



## Literature Survey on Islamic Microfinance

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**Abstract:** Islamic microfinance can be seen as an emerging industry in some Muslim countries like Indonesia, Malaysia, Pakistan, Bangladesh, and MENA regions. It acts as a movement to eradicate poverty in the society and to help improve the social standard of the poor people. The concept of Islamic microfinance is similar to those implemented in conventional microfinance except for it adheres to several points and concepts which in line with the Shariah rulings. As a growing industry, Islamic microfinance does facing several challenges such as limited outreach in the market, lack of expertise in the industry, governance and management problems, and many more. Hence, this paper will discuss further the issues and challenges faced by Islamic microfinance institutions in selected Muslim countries. Plus, some suggestions are given at the end of this paper to solve these issues.

**Keywords:** *Islamic Microfinance, Microfinance, Micro-Credit, and Islamic Finance.*

Article History

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### Introduction

Poverty has become one of the major problems in economic development, especially for developing countries. A huge amount of money and funds are needed for a country to uplift itself to a higher level of development by providing such facilities, infrastructures, and technology advancement. A similar concept can be applied for a smaller subject by looking at the well-being of each individual or household in the society. Every individual requires a certain amount of money to develop themselves as well as their family to fulfill their needs. The standard of living and the quality of life of each individual can be improved by having a surplus amount of savings or assets after deducting the expenses and liabilities that they need to pay. Hence, that is one of the major reasons why the poor cannot improve themselves as well as to get out of their circle because they did not have proper access to get the funds to develop themselves.

As for the rich, they can easily apply for the loans and get support from the banks to finance their projects. But, it is quite difficult for the banks to approve loans to a poor family as they are riskier than the rich because they do not have enough money to pay back the loan together with high interest, thus there are high chances of defaulted loans. To help solve this issue, there is a new movement that is currently growing to help provide financial services to the poor, known as microfinance. The term microfinance is interchangeable with the word microcredit which simply means a small loan or small credit. A few studies have been conducted in the past which prove that microfinance acts as an instrument to alleviate poverty which some of the programs under microfinance seem to be successful like in the case of Grameen Bank in Bangladesh, Bank Rakyat Indonesia in Indonesia, Amanah Ikhtiar Malaysia in Malaysia, CARD in the Philippines, FINCA and ACCION in Latin America and many more around the world (Saad, 2012).

For the past three decades, microfinance has been widely used to provide the 'non-bankable' segment of society to overcome the issue of poverty. Microfinance grants several financial instruments such as deposit, a disbursement of small-size loans for business expansion and generating new projects, payment services, money transfers or micro-insurance to low-income household and their micro-enterprises (Hassan et al., 2013). The poor are considered as 'non-bankable' and not creditworthy as a result of not having enough physical assets. Hence, they can opt to provide social collateral via group

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lending, peer monitoring, as well as joint liability. As a result, these will eventually give a positive impact in terms of increased repayment rate, decrease adverse selection, and lower the rate of defaulted loans. The next section of this paper will explain briefly microfinance and Islamic microfinance, the brief history of Islamic microfinance in selected Muslim countries, the challenges faced by these Islamic microfinance institutions, as well as the way forward or the suggestions given in order to solve these issues.

### Microfinance and Islamic Microfinance

Another way of defining microfinance is it acts as the provision of financial services and products to those who have been excluded from conventional financial institutions or programs due to low economic status. It comprises of small scale venture capital, savings, microcredit, and insurance (Dhaoui, 2015). These services are only provided for those who only have strictly limited financial means and the number of loans given is in a smaller portion as compared to normal loans provided by the banks and other financial institutions. According to Otero (1999), microfinance gives access to capital for the poor which allows them to self-employed to generate productive capital, as well as to protect the existing capital owned by them, and to deal with the risk in protecting their assets against capital loss. In other words, microfinance tries to create wealth and assets of the poor and hardcore poor people (Al-Mamun et al., 2010).

Morduch (2009) stated that the idea of microfinance helps to alleviate poverty as most of the financing schemes given to the poor are uncollateralized loans. It is contrary to the loans given by the banks and other financial institutions where their borrower must pledge an asset against the loans as collateral. The main difference between bank loans and microfinance is the payment or loan is in small size and was given only to the poor and micro-entrepreneurs. Plus, its terms and conditions are more flexible than bank loans (Abid & Shafiai, 2017). Another scholar defines microfinance as a small-scale financial service that is given to small enterprises or micro-enterprises, mainly for their credit and savings. But, nowadays, it has been broadened to a larger scope of financial supports which includes micro-savings, micro insurance, remittances, and other payments. All of these instruments were given to help improve the social lives of poor people (Rokhman, 2013).

