

Integrated Waqf Based Islamic Microfinance Model (IWIMM) for Poverty alleviation in OIC Member Countries

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Abstract: Poverty dominates the agenda of developing countries. Poverty was and still is one of the major impediments of human progress and societal development. Its existence is as old as human history while its alleviation is attributed to effective and successful economic policies. Various approaches/policies are offered towards reducing poverty. These policies vary depending on time, space and the country concerned. However, reduction of poverty the major goal of many economic systems as stated by the Millenium Development Goals, thought sometimes not explicitly stated It was found that in OIC member countries religious and cultural norms drive preference of Islamic microfinance over conventional microfinance. The study further developed an Integrated waqf based Islamic micrfinance model (IWIMM) for poverty reduction in OIC memebr countries. This is expected to overcome the challenges of conventional microfinance such as, high cost of capital, low quality of human resource, vulnerabilites of poor borrowers due to lack of sustainable takaful and limited products for the clients with different occupationanl backgrounds. However, the model is yet to be verified empirically. Thus, further studies should be conducted to test the model using quantitative techniques such as, structural equation modelling (SEM).

Key words: Microfinance • Integrated Waqf Based Islamic Microfinance • Poverty • Muslim countries

INTRODUCTION

Poverty was and still is one of the major impediments of human progress and societal development. Its existence is as old as human history while its alleviation is attributed to effective and successful economic policies. Various approaches/policies have been put forward aimed at reducing poverty and they vary according to the geographical location, time and space. Poverty reduction remains a major goal of many societies regardless of ideological beliefs. Presently, Muslim countries are caught into the trap of poverty. In 2009, out of the 49 Least Developed Countries (LDCs,), 22 are OIC member countries. Of these 22 countries, 18 are listed among Highly Indebted Poor Countries (HIPs). The LDCs are those countries that are considered by The United Nations considers LDCs as the poorest and weakest segment of International community. They are handicapped economically, institutionally and in need of human resource development to enhance their economic performance. Beside the structural weaknesses, the

importance of politico-economic and socio-cultural dynamics in economic development can hardly be overemphasized [1]. To break out the vicious circle of poverty and underdevelopment, deliberate attempt needs to be made to implement effective policies and programs.

It is noted that geographical as well as regional distribution of the OIC-LDCs based on resource endowments may be viewed as a contributing factor that hinders economic growth and development performance. In addition, the structural weaknesses and lack of capacities related to growth and development impede those countries` efforts to improve the standard of living of the majority of their populations. Beside the structural weaknesses the importance of politico-economic and socio-cultural dynamics in economic development can hardly be overemphasized.

Those countries contributed only 6 percent of total global output despite the fact they constitute almost a quarter of the total population in 2008. The SESRIC report suggests the establishment of microfinance programs

particularly for agriculture sector whose contribution to GDP has been declining over the decades. This holds in the OIC-LDCs, in particular and the global perspective, in general [1]. At a very micro-level, lack of access to business training, finance and human resource development is a major contributory factor behind the limited role of microenterprises in accelerating overall economic development. The paper is divided into 5 sections. Having discussed conceptual and measurement aspects of poverty in section one, section two focuses on the challenges of microfinance development. These include exploitative interest rate, over indebtedness, limited products, lack of shariah compliance and low human capital among others. Section three discusses the methodology used in the study. Section four presents the proposed model and finally section five suggests policy implications.

Motivation of the Study: The research is motivated by a number of factors. Firstly, poverty issue is becoming stumbling blocks to the development of Muslim countries and communities. This is connected to high level of unemployment that leads to low level of income for households. Lack of income leads to poverty and poverty stricken societies are paralysed for any development agenda to take place. Thus, there is need to harness resources to fight poverty in Muslim countries and communities. Secondly, the availability of waqf/sadaqa resources that can be utilised to fight the menace of poverty is potentially high. Thus, combining these resources with entrepreneurial ability of the poor clients will assist to reduce significant number of poor in OIC member countries. Thirdly, microfinance that is recently realised as an effective tool of fighting poverty can be used as an instrument to channel the resource, train human resources so as to effectively participate in business enterprises that will help them exit from poverty. Fourthly, conventional microfinance penetrating into Muslim lands faces rejection. Essentially, the claim that microfinance made in reducing poverty is counter argued due excessive charge on loans leading to exploitation and over-indebtedness of the poor clients among others. Therefore, an Islamic microfinance will be more transparent and more flexible to the participants. It is expected to, among others improve the living standard of the poor and promote financial inclusiveness and fairer income and wealth distribution in the society.

