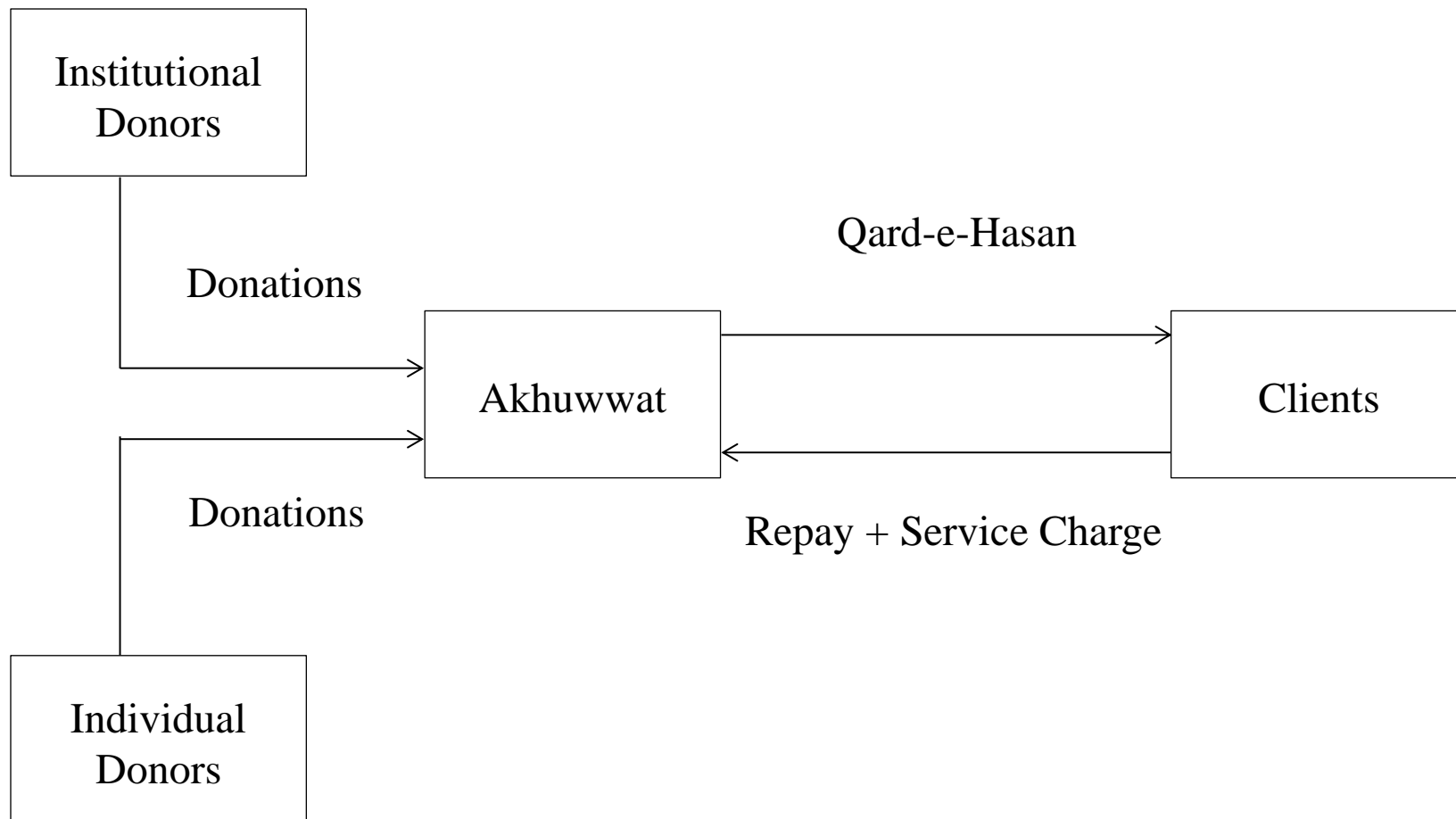
Required Policy and Design Options

- Interest rate caps. **Caveat:** If binding, open ways to loan sharks.
- Flexible payment options. **Caveat:** Moral Hazard
- Client protection and compliant resolution systems
- Integrated credit information flow
- Utilising Fintech for effective outreach as well as facilitating swift credit analysis
- Microfinance and social interventions targeting:
 - Vaccinations
 - Lifecycle and nutritional changes
 - Health awareness
 - Literacy, education, capacity building, knowledge sharing etc.