In other words, microfinance is any financial services given to the poor in terms of the individual loan, group loans, micro leasing, micro loans or fund transfer to enlarge the business of poor people and to help them in facing exceptional emergencies. While a microfinance institution (MFI) is the organization that offers financial resources to the needy and poor people. MFI covers in terms of the legal structure, mission, vision, methodology, and sustainability in supporting the financial resources to their clients of poor people and those who cannot get access to the financial banks (Aslam, 2014). The services supplied by MFI can facilitate the poor to smoothen their needs and consumption, manage their risk better, gradually builds their assets, help them to extend their micro-enterprises, improve their income-earning capacities, as well as increase the quality and standard of their life (Rokhman, 2013)

The concept of microfinance was taken place in the 18<sup>th</sup> century whereby small operations of micro-lending were introduced by Jonathan Swift, through the Irish Loan Fund system. This system was to improve the conditions of poor citizens of Irish. However, the practice of microfinance became known in the 1970s which was started by Muhammad Yunus in Bangladesh in 1976 through the organization of Grameen Bank (Kagan, 2019). People believe that the microfinance scheme contributed a lot to poverty alleviation, improvement in schooling, and supported the expansion of millions of small businesses. After seeing the success in implementing the microfinance scheme in Bangladesh, this practice was widely spread to other regions in the world including Africa, Latin America, Asia, Eastern Europe, and also those nations of developed countries like Norway, the USA, and England (Rahman et al., 2017).

Microfinance can be proposed by different kinds of organizations, whether it is from informal and traditional institutions or local and international NGOs financed by the donors, cooperatives and credit unions, local government institutions, specialized financial institutions, and formal commercial financial institutions (Nawai & Bashir, 2009). According to Siwar and Talib (2001), the microfinance program has become a popular approach particularly in helping those poor people that were excluded from the formal credit sector.

One of the important characteristics of microfinance is that the financial services are given to the poor and micro entrepreneurs where the size of the loans is small. The aim of microfinance is normally to help the poor for their business expansion as well as generating new projects for those who not eligible to get loans from commercial banks and other financial institutions. Plus, the terms and conditions of these loans are usually more flexible and easy to understand as compared to bank loans. The basis of repayment for microfinance is for short term financing where the payment is made on a weekly basis (Rahman, 2010). Under the microfinance program, they will provide educational programs for the poor and teach them the principles of investing to start up a new business and offer them some class to teach them skills such as bookkeeping, cash-flow management, technical and professional skills like accounting (Kagan, 2019).

After the success of microfinance schemes that proves to be helpful towards the poor people to uplift their standard of living, Islamic microfinance started to emerge because many low income Muslims would prefer to have Shariah-compliant financing modes. The purpose of Islamic microfinance is quite similar to conventional microfinance except for it adheres to the rulings of Shariah and did not include interest because *riba* is prohibited in Islam. Many economists believe that there is a common goal in Islam and microfinance in terms of making people self-reliant, enterprising, and self-respecting (Dhaoui, 2015). Islamic microfinance which includes Shariah-compliant mode of financing and giving credit without collateral or any asset as the guarantee towards the poor can be seen as an effective way of reducing poverty, empowering and increasing the productivity of the poor, giving social benefits to them in a sustainable means, and aiding economic development.

Some of the financing instruments offered by Islamic microfinance are *qard-hassan* which is the interest-free loan, *murabahah* which is mark-up trade finance, *salam* or known as forward purchase credit, *istisna'* the one that project financing, and *ijarah* which is the facilitation of operational lease (Wilson, 2007). Participatory schemes like *mudharabah* and *musharakah* have great potentials for Islamic microfinance because these instruments can satisfy the risk-sharing for micro entrepreneurs. But, these schemes require some skills in managing the risks inherent in the structure of those contracts (Rahman, 2010). Whereas, such contracts like ensuring capital needs (*qard hassan*), equipment (*murabahah*), and leased equipment (*ijarah*) are relatively easy to manage by the poor and potential micro entrepreneurs.

