Integrating Islamic Banking, Zakat And Waqf With Islamic Microfinance In Poverty Alleviation

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Abstract

Microfinance telah didesign untuk membantu masyarakat berpendapatan rendah. Hal ini disebabkan karena mereka tidak memiliki jaminan atau agunan yang memberikan suatu hambatan kepada mereka untuk mendapatkan fasilitas perbankan. Berdasarkan penelitian yang telah ada, sector microfinance telah berhasil dalam mengurangi jumlah kemiskinan di banyak negara. Khususnya bagi masyarakat Muslim, Islamic microfinance telah menjadi alternatif bagi usahawan Muslim yang kurang beruntung (miskin) untuk dapat menikmati fasilitas perbankan. Akan tetapi, ada beberapa hambatan dalam penerimaan dana yang dihadapi oleh Islamic microfinance. Hal ini disebabkan Islamic microfinance harus selektif dalam memilih sumber keuangan yang akan digunakan. Dengan kata lain, sumber keuangan haruslah dari sumber yang halal. Mengkaji hal tersebut, kontribusi dari perbankan Islam sebagaimana yang terintegrasi dalam zakat dan waqf fund melalui microfinance dapat menjadi suatu alternative cemerlang dalam menyelesaikan kelangkaan sumber keuangan tersebut. Objektif utama dari artikel ini adalah untuk mendiskusikan potensial dari Islamic financial schemes dalam mengurangi jumlah kemiskinan. Artikel ini merupakan “theoretical paper” berdasarkan pada literatur yang tersedia dan pengalaman dari riset sebelumnya. Dalam artikel ini penulis berpendapat bahwa Islamic microfinance dapat meningkatkan kemampuan Muslim dengan berpendapatan rendah sebagai peminjam modal di bank yang akan digunakan untuk peningkatan usaha dan juga dapat mengurangi jumlah kemiskinan. Akhirnya, suatu harapan besar ditumpangkan pada Islamic microfinance untuk meminimalkan permasalahan kemiskinan dalam komunitas Muslim.

Key words: Islamic micro finance, Islamic banking, zakat and waqf institutions, poverty alleviation.

1. Introduction

In the last decades, Islamic finance has developed immensely as one of the most important trends in the financial world. This phenomenon is not only because the demand among Muslim for Islamic financial products and services, but also due to the Islamic finance sectors have contributed significantly to the global GDP (Ahmad and Ahmad, 2009). Among other things, Islamic banking is evidenced as the fastest growing industries which have posted double-digit annual growth in 30 years (M.Iqbal and Molyneux, P (2005). As part of Islamic economic system, Islamic banking is expected to contribute to the socio-economic development of Muslim society. The existence of Islamic banking is intended to a just social order through the economic development, and equitable distribution of income and wealth (Chapra, M.U, 1982). Further, the difference between Islamic banking and conventional banking is not only in terms of how it conducts the transactions but also the contribution to the society. Generally speaking, it is indeed that Islamic banking should be concerned about social justice and poverty alleviation. Nevertheless, it seems like the Islamic banking and finance
industries predominantly focus on profit maximization and try to compete with their conventional counterparts in meeting their bottom line.

Therefore, Islamic microfinance has received a lot of attention as an alternative to develop rural communities’ economics and key to reducing poverty. The Islamic microfinance is designed to assist the poor as they have some barriers in accessing the Islamic bank services. There are some factors which can be the obstacle for the poor people to access the bank such as the absent of collaterals, illiteracy, lack of assets and land and so on. In general, the existence of Islamic micro finance is the big hope to alleviate the poverty (Dusuki, 2008).

Furthermore, Dusuki (2008) also state that although Islamic micro finance is not as advanced as Islamic banking in fund mobilization, there some alternatives of funding to be considered. There are several ways for fund mobilization in Islamic microfinance beside deposits and equity which among other things are from: government grants, donations, zakat and waqf funds.

The main aim of the paper is to discuss the potential of Islamic financing schemes in poverty alleviation. This paper is theoretical in nature which is mainly based on literature review. The paper argues that Islamic microfinance can improve the low income Muslims as a borrower and can reduce poverty alleviation. To achieve this objective, this paper is organized as follows: the next section will discuss basic characteristics and principles of microfinance. The discussion about experience of microfinance in alleviating the poverty will be presented after that. The rest of paper will contain of some thoughts of the Islamic principles microfinance and how it can be linked with other institutions such as Islamic banking, as well as waqf and zakat institutions. The discussion about risk management will be presented before conclusion.