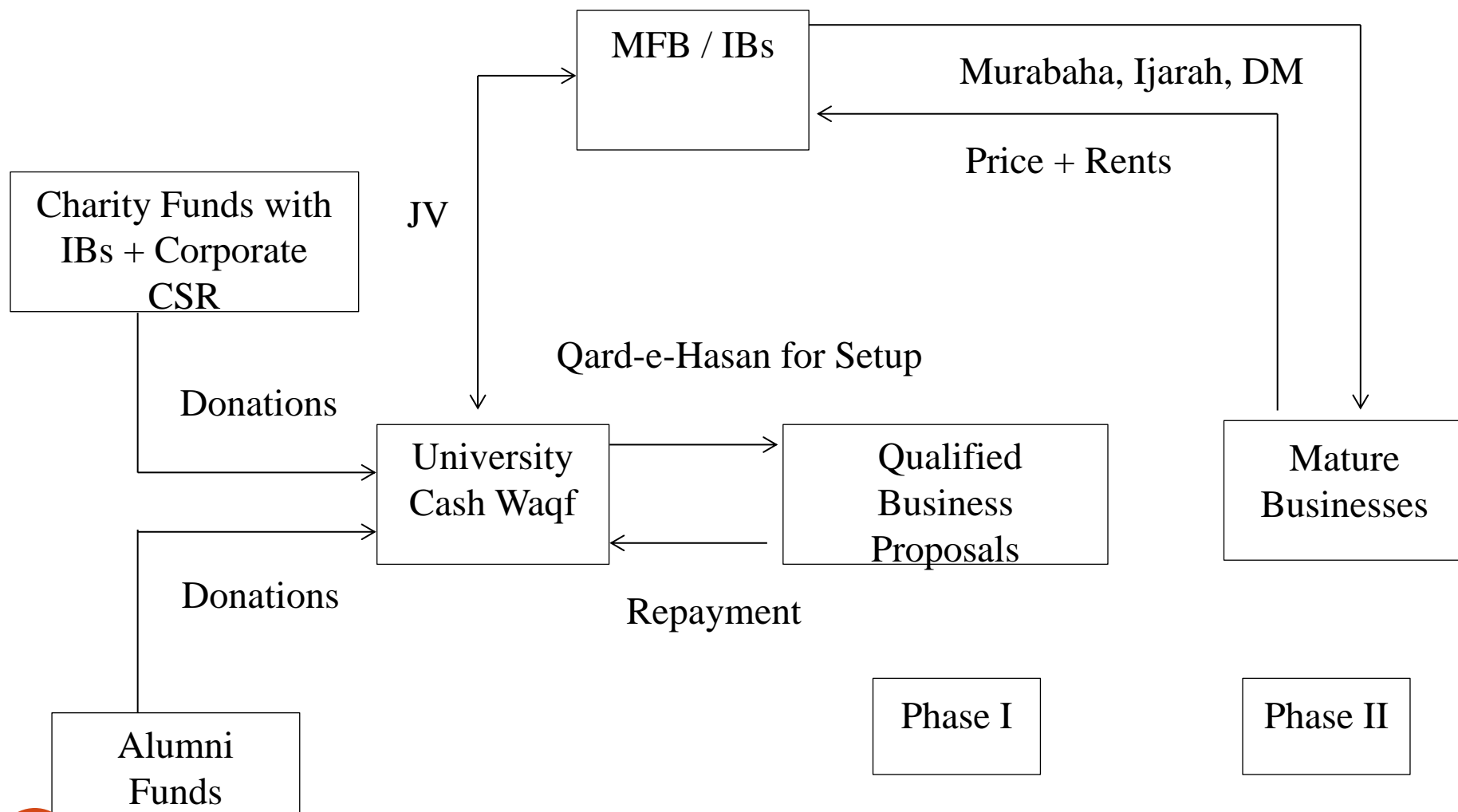
Islamic Microfinance Structures