Microfinance comprises of both financial as well as non-financial services. Financial services provided by microfinance are those services such as microcredit, micro-savings, and micro-insurance products. Whereas, the non-financial services of microfinance are by providing healthcare services, skills and training programs, marketing and management activities, education, self-confidence development, and enterprise development (Hossain, 2019). Islamic microfinance instruments can be divided into two categories which are profit-based and charity-based. There are three basic models under profit-based instruments which are trade base mode like *musawamah*, *murabahah*, *salam*, and *istisna'*. Next is the second category of partnership such as *musharakah* and *mudharabah*. Lastly, the third category is a rental base mode like diminishing *musharakah* as well as *ijarah*. The example of charity-based Islamic microfinance schemes are *zakat*, *sadaqah*, and *waqf* (Aslam, 2014). Apart from that, there are four main principles derived from the Islamic laws that must be preserved in developing any modern Islamic finance instruments as well as the core of Islamic microfinance. These elements are the prohibition of *riba*, risk sharing, calculations of the time value of money, and the prohibition of *gharar* or uncertainty created due to lack of information and control in any economic transaction (Dhaoui, 2015).

According to Karim (2012), even though the demand for Islamic microfinance in Muslim countries is high, yet it only signifies less than one percent of global microfinance outreach. The Consultative Group to Assist the Poor (CGAP) surveys in Jordan, Syria, and Algeria showed that about 20% to 40% of the respondents stated that religious reasons are the main obstacles for them not choosing conventional microfinance. Studies by USAID and IFC/FINCA highlight the same reasons where 24.9% and 30% of the respondents in Jordan and Syria respectively, did not engage in conventional loans due to religious reasons. Another study done by the Frankfurt School of Finance and Management on microenterprise owners in Algeria proved that 20.7% of them avoid micro-loans due to the same reasons. About 40% of the poor in Yemen demanding for Islamic financial services and they are willing to pay higher prices for Shariah-compliant financial products and services.

A report by Bank Indonesia stated that approximately 49% of the rural people in East Java prefer Islamic bank institutions. An estimated of 54.4% of microfinance clients in Indonesia would choose

Islamic microfinance due to religious reasons. Another study in Bangladesh shows that more than 80% of the respondents would prefer to use Islamic products as compared to conventional products. A survey done by Al-Huda Centre of Islamic Banking and Economics in Azad Kashmir, Pakistan proved that 99% of the respondents opt for Islamic microfinance services (Karim, 2012). Although there is a strong demand for Islamic microfinance products and services, the growth of the Shariah-compliant microfinance sector remains slow. The major reason for this trend is due to the fact that the facilities and services of Islamic microfinance are mainly provided by specialized parties like NGOs and donors instead of Islamic banks. The report by Kuwait Finance House Islamic Microfinance stressed that Islamic banks are discouraged in engaging in microfinance because of four main factors. The reasons given in that report are due to the lack of real profitability of microfinance, the risks related to microfinance, lack of knowledge and expertise, as well as the belief that the poor are becoming poor due to the lack of skills.

## **Brief History of Islamic Microfinance in Selected Muslim Countries**

### ***Islamic Microfinance in the MENA Region***

#### *Yemen*

The first Islamic microfinance in Yemen was launched in 1997, known as the Al-Hudaidah Microfinance Program. This program was funded by grants from Yemen's Social Fund for Development (SFD) and the United Nations Development Program (UNDP). This program used murabahah model of cost plus markup for its targeted customers based on a group lending approach. The first microfinance bank in Yemen was the Al-Amal Microfinance Bank which started its first operations in 2009. It was a result of joint efforts and partnership between the Yemeni government which denoted by the Social Fund for Development which owns 45% share, the Arab Gulf Program for United Nations Development Organization with 35% share, and the contribution from the private sector which consists of 20% share. Its main goal is to give economically active micro enterprises with small loans and financing, especially towards women and young entrepreneurs.

#### *Syria*

The first Islamic microfinance experiment was done in the rural area of Jabal al Hoss, where it is one of the poorest areas in the country. The project was known as the Rural Community Development Project (RCDP). It was set up in 2000 as a joint program between the Syrian Ministry of Agriculture and Agrarian Reform and the UNDP with the main goal of establishing rural savings and credit services by village development funds. This approach is known as Sanadiq system in Arabic which encourages local ownership through musharakah structure. The villagers buy the shares and become the owners, and then they will receive annual dividends by using a profit-sharing scheme. The RCDP used flexible lending with no standardized loan terms for loan disbursement schemes and the profit margin is determined by using murabahah structure.