Significance of the Study: The proposed research is expected to contribute to poverty alleviation in Malaysia and other OIC member countries by developing an integrated Waqf and Islamic microfinance institutions.

- The research is expected to promote both Waqf and Islamic microfinance institutions.
- The research will open up the investment opportunities and human resource development among OIC member states.
- The proposed research will significantly enhance socio-economic cooperation among the OIC member countries.
- The research findings and outputs can be replicated to the rest of Muslim countries to promote a balanced socio-economic development of the Muslim Ummah.

Poverty: Identification and Measurement: United Nations defined poverty as “a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society. It means not having enough to feed and clothe a family, not having a school or clinic to go to; not having the land on which to grow one’s food or a job to earn one’s living, not having access to credit. It means insecurity, powerlessness and exclusion of individuals, households and communities. It means susceptibility to violence and it often implies living on marginal or fragile environments, without access to clean water and sanitation” (UN, 2012?).

According to the World Bank estimate, based on the revised poverty line cut-off of USD1.25 a day per person, only East and South Asia’s regions are expected to reduce poverty by half by 2015[2]. This indicates that all developing regions have lost momentum in achieving their goals on poverty. If nothing is done the incidence of poverty stricken household would rise from 1.3 billion in 1999 to nearly 2.0 billion by 2015 [3]. According to [2] currently there are about 1.4 billion people live on less than USD1.25 a day and 2.6 billion on less USD2 a day, in the developing countries.

It is estimated that the recent global financial crisis pushed additional 50 million people below the poverty line of 1.25USD a day and 64 million more below the poverty line of 2USD a day in 2009 [3]. This confirms the vulnerable nature of the poor people across the globe. The situation is worse in less developed countries where the chances of survival is much more difficult and slimmer compared to developed or developing nations.

In fact, poverty is complex as well as multidimensional and due to its nature a single income or consumption based indicator cannot be captured or even by broader material proxy of income poverty [4]. “The dollar a day” poverty line or more precisely USD1.25 a day measure is found to be quite insufficient¹. This suggests that more alternative measures need to be developed to supplement the already existing efforts. This is why; recently developed alternative approach covering income poverty together with non-material dimension was applied to more than 100 developing nations. The new concept is termed as Multidimensional Poverty Index (MPI) which is used by United Nations Development Programme (UNDP) in its “Human Development Report” in October, 2010 [5].

Economic crises both past and present increased inequality and the situation may likely worsened over time unless appropriate measures to protect the poor are put in place. The wide and ever increasing inequality aggravates the risk of social problems. The extent of poverty and deprivation in the world adversely affect social security and peace. Today, the world is becoming more informed and concerned about poverty and investment is being made toward fighting it. Indeed, investments in poverty alleviation can have high economic and social returns [3]. One strategic way of investing in poverty alleviation is through microfinance that can enable the asset-less poor to create income generating activities which is more capable than giving direct assistance to the poor.

[3] asserts that a successful broad-based growth strategy includes macroeconomic stabilization policies that provide incentives for employment-creating production, augmented by sectoral policies. This encourages employment of the poor and improves social services, rural development and investment policies. All these promote institutionalization, structural transformation and expand employment opportunities, making services available to the poor such as, education, health and other social amenities. Consequently, job opportunities and structural transformation in the economy would require higher skills, including low-income groups, to effect and sustain growth. These are the basic ingredient for the reduction of poverty. This requires increasing both the quality and quantity of human capital.

Microfinance Defined: Recently, there is growing concern for financial services beyond microcredit. Consultative Group to Assist Poor [6] of World Bank defines

“microfinance” as ‘the provision of formal financial services to poor and low-income (and, for credit, in particular, non-salaried) people, as well as others systematically excluded from the financial system.’ Previously the term used was microcredit, but with the increasing recognition of the broader needs of financial services by the poor, the term microfinance replaces microcredit. This was advocated also by the founder of modern microfinance [7-8]. In fact, recently, financial inclusion is emphasized to reflect much broader scope of financial coverage needed by the poor. However, microfinance, at least at regulatory level is likely to continue to be used not only now but also in the near future to come. These needs include microcredit, savings, transfers, remittances and insurance.