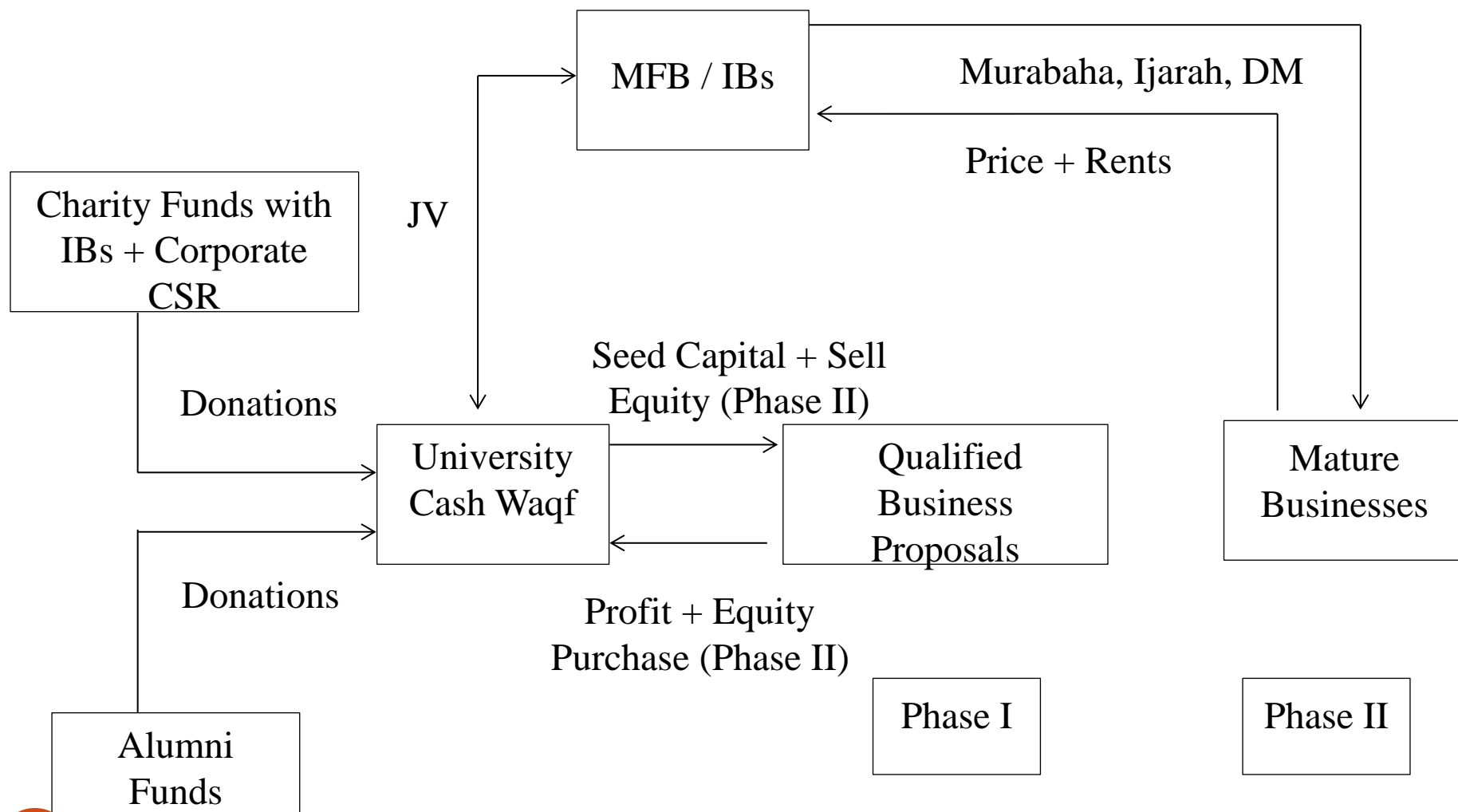
Akhuwwat Qard Based Microfinance Program