#### *Iraq*

The first Islamic microfinance in Iraq was Al Takadum, where it was registered with the Iraqi NGO Office of the Ministry of Civil Affairs in the mid-2007. The only product provides by Al Takadum is the individual loans based on murabahah structure.

#### *Sudan*

In Sudan, the main providers of micro loans were supplied by the NGOs and the rural development projects. Even though there were several Islamic Banks in Sudan which offer Islamic microfinance schemes such as Sudanese Islamic Bank, Faisal Islamic Bank, and the Islamic Cooperative Development Bank, but unfortunately their outreach continued to be limited. The leading mode of financing is murabahah which is 40%, followed by qard hassan with 17.6%, and then ijarah with 14.5%, next is salam with 10%, and lastly mudarabah with 3.7%. In 2007, the Central Bank of Sudan (CBOS) set up a microfinance unit as part of the strategy to develop the microfinance industry. In 2010, CBOS make a ruling which stated that all banks in the country must channel a minimum of 12% of their

portfolios into microfinance. After that in 2011, the CBOS Policies 2011 obliged all banks to develop a specialized unit for microfinance.

### ***Islamic Microfinance in Malaysia***

In Malaysia, the microfinance sector is controlled by small and medium enterprises (SMEs) whereby 90% of the SMEs are characterized as micro enterprises. Microfinance providers in Malaysia can be divided into four main categories, which are microfinance institutions, cooperative, development financial institutions, and commercial banks with microfinance schemes. There are three central microfinance institutions in Malaysia, namely Amanah Ikhtiar Malaysia (AIM), Yayasan Usaha Maju (YUM), and Economic Fund for National Entrepreneurs Group (TEKUN). Both YUM and TEKUN are under the legislation of the Ministry of Agriculture and Agro-based Malaysia, while AIM is one of the NGO body. The AIM and YUM provide loans to the poor and extreme poor female members, whereas TEKUN forces on the poor and moderately poor people in the community.

The government of Malaysia has given the order for development institutions like Bank Rakyat, Bank Simpanan Nasional, and Agrobank to offer micro credit facilities in order to support the growth of micro enterprises by expanding their access to the formal financial system. Bank Rakyat provides an Islamic pawn-broking instrument, while Bank Simpanan Nasional gives micro-loans to finance non-agricultural activities, and Agrobank offers microfinance to micro enterprise in the agriculture and agro-based industries. Not only that, Malaysia's government also give the opportunity to commercial banks to provide microfinance through their participation in the Pembiayaan Mikro scheme which was announced in 2006. Microfinance instruments offered in Malaysia are Shariah-compliant products. For instance, Bank Rakyat offered microfinance products based on rahn, AIM offered qard hassan, and bai inah was given by several participating financial institutions.

In Malaysia, the two main Islamic microfinance providers are AIM and Bank Rakyat. AIM is one of the NGO in Malaysia that was established in 1987 with the purpose of eradicating extreme poverty in Malaysia. AIM was said to be the replication of the oldest Grameen Bank in Asia. Another alternative for Islamic financing instrument is rahn which means pawning. The largest Islamic cooperative in Malaysia is Bank Rakyat and it is the first cooperative in Malaysia which provides Islamic pawn-broking scheme in 1993 which called as Ar-Rahnu. The ground rule of Ar-Rahnu offered by Bank Rakyat is based on the concept of benevolent loan (qard hassan), trustworthiness (wadhiah yad-amanah), safekeeping with guarantee (wadhiah yad-dhamanah), and the fee for safekeeping (al-ujra). Other than Ar-Rahnu, Bank Rakyat also offered Islamic microfinance instruments based on bai inah structure to its members starting from 2007.

### ***Islamic Microfinance in Indonesia***

Islamic microfinance in Indonesia was first introduced in 1990s. The providers of Islamic microfinance in Indonesia can be divided into three sub-groups, which are the division of Islamic banks, Islamic rural banks that are known as Bank Perkreditan Rakyat Syariah, and lastly the Islamic financial cooperatives like Baitul Maal wa Tamwil (BMT). Bank Rakyat Indonesia (BRI) is one of the biggest and successful microfinance institutions in the world. It works based on the commercial model and also in charge to roll out government finance schemes. The regulation and supervision of Islamic rural banks in Indonesia, known as Bank Pembiayaan Rakyat Syariah (BPRS), is similar to Islamic commercial banks. BPRS's modes of financing are dominated by murabahah with 79% of total financing, followed by musharakah schemes with 10% of total financing, next is mudarabah and qard hassan which organize only approximately 3% of the total financing.