For instance, despite having the moderate growth rate of 5 percent in countries like Bangladesh, the gains in development are disproportionately recorded in 2010. This is against the Washington consensus” that high economic growth will bring about reduction in poverty or what is called trickle-down effect. Yet, the mechanism in which the growth will spread is loosely stated and not effectively proven in developing countries. In fact, Stiglitz report (2010) on financial crisis reported that Washington consensus policies and its adoption had served the developing nations so poorly. In fact the report warned that “Unless something was done, almost surely, there would be more crises in the not-too-distant future.”

The increasing recognition of Islamic financing principles deserves special attention. The Stiglitz report (2010) emphasizes the need for a better distribution of risks between lenders and borrowers in world markets and creation of financing mechanism for development cooperation. The growing inequality in most countries of the world has brought about potentially weak effective demand that further aggravates poverty and inequality.

Challenges of Microfinance Development in Muslim Countries: This section surveys the literature on the major challenges facing microfinance industry. These range from high and exploitative interest rate to over indebtedness, limited products, lack of sharia compliant and cultural values as well as low human resource capability among others.

Interest Rate and Exploitation of the Poor: Charging poor microfinance client very high interest rate has sparked public debates. It has further strengthened critiques

¹The “dollar-a-day” poverty threshold is purchasing power parity (PPP) adjusted dollar that has the same purchasing power in all countries (ADB, 2010).

position on the tendency of MFIs to exploit poor borrowers. The interest rate charge by MFIs ranges from 25 to 50 percent of the amount borrowed. This high rate compared to market rate has serious implications for the income and welfare of poor borrowers since they have to pay high and fixed rate together with the capital regardless of what is the outcome of their business undertakings in the market place. High administrative cost of issuing loans to small borrowers is commonly cited as the reason for the exorbitant rate paid by the poor in the form of interest rate.

According to the [6] it is not in favour of market players to set how much rate to be charged by micro-lenders. It stated that "Interest rate caps can restrict access by making it impossible to serve small or remote borrowers. It may be politically difficult to set a cap that is high enough to cover the unavoidable costs of micro-lending and a profit margin adequate enough to attract capital to low-income financial services" However, this seems to be contradictory with the World Bank strategy of fighting poverty. According to the World Bank, one of the strategies to fight poverty is to "provide governments zero-interest development financing, grants and guarantees."² Thus, interest is perceived to have negative impact at macro level as well as micro level of the economy. In fact, high interest rate is one of the major causes of business bankruptcies even in non-Muslim countries [9].

However, lack of transparency related to loan administration creates suspicion about the amount to be paid by the poor due administration of the loan. Even the regulatory control measures to protect poor borrowers remain ineffective. The activities of micro-lenders in India in 2011 (non-Muslim country) appealed to the Central Bank of India to draw a line between profits and profiteering through its new national guidelines for micro-lenders. The annual interest rates are capped at 10-12 percentage points above the borrowing costs and that amount to 23-27 percent (The Economist, Jan, 12, 2013). In Nigeria similarly, the Central Bank of Nigeria confiscates the license of more than 200 microfinance banks due to fraud, excessive charge on the poor and mismanagement, among others [10].

In fact, administrative cost could be reduced through increased efficiency. This will reduce public criticism on the microfinance industry. One way to cap interest is to enforce and ensure effective disclosure and encourage more competition among lenders and microfinance institutions [6].

Over-Indebtedness: Research findings suggest that clients of microcredit are becoming over-indebted [11]. The issue of over-indebtedness is related with the amount of loan borrowed, the number of institutions patronised by a client and the ethical consideration of the clients. Over-indebtedness in microcredit is usually measured by: i) the collection of performance of the lending institutions ii) debt to income ratios and iii) increases in loan sizes, terms or rescheduling. Thus, inadequate internal control allows borrowers to repay loans by borrowing from another microcredit institution or the staff of microcredit rolls over unpayable loans [6]. The clients when become over-indebted also become depressed so much so that they can commit any form of crime including suicide. Hence, appropriate policy must be put in place to regulate abusive lending and collection practices. Sometimes, the institutions subject the clients to intimidation and coercion [12-13]. This leads to loss of dignity by the clients. In few cases, the lenders are barred from lending to a borrower with outstanding loan or controlled for abusing the clients' right to dignity [14]. This call for reviewing the lending and borrowing practices in line with the best practices and such guidelines are readily available in the Islamic financial principles of lending and borrowing. In a hadith reported by Abu *Hurairah* May Allah be pleased with him reported that the Prophet (peace be upon him) said "whoever owed people's money with intention to pay them back, the Almighty Allah will pay for him, but whoever owed it with an intent to waste it, the Almighty Allah will waste him too" (Sahih al-bukhari, vol.5 p.45).