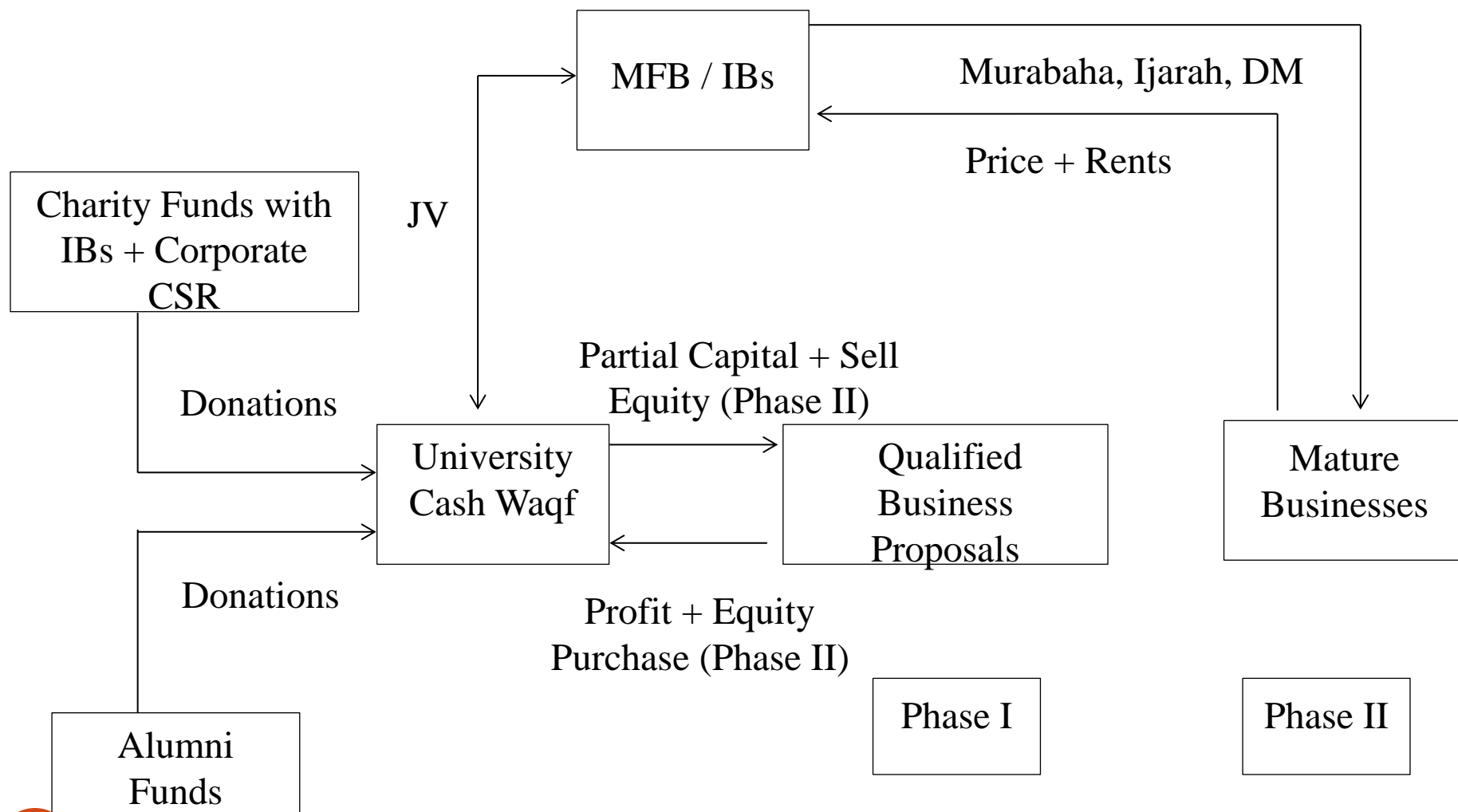
Financing Start-ups Using Qard-e-Hasan



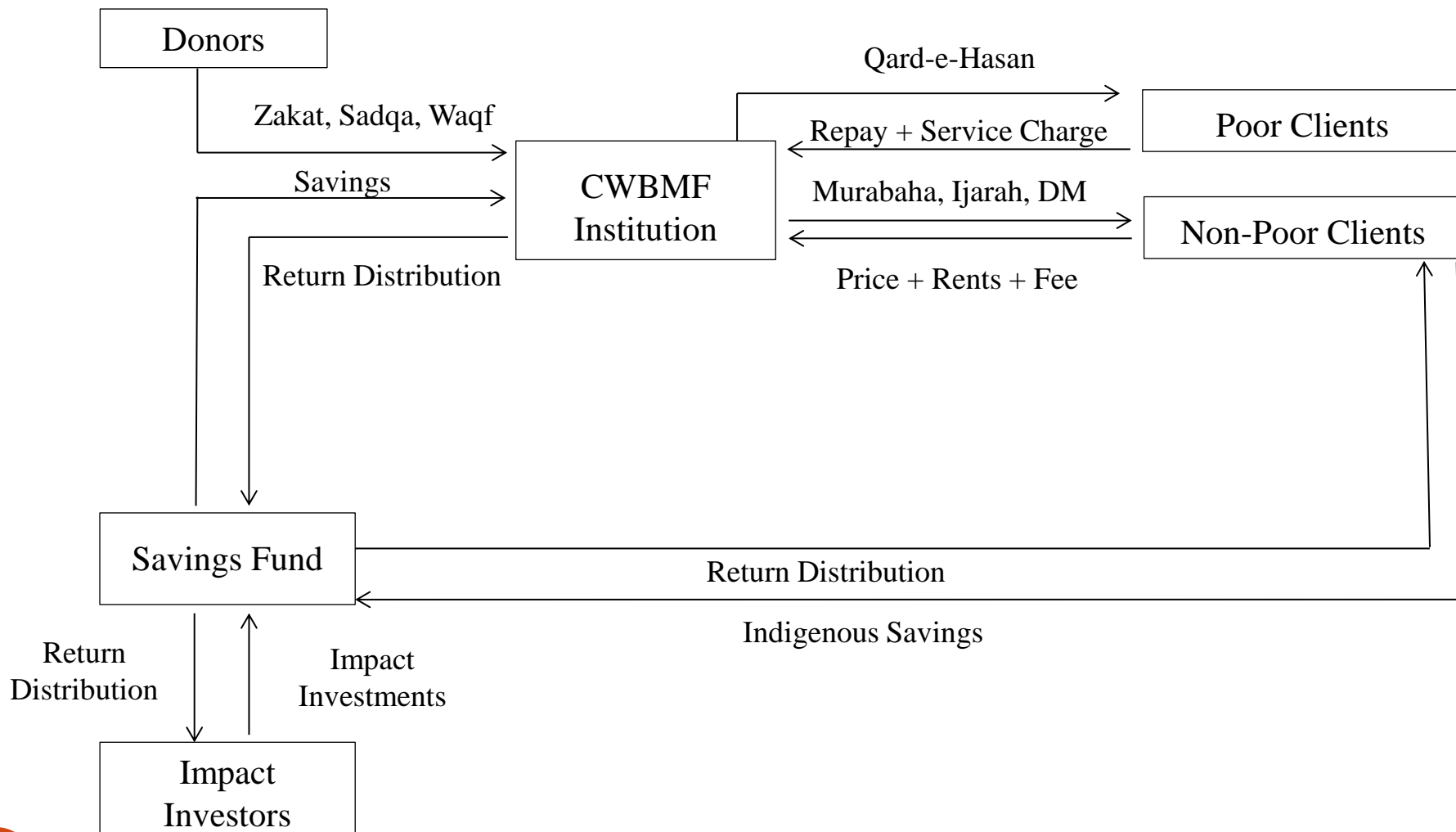
Financing Start-ups Using Mudarabah



Financing Start-ups Using Musharakah



Cash Waqf Based Micro Finance (CWBMF) Model



Designing Incentives for Effective Targeting

- Need to differentiate between the different categories of poor people.
- Let us define two categories of poor people in order to distinguish between moderate poor and ultra-poor.
- Non-poor people can be with and without investible capital.
- These four groups require income support, social and public support and market based finance.
- Usually, the poor people do not have investible capital.
- Non-poor people usually have an existing income source.
- In Table 1, the number in parenthesis denotes the level of priority. (1) Highest (2) Lower (3) Lowest.
- Priority rationalized through subsidized rates, rationing, and higher or lower PSR.
- Microenterprise is abbreviated as 'ME' and Profit Sharing Ratio is abbreviated as 'PSR' in Table 1.