Baitul Maal wa Tamwil (BMT) which provides savings and deposits accounts, is more flexible and has greater outreach than BPRS. Plus, unlike BPRS, BMTs did not fall under the obligation of banking regulations in Indonesia and they also have a well-established system of Islamic pawn. This Islamic pawn can either be supplied by the state, Islamic banks or Islamic cooperatives. BMT is a community-based financial institution that practices profit-sharing and applies Islamic moral values and group solidarity to reassure loan repayment. They provide three methods of services which are microfinance, zakat, and social welfare program, as well as entrepreneurship training.

### ***Islamic Microfinance in Pakistan***

The first experiment of Islamic microfinance in Pakistan was through the Aga Khan Rural Support Program in the early 1980s. The example of famous Islamic microfinance in Pakistan is Akhuwat and Islamic Relief. Akhuwat is a non-profit organization with the objective of giving an interest-free microfinance to the poor in order to increase their standard of living. It was formed in 2001 and it acted as a pioneer for micro credit that aligned with Islamic principles in Pakistan. Some of the Islamic microfinance schemes offered by Akhuwat are qard hassan and other diversified loan products. Plus, it also provided other services like business development, insurance, and health-related services to its clients. Other than that, Akhuwat does not only focusing on financial transactions, but the efforts given to its clients are beyond than that. For instance, Akhuwat helps its clients in terms of giving social guidance, capacity building, as well as providing entrepreneurial training for them.

One of the unique features of Akhuwat is its mosque-based model which required all transactions to take place at the local mosque including loan appraisals, loan disbursements, and collections of loans. Thus, every activity occurs around the mosques and other religious centers like local shrines and churches. They provide loan disbursements and fundraising in those religious centers to promote close interaction with the community. The schemes provided by Akhuwat are collateral-free group and individual financing based on mutual guarantees which its recovery rate is shown to be 99.8%. Another example of Islamic microfinance in Pakistan is Islamic Relief Pakistan (IRP) where it was established in 1992. It has effectively given a lot of relief and development projects for both large and small-scale emergency projects to those who are involved in earthquakes and other natural disasters in Pakistan. As mentioned before, Akhuwat gives qard hassan loans to the poor people, while IRP mainly provides advances mudarabah financing to individuals based on a combination of personal guarantors, group savings accounts, and community recommendations to certify the repayment.

### ***Islamic Microfinance in Bangladesh***

Bangladesh is one of the earliest countries to introduce microfinance schemes through the introduction of the Grameen Bank projects in 1976. Islamic microfinance in Bangladesh is said to be among the largest global market outreach with an estimated 100,000 clients. Among the leading Islamic microfinance providers in that country include commercial banks like Islamic Bank Bangladesh Limited (IBBL) and Social Investment Bank Ltd. Another Islamic microfinance institution in Bangladesh is microfinance-NGOs (MFI-NGOs), for instance, Al-Fallah and Rescue. The Microcredit Regulatory Authority (MRA) is the one that regulates the MFI-NGOs in Bangladesh. The MRA was introduced in 2006 and its purpose is to ensure the transparency and accountability of microfinance operators.

The biggest provider of Islamic microfinance in Bangladesh is the IBBL, where it introduced its Islamic microfinance program which known as the Rural Development Scheme (RDS) in 1995. The purpose of providing RDS was to eradicate rural poverty by engaging a community development approach, giving small and micro investments. The RDS is a group-based microcredit scheme that followed the model of Grameen Bank and provides Islamic microfinance instruments such as murabahah, mudarabah, bai muajjal, bai salam, hires purchase, and musharakah. The financial services provided by the RDS focuses on four divisions of the community, specifically for hardcore poor, moderately poor, microenterprise, and small farmers. The majority of its investments are allocated to a moderately poor family and mostly concentrated in the agricultural sector.

### **Challenges of Islamic Microfinance in Selected Muslim Countries**

The emergence of Islamic microfinance institutions in this current world brings a lot of benefits to the society and the economy as it helps to improve the standard of living of the poor people. Not only that, both conventional and Islamic microfinance institutions play an important role in eradicating poverty in this society. However, there are some issues and challenges faced by these Islamic microfinance institutions in providing micro-financial schemes and services to their clients.