Limited Products: Despite the popularity of microfinance, the available products for the micro-entrepreneurs to choose are very limited. Initially, the microcredit focuses on 'credit only', neglecting other financial needs of the poor borrowers. Even where the scope is wider such as in microfinance and financial inclusion, the borrowers have limited sovereignty on the type of products they will be offered. Hence, there is mismatch between the needs and supply of financial services in microfinance industry. As in commercial banking, microfinance products needed by the clients include microcredit, micro-insurance, transfers, savings and investment opportunities. However, this has not been the case in the conventional microfinance in Muslim countries.

Given this limitation, project financing that comprises of 3 elements are hardly relevant for the development of the industry especially in Muslim countries. These are I)

²Please see http://www.worldbank.org/mdgs/poverty_hunger.html.

individually initiated products ii) Group initiated products and iii) institutions initiated products as have been delineated below. This limited product syndrome is hardly capable to unlock the potentials of the entrepreneurs in the informal sector in Muslim countries. This is particularly due to limited formal jobs, low pay and long working hours as evident from in the informal sector.

Shariah Compliance and Cultural Values: Though fundamental in Islamic teachings, the issue of cultural values receives less attention among researchers, policy-makers and other stakeholders in microfinance institutions. Islam is a comprehensive religion that talks not only about financial aspects but spiritual, social and cultural aspects as well. It is a common knowledge that, Islam gives high regard to the institution of family and family values. In Islam, the family is the unit of society and not individual [15]. Microfinance has the potential to bring economic benefit to the clients embedded with many family and cultural values.

[16] argues that the stagnant of Islamic microfinance development in Indonesia is due to lack of attention to the cultural differences. [16] studies the impact of culture on the development of microfinance in Indonesia. [17] asserts that the religion and cultural sensitiveness of Muslim world deserve a greater attention in order to ensure inclusiveness in the global financial system. No doubt, understanding the local culture will improve the effective delivery of microfinance (Phlong, 2009). Similarly, [18] finds that cultural orientation in microfinance plays a vital role for the success of microfinance. These studies indicate the diversification requirements with regards to cultural differences [16]. This is confirmed by Karim, Tarazzi and Reille (2008) that innovative designs of a range of sharia-compliant products and services would increase financial coverage to a broader segment of the Muslim clients. At the end, the culture is predicated to affect the success or failure of microfinance [16]. Ignoring these cultural differences is likely to inhibit microfinance penetration and its overall performance in the society.

In light of this, a recent study by [19] stated that a strictly economic response does not fully address many significant challenges faced by individuals and families when crises occur.” Human development must be treated at the core of economic development. Many small programs can be tailored to fit the needs, culture and customs of specific region. It added that ...small steps can begin to add up to larger gains that can ripple through and spill over into all these areas of family and community life” [19].

A more recent study by [15] focuses on the performance of microfinance in OIC member countries and non-member countries. Their objective is to explore if there exists any significant difference between the two set of countries. They build on the popular belief that religious and cultural norms in Muslim countries may demonstrate preference of Islamic microfinance over conventional microfinance. Based on the 754 microfinance institutions in 33 OIC member countries and 50 non-member countries they analyse performance of microfinance based on: a) outreach b) loan recovery and profitability c) overall financial performance with respect to country specific and firm level variables. Interestingly, their findings show that country GDP size is positively related with profitability. Similarly, the percent of women borrowers is a significant predictor for loan recovery and firm profitability in the OIC sample and otherwise in the rest of the world sample. In addition, the results show that country’s religious inclination as defined by the years taken before joining OIC membership after independence of that country, plays a significant role in predicting some popular Islamic belief with regard to conventional microfinance vis-a-vis low market penetration of conventional microfinance outreach in more religiously inclined OIC member country.

Table 2.1 below shows the preference of Islamic financial products including Islamic microfinance in Muslims countries. In fact, the majority of the Muslims confronted with the problems of poverty can only be reached through Islamic microfinance services. This reject the interest-based loans by commercial banks in those countries. For instance, in Algeria, a study by Bankacademie International (2006) shows that 20.7% of microenterprise owners’ do not apply for loans primarily because of religious reasons. The studies based on Afghanistan, Indonesia, Syria and Yemen further indicate that some conventional micro borrowers tend to switch over once Islamic products become available [6]. This story remains the same in the case of Nigeria, Bangladesh and other OIC countries showing greater preference for Islamic microfinance over conventional microfinance.