2. Review Of Literature

2.1. Micro Finance: The Principles And Characteristics

In general, microfinance can be defined as “program that extends small loans to very poor people for self employment projects that generate income in allowing them to take care of themselves and their families” (Abdul Rahman, 2008). It is expected that with micro finance, poor people got their opportunity to change their lives to become better (Nasyrin, 2009). Interestingly, the microfinance has been recognized by The World Bank as an approach to address income inequalities and poverty.

There are several characteristics of microfinance. Firstly, it provides small short-term loans which are mainly addressed to poor farmers and villagers. The purpose of giving loans is to enable them to grow crops, to buy farm animals, or to start micro-enterprises (Fruman, C. and Goldberg, M, 1997). This could also encourage the poor farmers to be more productive and creative in creating the new micro enterprises.

The second characteristic is microfinance has different type or collateral. The collateral is not fixed or tangible assets, rather usually is based on group peer pressure. Meaning that a group of people will work together and they are responsible for helping and encouraging each other to pay back the loans. In case the loan is not paid back by one member of the group, the other members will get penalty by not getting loans in the future (M.Yunus, 1997). There are some advantages of group lending, among other things are it can reduce moral hazard problems. Usually, moral hazard problems occur from the fact that financial institution cannot effectively monitor borrowers. Through the group lending, the member of the group has agreed to shoulder a
monetary penalty and monitor each other.

Another characteristic of microfinance is the relatively easy and quick way of evaluating the qualifications of the borrowers. There would be no lengthy waiting period and evaluation time would be short (Fruman, C. and Goldberg, M., 1997). This is important as it might be difficult for the poor to undergo the bureaucratic procedures.

Still from the same scholar, Fruman, C. and Goldberg, M. (1997) state that the fourth characteristic is high-repayment rates. The reason behind the high rates is to recover transaction costs, so microfinance institutions can be sustainable. However, charging interest in microfinance could be another debate whereby it is not comply with Islamic principles. The discussion about Islamic model of microfinance will be presented in another section of this paper. The final characteristic is it should be located in the convenient location hence easy for accessing the financial services.

Although the microfinance sector is addressed for the poor people, it should not be underestimated as successful microfinance had proven can be profitable and sustainable (R Dhumale, & Sapcanin, A, 1999). The experience in some countries has shown that the poor are actually bankable and willing to pay premium for financial services they got. As a matter of fact, microfinance has been practiced differently in many countries with different approaches. The following section will therefore highlight some evidences of how microfinance has been successful in eradicating the poverty problems.

2.2. The Experience of Microfinance in Poverty Alleviation

Perhaps, the most widely cited example for outstanding successful microfinance institution is The Grameen Bank. The award of the Nobel Peace Prize in 2006 to the Grameen Bank and its founder, Muhammad Yunus, brought microfinance to international attention. The Grameen Bank has 2,319 branches in the entire Bangladesh with 6.91 million borrowers. It is interesting to note that rather than demanding collateral and legally enforceable contracts, the Grameen Bank has developed a system, based in its words on “mutual trust, accountability, participation and creativity” (Wilson, 2007).

Actually the history of microfinance predates modern banking where it involved informal financing such as moneylenders, loans from friends and relatives and supply of credit from merchants and landlords. Most of this financing involved debt based credit. However, since there is an element of exploitation in this mode of financing, the poor were often indebted from generation to generation. As the consequence they still continue to use informal sources of finance, despite the increasing presence and impact of modern banking in many developing countries (Wilson, 2007).

Later on, the microfinance was widespread to Latin America and South Asia, but perhaps the well known was in Bangladesh in 1976, soon after the famine in 1974. It is proved that the microfinance movement has helped to reduce poverty, improved schooling levels, and generated or expanded millions of small businesses. Furthermore, this idea has now spread globally, with is being replicated in Africa, Latin America, Asia, and Eastern Europe, as well as richer economies like Norway, the United States, and England.

It is widely agreed that the primary mission of microfinance is to help poor people in assisting themselves to become economically independent. Although the Grameen bank is always be a good model for the success of microfinance, some critiques has been addressed to it. It is argued that the Grameen bank does not comply with...
shariah as it charges interests on its 
loans. There is a concern about shariah 
compliance as this issue is in line with 
the values and belief in the Muslim 
society. Therefore, the Islamic mode of 
micro finance is the best alternative for 
the Muslim community. The following 
section will discuss the basic Islamic 
finance in brief.

2.3. The Islamic Finance 
Principles
The Islamic financial sector is mainly 
characterized by some key principles 
deriving from the Shari‘ah. It has been a 
dogma among Muslim that riba’ is 
prohibited in Islam. All kinds and 
tention of Riba’ is not allowed in 
Islamic Finance. Therefore, the main 
objective of the establishment Islamic 
finance and banking is to provide the 
Muslim society with an ethical Islamic 
alternative to the conventional banking 
system that was based on riba’ (A. 