One of the issues faced by the Islamic microfinance institutions in the MENA region is limited outreach towards the unbanked people because of the structure of their branches, especially for those who live in rural areas. One of the factors is due to very poor promotion and advertisement about the Islamic microfinance instruments among the people. Plus, there are no proper ways and techniques of

spreading awareness about the importance and benefits of the Islamic microfinance sector, especially to poor people (Alshebami & Khandare, 2015). A similar problem faced by the Islamic microfinance institutions in Pakistan where they are dealing with the issue of limited market outreach. Even though the market for microfinance in Pakistan for both conventional and Islamic is large and growing, the issues related to sustainability and market outreach continues to be the challenges for this industry (Karim, 2012).

Next, the issue faced by the Islamic microfinance industry is related to its regulation and supervision. For instance, in Indonesia, research shows that the outreach for BMTs has been remarkable in the number of people served by these Islamic financial cooperatives. But, their regulation and supervision should be improved and augmented in order to deliver a more enabling framework for the cooperative industry and developing associations as well as federations offering a full range of support services. The establishment of Islamic financial cooperative, or Indonesia's BMTs, is in need of optimizing their services provision in order to maintain their sustainability and easy access for their clients and members. Besides, the problem related to regulation and supervision can also be found in Yemen where there is no separate law for their Islamic microfinance institutions that can legalize the activities in the market (Alshebami & Khandare, 2015).

According to Seibel (2008), the poor performance of Islamic microfinance in Indonesia is due to the governance and management problem where they lack of Islamic banking expertise. Plus, this problem is also due to the deficiency of mastering the overly complex models and Islamic banking practices. Not only that, there is insufficient internal control by the absentee commissioners as well as not enough external auditing as a result of small size below the limit required by the auditing. Besides, the money channeled into the Islamic microfinance institutions by the donors and government agencies is not done by proper and effective regulation and supervision which in the end might lead to the downfall of these Islamic microfinance institutions in the future (Seibel, 2008). In short, the problem is related to the lack of regulation, supervision, as well as reliable reporting.

Another issue related to microfinance institutions in the MENA regions is dealing with restrictive regulations for deposits. This problem was faced by the countries in MENA regions except for Sudan, Syria, and Yemen. Due to the fact that most of the microfinance institutions were registered as NGOs, other than these three countries, they were restricted from providing deposits in addition to loans (Karim, 2012). Thus, it leads to the problem of sustainability, particularly as savings are very crucial in maintaining the safety net for the poor and their cash flow management. Hence, a lot of commercial banks and investors are not willing to finance NGO-microfinance institutions which in the end, donor dependency, as well as government funded lending schemes, remains to plague the microfinance sector in those areas.

Not only that, the microfinance sector in the MENA regions faced the issue of lack of appropriate infrastructure, whereby in most situations, the legal and regulatory framework was underdeveloped and partially applied (Karim, 2012). According to Alshebami and Khandare (2015), the infrastructure in Yemen such as their electricity, safety, transportation facilities, and foreign currency stability is very poor and these factors become one of the challenges for their Islamic microfinance institutions to maintain and sustain in the market, as well as to reach the low-income society in the rural areas. Plus, Islamic microfinance institutions in Yemen face the problem of high operating costs which create a burden to the poor people as the cost of loans increases. Hence, it leads to the over-indebtedness of the clients in Yemen. Another consequence of high operating costs is that it forces the poor people to cancel their contracts with Islamic microfinance institutions and only depending on their family and friends which will not improve their standard of living.

Another issue faced by MENA regions is insufficient financial and operational capacities of microfinance institutions to narrow the gap in market outreach. In the Global Islamic Finance Report, it stated that approximately 5 million potential micro entrepreneurs that are unable to reach microfinance services (Karim, 2012). For instance, in Yemen, the source of funds for micro-financial instruments is very limited and it limits the outreach of these institutions to reach the rural people in far areas. Besides, the products provided by microfinance institutions do not cater sufficiently to the diverse needs of these micro entrepreneurs as microfinance institutions in the MENA region are mostly depends only on credit for enterprise investment (Alshebami & Khandare, 2015).