Human Capital Investment: There is an inherent link between human capital, poverty and economic growth particularly in developing countries. The complex and multifaceted nature of human development necessitates the use of a broader range of tools than is normally brought to bear on questions of economic policy. Economic depression can cause permanent damage to the cause of human development [19].

Table 2.1: Preference for Islamic finance in the Muslim world

Country	Survey (Year)	Findings
Algeria	School of Finance and Management (Bankacademie International) (2006)	A study revealed that 20.7% of microenterprise owners do not apply for loans primarily because of religious reasons.
Malaysia	Saad (2012)	Clients of AmanahIkhtiar Malaysia show willingness to participate in musharaka and other Islamic financial contracts if they are provided. They also pay Zakat from their loans.
Indonesia	Bank Indonesia (2000)	In East Java, 49% of the rural population considers interest prohibited and would prefer to bank with Sharia-compliant financial institutions.
Bangladesh	Rahman (2010), Mannan, 2007	There is strong need for Islamic alternative to microfinance. Islamic microfinance was also found to be significant contributor to poverty reduction.
Jordan	IFC and FINCA (2006)	Studies show that 25% and 32%, respectively, of those interviewed cite religious reasons for not seeking conventional loans. The study also showed that 18.6% of those interviewed rank religious reasons as the single most important factor in their decision on obtaining a loan.
Lebanon	Hamze (2001)	The success in outreach of Islamic programmes relative to conventional microfinance institutions strongly suggests that large numbers of poor people prefer Islamic finance. In addition, microfinance practitioners report that many of the poor refuse financial services unless they are Sharia-compliant.
Palestine	PlaNet Finance (2007)	More than 60% of low-income survey respondents claim a preference for Islamic products over conventional products. More than half of such respondents prefer such products even if they come at a higher price.
Syria	IFC (2007)	Survey revealed that 43% of respondents considered religious reasons to be the largest obstacle to obtaining microcredit. In addition, 46 percent of respondents who had never applied for a loan stated that religious reasons were the primary reason they had never applied. Nearly 5 percent of current borrowers said they would not apply for another loan for religious reasons.
Yemen	National Microfinance Foundation	An estimated 40% of the poor demand Islamic financial services, regardless of price.
Afghanistan,	FINCA (Afghanistan),	Microfinance practitioners (please see left) indicate
Indonesia,	German Technical	That in these countries some conventional micro borrowers tend to switch over once
Syria and	Cooperation Indonesia),	Islamic products become available (CGAP, 2008).
Yemen	Sanadiq in Jabal-al-Hoss (Syria), Social Fund for Sustainable development (Yemen) and Hodeidah Microfinance Program (Yemen)	
Nigeria	Adewale, 2006, Muhammad, 2013	Majority of micro entrepreneurs interviewed stated that their religion prohibits dealing with interest, thus the reason for avoiding conventional microfinance banks. In addition, they express their intention to utilise Islamic micro-investment model.
33 OIC Countries	Ashraf and Hassan (2013)	Religious and cultural norms in Muslim countries drive preference of Islamic microfinance over conventional microfinance.

Source: OIC Outlook Series (2012), Saad (2012) Adewale (2006) Muhammad (2013), Ashraf and Hassan (2013)

Human capital theory states that individuals shape their knowledge and skills for job experience through education [20]. Human capital or human development is the result of accumulated investments in growing children, including nutrition, education, stimulation and care, in a supportive environment that allows the child to flourish [19].

The benefits of human capital investment of microeconomic could be seen from marginal private cost and marginal private benefits of private investment in human capital. In other words, households decide to invest in the human capital of their children because of the higher expected payoff of these investments today or in the future. The decisions of how much to invest also depends on the expected net returns to the investments.

It is also argued that higher expected private benefits and lower expected private costs will encourage greater private investment [19]. The maximum private investment is achieved where the present discounted value of the expected marginal private benefits equals the present discounted value of the marginal private costs. These marginal private costs and benefits vary across household, gender, environment and other characteristics such as access to credits [19].

Yet, the household has a choice in his production function i.e. to produce for sales or for domestic consumption. The question of specialization comes into being which requires the household/firm to focus on the production having comparative advantage.