There are two types of riba i.e. credit 
riba’ (riba’ al-nasi‘ah) and surplus riba’ 
Credit riba’ is created from any delay in 
settlement of a due debt, regardless 
whether the debt is in the form of goods 
sold or loan. Whereas, surplus riba (riba’ 
al-fadl) is the sale of similar items with a 
disparity in amount in the six 
canonically-forbidden categories of 
goods: gold, silver, wheat, barley, salt, 
and dry dates.

There are basically 3 ethical reasons for 
the unlawfulness of riba’. Firstly, 
charging interest will lead to exploitation 
and which is in turn lead to a massive 
equity. Charging excess or surplus in 
exchanging one commodity against the 
other will lead to the exploitation of 
the borrowers. Secondly, since interest or 
riba’ is predetermined and the creditor is 
certain to receive the interest imposed, it 
may prevent the creditor from being 
involved in any occupation hence the 
creditor has not made any effort in 
acquiring income. This situation will 
hinder the progression of worldly affairs. 
Finally the unlawfulness of riba’ is due to 
an end of mutual sympathy, human 
goodliness and obligations because the 
practice of riba’ may lead to borrowing 
and squandering (A.I Qureshi, 1991).

Thus, the profit and loss sharing 
arrangements become an alternative to 
riba’ and it is considered as an ideal 
mode of financing in Islamic finance. It is 
expected that this profit and loss sharing 
will be able to eliminate the inequitable 
distribution of income and wealth (M.N 
Siddiqui, 2001). Furthermore, the profit 
and loss sharing may lead to a more 
efficient and optimal allocation of 
resources as compared to the interest-
based system. The depositors are likely 
to get higher returns leading to richness, 
however it is hoped that progress towards 
self-reliance will be made through an 
operating rate of savings. Thus, this will 
ensure justice between the parties 
involved as it is dependent on the 
operational results of the entrepreneur 
(M.N Siddiqui, 2001).

Besides riba, Gharar, which means 
uncertainty and also speculation, is also 
strictly forbidden in Islam. Moreover, no 
haram or unlawful transactions such as 
the production of alcoholic beverages or 
gambling may be authorized under an 
Islamic finance scheme.

With regard to Islamic micro finance 
sectors, the simplest way to apply 
Islamic principles in the micro finance is 
by adopting the Islamic banking 
principles. The programs such 
mudaraba, musharaka, and murabaha 
which are predominantly offered the 
Islamic banking could also be applied in 
the micro finance. The application 
Islamic banking schemes to micro 
finance is believed can accelerate the 
poor entrepreneurs. However, the main 
obstacle of Islamic micro finance is lack 
of fund. This problem could be a major 
constraint to the growth and efficient 
operation of the Islamic micro finance. It 
is therefore, there is an idea to integrate 
Islamic micro finance with the Islamic bank and 
the zakat and waqf institutions. This 
issue will be elaborated further in the 
next section.
3. Analysis

3.1. Integrating Islamic Banking with Microfinance

As far as micro finance sector is concerned, there are not many commercial banks which actively involved in micro finance industry. As a matter of fact, there are some possible ways in which the Islamic banks can contribute to the development the micro entrepreneurs. The concern over credit provision for the poor via micro finance to achieve greater social welfare is very relevant to Islamic banks. Islamic banking could offer viable projects that are rejected by conventional lending institutions because of insufficient collateral on a profit-sharing basis.

At the same time, the application of Islamic banking products to microfinance is proving to be successful in alleviating poverty. In certain circumstances the mudaraba (profit sharing) and murabaha (buy-resell) methodologies may be appropriate for microfinance. Although the murabaha (buy-resell) model creates high initial transactions costs, it can be offset by low loan administrative and monitoring costs given the simplicity of the model. However, murabaha has been often criticized for being a hidden form of interest-based financial product. Therefore, it is important to stress that Islamic micro finance products are not a mere religious make-up operation of conventional financial products.

While the mudaraba (profit sharing) model may require the frequent determination of business profits and in to some extents it be used to achieve the goals of micro enterprise lending. This instrument may be costly and not always easy to implement, but when managed with expertise it proves very profitable for the lending institution. This scheme could also give thousands of entrepreneurial poor access to microfinance.

Other types of Islamic lending qard al hasanah —such as (benevolent lending with a service fee)—may emerge as more practitioners implement Islamic lending principles in microfinance institutions. However since this scheme involves charitable assistance which requires subsidies or cross subsidies, the inclusion of zakat and waqf funding into micro finance could be an alternative. This will be the next issue in this paper.