As for the Islamic microfinance institutions in Pakistan, most of the potential borrowers in Pakistan opt not to engage in the microfinance sector because of several reasons like lack of awareness, low

financial literacy, as well as religious beliefs. Other than that, in a study done by a group of researchers about the critical financial analysis of Akhuwat shows that this organization is giving its services to all poor people who live below the poverty line together with the extremely poor groups. The interest-free loans provided by Akhuwat can be a strong tool to eradicate poverty. However, this study proved that the growth of Akhuwat's loan portfolio had decreased with a sharp decline in its equity growth over five consecutive years (Akhter et al., 2009). This trend might bring some issues that may affect Akhuwat's financial stability in the future.

According to Karim (2012), in the case of Indonesia, even though there are numerous Islamic microfinance institutions in Indonesia, but the size remains small. Hence, this is one of the challenges for them to attract more clients to participate in this industry and to fight against poverty. Next, the problem with Islamic microfinance institutions in Indonesia is the need of making organizational changes. Microfinance institutions provide guidance supervision to the customers but there is no entity or agency that is monitoring and supervising the microfinance institutions. For example, in Indonesia, a microfinance provider known as Baitul Maal wa Tamwil (BMT) is their traditional organization of Islamic microfinance institutions, faced problems with the emergence and a growing number of BMT due to lack of legal rulings which govern the protection and guarantee customer's funds (Nugroho, 2014).

Another challenge of Islamic microfinance in the MENA region is the slow growth and development of this industry. The reason is mainly due to a lack of commitment by the policymakers in developing a more professional microfinance industry. Plus, there is not enough innovation and creativity for new Islamic products and services to be offered to the society. Last but not least, the next challenge for the Islamic microfinance industry in Yemen is the lack of trained and qualified staff that fit the requirements made by Islamic microfinance institutions. For instance, to be more specific, there is no Shariah advisor who can frequently give consultations to their Islamic microfinance institutions (Alshebami & Khandare, 2015). The need for Shariah advisor is very important to make sure that the products and services that they offer meet the requirements made by the Islamic law.

### **The Way Forward**

This section of the paper provides some suggestions and recommendations to resolve the challenges faced by the selected Muslim countries. As stated in the previous section of this paper, one of the challenges for Islamic microfinance institutions in Yemen was due to its high operating costs. Hence, in order to solve this issue, it is advisable to reduce the operational cost and other charges in the Islamic microfinance institutions to the lowest level possible to help the poor people and by doing that would encourage them to apply for this credit instruments. Plus, they should be focusing more on the rural areas as the majority of the poor people are coming from those far rural areas. Alshebami and Khandare (2015) suggested that the Islamic microfinance institutions in Yemen reduce their traditional collateral system to the minimum acceptable level and at the same time the group lending should be maximized.

Apart from that, the government also plays a vital role in maintaining the sustainability and the successfulness of the Islamic microfinance institutions. One way that government can help these financial institutions is by providing a proper and better infrastructure and other related facilities to make sure that poor people in the rural areas are able to reach and get financial assistance. Next, the government can help this microfinance industry by giving some support and grants to the newly emerging Islamic microfinance institutions in the market until they can sustain on their own. Other than that, the Islamic microfinance institutions should increase the awareness and promotion about this sector and educate more people about this industry in order to maximize the coverage of people to benefit from their products and services.

Besides, Islamic microfinance institutions should have a direct way in consulting and cooperating with the international organization that has lots of experience in dealing with this field. Hence, they can benefit from them and might work more effectively in providing microfinance schemes to the poor people. In other words, there must be a continuous innovation and creativity for the products and services offered by the Islamic microfinance institutions in the market (Alshebami & Khandare, 2015). Last but not least, Islamic microfinance institutions should arrange some proper agreements with the training companies to train their personnel and provide them with the required skills in order to solve the issue of shortage in the qualified staff in this particular industry.

In the case of MENA regions, some initiatives have been taken with regard to the issue of lack of an appropriate infrastructure by implementing a few regulatory frameworks. For instance, Syria, Yemen, and Egypt presented laws and regulations for the microfinance industry. Egypt implemented the regulation for non-deposit taking institutions, whereas Yemen and Syria introduced laws approving the creation of deposit-taking microfinance institutions. The central bank in Iraq with the assistance of USAID-Tijara, offered an SME Finance Companies Ordinance to promote the commercialization of the microfinance sector by making the way for NGOs microfinance institutions to transform into non-banking financial intermediaries (Karim, 2012).