However, this marginal private cost and benefit tends to undervalue the significant role of human knowledge by looking it only from private gain and neglecting the social benefit. From Islamic economic perspective it is beyond private gain but also a duty for the household as unit of the society to impart knowledge and skills to his family members. This can be done by investing in the children to attend educational institutions due to its numerous benefits over teaching at home.

However, the existence of externalities caused by market failures makes it impossible to make private gain without corresponding unpaid social benefit or cost. Yet, even if marginal private costs and benefits are aimed at equalizing the present discounted value and future discounted value to produce optimum point, distribution could be a major obstacle. Distribution as noted by [19] is a major policy motive distinct from efficiency since a highly efficient economy might have a highly undesirable distribution of resources. So there is dire need to balance between the two concepts.

In 2012, it is estimated that 53.4 percent of the population in the OIC are youth between 0-24 years. This seems to be the highest compared to the world, comprising developing countries as well as developed countries. According to [21] the demographic structure of Muslim countries and the potential opportunities in various economic sectors are likely to develop entrepreneurship that will create a huge social capital alongside physical and financial capital formation resulting in an endogenized growth in the society [22]. At a start, the financial gap could be filled up by the term 'crowd funding' which refers to a collective cooperation of a network of people gathering resources to support the initiatives of others willing to establish, build or develop a specific business or project [22]. In Muslim countries, equity based principles should be applied to crowd funding³ to support the bulk of entrepreneurs.

The most recent financial crisis has caused great damage to the world economy in 2007-2008. Since then, the World economy is characterized by a number of unpleasant realities namely, loss of jobs and skills attached to it; high unemployment particularly for youth; sudden cuts in government spending; excessive indebtedness; ironically the rising prices of basic necessities and poor performance in the West and incapability of emerging economies to act as more powerful locomotive for the World as a whole [23].

MATERIALS AND METHODS

This study uses both quantitative and qualitative methods of inquiry to develop the model. Initially, a critical and extensive literature review was made to investigate the existing framework of Islamic microfinance, waqf practices and other programs of fighting poverty in OIC member countries as well as other developing countries. The findings reveal that there is lack of integrated approach in fighting poverty in those countries. More so, the research in the area is limited, thus, posing additional challenge to explore the practice. From the literature survey the following are worth noting:

- While poverty record is readily available in most of the countries and poverty reduction vary across the countries, hence, it declines, remain stagnant and yet in many other countries it increases.
- Despite the significant role of the institution of awqaf, it is highly understudied in those countries. The practices vary face inefficient management system.
- Most of the studies on Islamic microfinance and waqf/zakat remain theoretically and conceptually based with little application in microfinance (Muhammad *et al.*, 2011, Hassan and Alamgir, 2010, Shirazi 2013 and Ahmed, 2007).
- The potential of growth and development in Muslim countries in the areas of human resource, availability of capital resources, the environment and markets is very high and promising. This needs proper planning to exploit it.

In addition, intellectual discourse on the structure of the model was held and developed through a number of discussions/interviews involving practitioners in Malaysia. These intellectual sessions help to provide direction and revise the model from its initial structure. On the quantitative side, the researchers have examined the relationship between poverty and its co-determinants such as waqf-based Islamic microfinance related products. The researchers have developed a theoretically sound and statistically robust questionnaire to investigate various dimensions of this research. The structured questionnaire was developed by the researchers based on the objectives of the study. A pilot survey was then conducted in Kuala Selangor with a sample of 101

³A way of generating capital through massive donations from a particular group that shares common interest to support a particular cause

respondents to validate the instruments and test the model based on the perceptions of the clients of microfinance. The respondents were drawn from the clients (sahabat) of AmanahIkhtiar Malaysia (AIM), the largest microfinance provider in Malaysia. The sahabat or respondents include 100 percent women. Research assistants were employed to assist in administering the questionnaire based on participatory observation. According to Campbell (2003), this approach can help reducing missing information and inaccuracy.

The findings of the research show that the instrument is reliable. The values of cronbach alpha of the constructs were all above 0.5 except Islamic microfinance construct. This may be due to low awareness of the Islamic microfinance practice. In addition, means and standard deviations were computed and the average mean of all the 43 items is 3.285 while the variance is 0.544 indicating a relatively good measurement item. The communalities were all above 0.6 which is quite good for an exploratory or pilot test.

Three sessions were organized to present the findings from pilot study. Other similar fora among the researchers and practitioners such as AIM were used to share the findings and provide inputs that led to further improvement of the model.