Designing Incentives for Effective Targeting

Poverty Groups	Income Support	Social & Public Support	Market Based Finance
Ultra-Poor	Zakāt (1)	Bait-ul-Maal (1) Waqf	Mudarib in ME, PSR (2)
Moderate Poor	Zakāt (2) Qard-e-Hasan (1)	Bait-ul-Maal (2) Waqf	Mudarib in ME, PSR (3)
Non-Poor with Zero Investible Capital	Qard-e-Hasan (2)	Bait-ul-Maal (3) Waqf	Murabaha (1) Salam (1)
Non-Poor with Investible Capital	Not Applicable	Not Applicable	Murabaha (2) Salam (2) Musharakah Rabb-ul-Maal in ME, PSR (1)

Designing Incentives for Effective Targeting

- Ultra-poor will enjoy higher PSR than moderate poor people in microenterprise Mudarabah as Mudarib.
- They will not be provided with any debt with or without mark-up to avoid indebtedness before they reach a sustainable income and asset base to increase chances of poverty exit.
- They will have no incentive to underperform, shirk or free-ride. Their consumption needs can be fulfilled through Zakāt and Bait-ul-Maal.
- Their educational and health needs can be met through especially designed Waqf based educational and health centres.

Designing Incentives for Effective Targeting

- Moderate poor people will be provided with Qard-e-Hasan, but they will have lesser PSR in microenterprise Mudarabah.
- They will have lesser priority in Zakāt distribution and support from Bait-ul-Maal.
- They would want to show themselves as ultra-poor, but then they will not have availability of Qard-e-Hasan.
- If they want to access subsidized debt based modes of finance like Murabaha and Salam, they will have to show themselves as non-poor with zero investible capital. But, in that case, they:
 - Cannot remain Mudarib in microenterprise.
 - Will have lesser priority in access to Qard-e-Hasan.
 - Will have to make frequent rental or instalment price payments.
- Hence, the moderate poor people will have no clear incentive without any trade-offs to show themselves in any lower or higher poverty group.