By referring to the case in Indonesia, specifically by looking at BMTs, where they deal with problems as the number of BMT keeps increasing. This situation occurred as a result of not having enough legal rulings and supervision from their government. Hence, Nugroho (2014) suggests that the government of Indonesia should play a role in supporting and supervising the existence of BMT. As a result, the main objective of Islamic microfinance to eradicate extreme poverty in society can be achieved through poverty alleviation programs. Similar case as the BMTs, which is the Islamic rural banks (BPRS) in Indonesia also facing the problem of lack in the rulings and supervisions. They need a proper system of prudential regulation, mandatory auditing regardless of the size of the institutions, as well as effective supervision by appropriate financial authority, other than the Ministry of Cooperative and SMEs (Seibel, 2008). Plus, they also need a strong association that can provide a full range of support services to their clients. The same goes for the Islamic microfinance industry in Yemen, there is a need for establishing a special law to regulate the microfinance activities in the market (Alshebami & Khandare, 2015).

Next, Islamic microfinance institutions in Indonesia are growing in past years but according to the Global Islamic Financial Report (GIFR), the size of these institutions remains small. One way to solve this issue is by developing a better reputation of BMTs in Indonesia as well as improves further up to international scale. If this transformation process gave a positive influence on its economic growth and successfully alleviate extreme poverty, hence this proved the effectiveness of Islamic microfinance in improving the quality of life of the societies (Nugroho, 2014). Another suggestion is to provide a full range of support for their clients. For instance, a more successful Islamic rural bank can help by providing the training sites to future managers in order to attract others to join and gain the greater size of the institutions.

Some scholars raised the issue of sustainability when discussing the growing trend of Islamic microfinance. Both conventional and Islamic microfinance has shown a positive impact on improving the social status and economic standard of the poor people. However, one of the challenges is to maintain the sustainability of these microfinance institutions. According to Hossain (2019), currently, there is a growing number of implementing zakat and sadaqah for the purpose of reducing poverty. These practices can be implemented through multi-dimensional projects and programs provided by the Islamic microfinance. For example, the implementation of the zakat-based group lending and microfinance program by Elzawa in Indonesia (Sudirman, 2016), and the zakat-based community program in Brunei (Jaelani, 2016).

Recent scholars suggest the use of an integrated Islamic microfinance model which combines the practice of waqf and zakah into microfinance institutions. The former research only looked at the conceptual and theoretical aspects of the integrated model. However, recent study focus on answering this particular research gap, specifically in considering the perception of Islamic microfinance borrowers based on this model because it is crucial to get their points in terms of the applicability, suitability, and sustainability of this particular model (Haneef et al., 2015). Some researchers suggest that the level of awareness from the borrowers or the clients of Islamic microfinance can be developed through social networks by the microfinance institutions. Not only that, but the waqf institutions can also play the role by contributing their funds to the Islamic microfinance institutions.

Next is with regards to the problem faced by Akhuwat in the reduction of its loan portfolio growth due to the decline in its equity growth, this problem can be solved through some integration with other agencies and bodies. For instance, Akhuwat can integrate with other non-government organizations (NGOs), non-profit organizations (NPOs), awqaf agency, takaful industry, and zakat institutions. Other than that, Akhuwat can include professional training and capacity building institutions in order to supply Islamic microfinance services and products for those extremely poor individuals or groups under one

roof. In the end, these actions will not only help to increase the living standard of the poor but also will contribute towards the economic development in Pakistan and brings prosperity towards the country.

### Conclusion

Throughout the overall discussion, we can conclude that even though Islamic microfinance institutions are still at its infancy level, but it is developing and emerging towards serving the society especially the low-income group people. Microfinance instrument seems to be one of the best ways to help improve the social standard of living for the poor people as well as encourage the growth of the economy by giving them loans and training to involve in the business activities.

Although there might be some issues and challenges regarding the Islamic microfinance industry, everyone is playing their roles to find the best solution possible to cater to these issues. The governments, NGOs, as well as the financial sector itself, should play their roles in making sure the sustainability of the microfinance industry as it gives a lot of benefits towards the economy and improves the social standards, particularly for the poor people and micro-enterprises. Numerous studies have been done by the researchers and academicians in developing the best model possible to help poor people and low-income groups. Plus, recent study is still ongoing in finding the best way to fight poverty through both conventional and Islamic microfinance institutions. Hence, by successfully lowering the poverty rate of every country, we might be able to narrow the gap of inequalities between the rich and the poor and hopefully in the future we might solve a lot more problems of inequality in this society.

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