Integrated Waqf Based Islamic Microfinance Model (IWIMM): Integrated waqf based Islamic microfinance model can be defined as a microfinance model that complies with sharia and aimed at reducing poverty in

terms of enhancing the material-wellbeing and empowering the poor members of the society. The model addresses some of the key challenges of microfinance including Islamic microfinance as practiced in Muslims countries and communities. These include human resource, scarcity of capital and mutual assistance in the form of takaful, project financing and poverty reduction.

Waqf/Endowment: Waqf plays a significant role in the Muslims history since its emergence in more than a millennium in the Arabian Peninsula. Recently, the voluntary and charitable acts such as waqf, zakat and sadaqa receive much attention than ever before as a result of increasing inequality and extreme poverty in the Muslim world.

The inequality gap and poverty level necessitates the need to explore Waqf resources as way of reducing the inequality and reduction of poverty in Muslims communities. It is in this regard, Muhammad Ali (2011); President of Islamic Development Bank (IDB) asserts that “Socio-economic justice and equitable distribution of income and wealth are among the paramount goals of the Islamic economy. At a time when major Muslim countries are passing through a phase of Islamic Renaissance, the importance of mainstreaming the key institutions of the Islamic economy, such as, Zakat, Awqaf and Sadaqah can be hardly overemphasized.”

It is not a surprise when, the president lamented the need for NGOs to revitalise the role of waqf in Muslim countries. According to him “As regards the private and

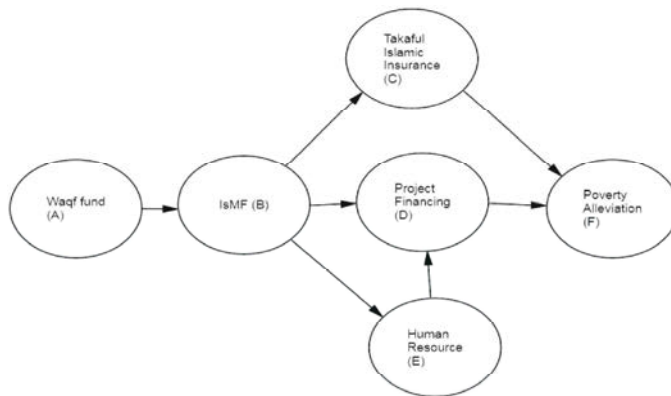


Fig. 4.1: Proposed Model

Source: Field Survey (2012)

Notes: The respective arrow indicates that i) waqf fund could be used to reduce the cost of capital for Islamic microfinance ii) Islamic microfinance could offer takaful financing, project financing and partake in human resource training iii) In turn, trained human resources can participate in the project financing. iv) Project financing is expected to reduce poverty and finally v) takaful financing is expected to reduce poverty

the voluntary sector, an NGO body at the level of OIC member countries needs to be established for providing help and support for all member countries and Muslim communities to spearhead a campaign for recovering those lost Awqaf assets. Let us declare the coming decade as the decade for recovery of lost Awqaf all over the Muslim world.”

This effort coupled with the existing practices of waqf will ensure resource mobilization. The utilization of this will be a catalyst for using the Islamic microfinance to fight poverty. The sources of fund from the potential donors could come from i) Waqf donations ii) Government, iii) Charitable entities iv) Corporate Social Responsibility (CSR) by banks/financial institutions or other corporations v) IDB/other international donor agencies vi) Public donations. These various sources are likely to allow flexibility in running a microfinance programs consistent with the ability, scope, legal requirements/jurisdictional differences of the respective institutions.

Islamic Microfinance/NGOS: Microfinance institutions, Non-governmental organizations and various government schemes that focus on poverty are the potential platforms for the implementation of the IWIMM in Muslim countries and communities. In addition, waqf and zakat institutions have the potential of utilizing the zakat proceeds for the genuine socio-economic development of the poor in their respective communities.

In comparison with conventional microfinance and informal microfinance, interest-free microfinance in Bangladesh is found to be greatly contributing to creating job opportunities for unemployed rural poor and enhancing economic growth in the nation [24]. In fact, [25-26] argue that the rate of labour absorption by this sector is significantly higher relative to that of large scale industries.

Project Financing: International Project Finance Association (IPFA) defined Project financing as “The financing of long-term infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure where project debt and equity used to finance the project are paid back from the cash flow generated by the project.” (Investopedia.com, 2012).