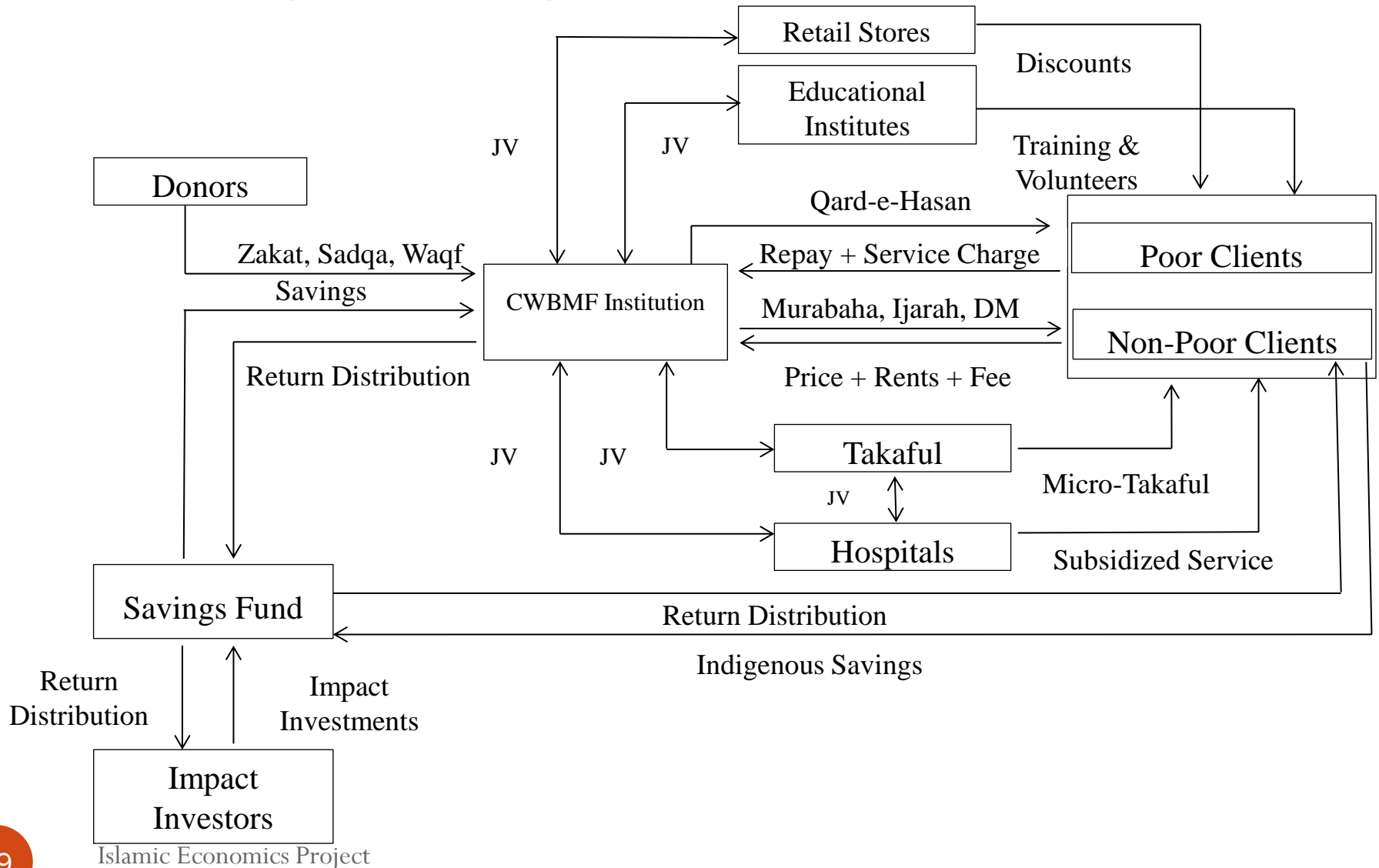
Designing Incentives for Effective Targeting

- Non-poor people with income source, but without investible capital would qualify to obtain subsidized finance using Murabaha and Salam.
- They will not be able to invest in microenterprise Mudarabah with highest PSR unless they show themselves as non-poor with investible capital.
- In that case, they will not qualify for Qard-e-Hasan or any income support from Zakāt or Bait-ul-Maal. They will also be disqualified from debt based Microfinance at the subsidized mark-up.
- If they show themselves as poor, then they will not be able to obtain debt based finance at subsidized mark-up. They will also not be able to keep their existing income earning occupation intact if they enter Mudarabah as Mudarib.
- Hence, these people also will not have any incentive to show in a higher or lower poverty group.

Designing Incentives for Effective Targeting

- Non-poor people with investible capital will qualify for debt based finance at market benchmark linked rates. It will encourage them to use equity based finance using the mode of Musharakah.
- They could also use their investible capital to enter in microenterprise Mudarabah as Rabb-ul-Maal. They will enjoy the highest PSR in order to incentivize their participation for creating a sustainable loop of funding for the microenterprises.
- But, these people would have an incentive to show themselves as non-poor with no investible capital so as to avail subsidized mark-up financing. But, they will lose out on availing higher PSR on investible capital.
- Tax incentives can be provided to the investment made and profits earned from microenterprise Mudarabah so as to incentivize investment participation.

Integrated Cash Waqf Based Micro Finance (CWBMF) Model



Thank You

Questions & Feedback

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