3.2. Integrating Zakat and Waqf with Microfinance

The idea of integrating micro finance with the zakah and waqf institutions is to overcome the limitation in fund mobilization. Micro finance can mobilize fund from the internal sources such as deposits and equity. But that alone might be not sufficient as most of micro finance customers are from the poor people.

Although Islamic micro finance could get alternative funding from government agencies, it imposes certain terms and conditions which are sometimes contradict Islamic principles. For instance, the funds from government are provided on the interest basis. Thus it will be impossible to conduct Islamic financial scheme as the source of the fund is not halal (lawful) (Ahmed, H., 2007).

Therefore, to resolve this problem there is possibility to integrate zakat and waqf institutions to Islamic micro finance. It implies that the zakat and waqf fund can be used as one of the external sources for microfinance. This integration is expected be mutualism as the certain portions of profit generated from that fund will be distributed back to the beneficiaries of zakat and waqf. In addition it could also encourage the zakat and waqf institutions to manage...
the fund productively instead of leaving it idle.

The abovementioned discussion about integrating Islamic bank as well as zakat and institutions give insights that Islamic micro finance could mobilize fund other than internal sources i.e. deposits and equity. Nevertheless there are some issues for concern whereby managing micro finance is not free from risk. As the consequence, it will affect the Islamic bank and zakat and awqaf institutions at the end of the day. Thus there is should be an effort to manage the risk of Islamic micro finance. The following section will discuss the risk management in Islamic micro finance sectors.

3.3. Some Issues about Risk Management in Islamic Micro Finance

Having discussed the alternative of funding for Islamic micro finance, this section will specifically elaborate the issue of risk which cannot be avoided. The main concern of the Islamic banks to be involved in the micro finance project is how to manage their risk. The commercial banks always concern with risk as the banking business requires efficient and effective mechanism in managing assets and liabilities. Since the clients of micro finance are from poor people whose lack of physical collateral and sometimes illiteracy, thus Islamic micro finance will be faced with the credit risk. Therefore, the idea of group lending and peer monitoring could be one of the alternative to resolve this kind of risk. Moreover, setting up a channeling agent which will monitor the activity of the micro finance is another alternative to reduce credit risk.

While credit risk is also the main concern in utilizing zakat and waqf funds. The position of zakat and waqf funds in the micro finance balance sheet is in the liability side, meaning that it should be refund once the project has completed. As a matter of fact, zakat fund is not exclusively addressed to the poor; rather there are eight asnafs who entitle with this fund. It is true that nowadays there is discussion about making zakat fund more productive rather than just give it away to the beneficiaries. However, the amil of zakat fund should consider carefully how much the provision of zakat fund will be provided in supporting the micro finance. Thus, the safe way to assign zakat fund to micro finance is by allocating one-eighth of the fund as it is the right of the poor people. In addition, the micro finance should undergo the screening process carefully in selecting the potential clients.

With regard the use of waqf fund, there is another issue for concern. The essential feature of waqf suggests that the corpus of the endowment should be kept, implying that any use of waqf fund cannot bear any loss. In addition, there is a circumstance where the donors of waqf fund (waqif) restrict the use of the endowment. Meaning that the waqf manager (mutawalli) cannot use waqf fund other than what the waqif has mentioned. In this regards, it is the task of mutawalli to ensure that the portion assigned for micro finance is not the restricted funds. Otherwise, the mutawalli and micro finance manager could violate the waqif whims.

4. CONCLUSION

Microfinance is designed to assist the poor people as they have no collateral which cause barriers in accessing the bank services. It is witnessed that the micro finance sector has been successful in alleviating poverty in many countries. Not surprisingly then The World Bank has recognized microfinance as an approach to address income inequalities and poverty. The good example for outstanding successful microfinance institution is The Grameen Bank. However, since this bank charged interest on the loan, it
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Contradicts Islamic principles which prohibit any riba’ in the transactions. Therefore Islamic mode of micro finance becomes alternative for Muslim community.

There are some obstacles in fund mobilization faced by Islamic micro finance. This is because Islamic micro finance should carefully select the halal source of fund. Hence the involvement of Islamic bank as well as the integration of zakat and waqf into micro finance could be a good alternative in resolve lack of funding problem.

Despite there some potential risks which may be occurred in utilizing Islamic bank as well as zakat and waqf fund, there are also some possible ways to reduce the credit risk. The group lending is believed can be effective way in monitoring the micro finance clients. In addition to this, the establishment of channeling agent is expected can help monitoring process. The last but not least the issue regarding shariah compliance of the use of zakat and waqf should be borne in minds since these kind of fund have restricted rule. Above all, the existence of Islamic micro finance is the big hope to mitigate the poverty problem in the Muslim society.

Daftar Referensi