However, since our focus is microfinance, the arrangement and duration may be different. This is especially if the term project financing is viewed from Islamic perspective. Islam discourages debt although it does not prohibit it for permissible purposes. On the other

hand it encourages business undertakings through partnership arrangement. Hence, the relationship between Islamic financial institutions and customers is not of creditor-debtor relationship but one of sharing both risk and reward. This makes the structure of the project financing to be different. In addition, the nature and sources of the fund can be tied to the various project needs. For instance, a waqf fund for investment can be applied in financing long-term viable project.

Microfinance products and services usually are delivered through offering loans to the clients just like conventional banking approach. The major difference being the social collateral that replaces physical collateral. Other differences are dealing with micro-entrepreneurs based on small amount of loans; weekly meetings and compulsory savings among others. This approach assumes that poor individuals/ micro-entrepreneurs need nothing except finance to escape from poverty. However, researches have established that, a poor entrepreneur needs more than loan or microcredit (Muhammad, 2012, Ashraf and Hassan 2013). For instance, according to the founder of microfinance-Muhammad Yunus, in his popular book “Banker to the poor” wrote “ease services are not making significant impact to the clients. That is a mere intermediary between borrower and saver.

Group: Project financing can take the form of group financing whereby the institution and the clients agree to run a business. For instance, sewing school uniforms for children that could have linkage with cottage industry. The relevant institution can come to an agreement of mudaraba with the the group of the clients. The role of the clients are therefore: i) to sew the cloth; ii) to market the cloth; iii) to keep record of the business through the account of the investment. Depending on the different roles the clients can be divided to partake different roles to accomplish the same goal. Let us assume the clients are 5 in number for the first group named as Taqwa Group. In the production line there are 5 functions to perform, sewing the product, will be performed by a client, packaging by another client, marketing by client 3, keeping records by client 4 and client 5 supervise and liaise with the institution to meet the need of the group. On the other hand, the cottage industry could be run by another group of the clients.

The role of the institution however, is to provide capital needed, supply equipments and raw materials as well as business support such as training needed by the clients. The institution also advise the taqwa group on the dynamic nature of business environment.

Individual: In another dimension, since the market is very vast, there can be a client with a viable project proposal consistent with mudaraba mode of financing. The entrepreneur may be having his own business prior to joining the institution. He only needs capital to scale up his enterprise development. For instance, the entrepreneur sales household utensils in the area. He suddenly faces high competition due to urbanisation that is taking place in the area. This can reduce his market share and profitability. It is estimated that he can maintain his position and increase sales and profitability if he can get an amount equivalent to what he currently has. The institution can enter into a mudaraba contract whereby the pre-agreed profit sharing ratio to the institution and entrepreneur is 60 percent and 40 percent respectively. The current business record suggests high retruns due to increasing demand of new inhabitants in the area. The institution will evaluate the entrepreneur on his social, religious and financial ground. Attestation can be solicited from the imam or community leader in the area. Upon meeting the necessary requirement, the institution based on his request would order to purchase the items needed and pay the amount required directly. However, the IMFI would provide training for the entrepreneur before disbursement of the money. There can be a follow up evaluation after 2-3 months. This is to ensure the performance of the clients.

Family: With regard to the family, it is an undeniable fact that many micro-entrepreneurs are oriented to family business. This includes range between family members, employee or supervisor. It would be desirable that existing family microenterprises are encouraged and developed to become self-reliant and transform into a medium scale enterprise. This can only be done if all the necessary resources and human development skills exist. Depending of the product type. The family enterprise is expected to have tremendous potential growth in the area of operation. This kind of enterprise can take advantage of cultural attachment. For instance, there exist a number of homemade and locally processed food items. Many a times the house space could not allow business expansion although the scope for such expansion is very high. The supply of the food rarely meets the daily demand of the market. The micro-enterprise can be expanded by renting a space outside the house thereby employing additional staff that could be paid from the profit.

The role of the IMFI is to provide the capital for expansion on a musharaka basis. Training would be provided especially on management, marketing and record keeping. A special outlay can be set up using the additional capital available from musharaka contract. This will help to meet the market demand of the community based on their test and affordability.

Associations/Others: There are a number of different associations under different economic activites in different countries. These include farmers associations, manufacturing associations, trade unions and associations of mechanics, among others. Through these bodies, many viable project beneficial to the community can be undertaken.

The role of micro-entrepreneurs in solving the problem of unemployment is well acknowledged both in developed and in developing countries [27, 26, 25]. The large scale industries, despite its ability to create urban employment in the formal sectors, fail to absorb semi or unskilled rural workers mostly engaged in the informal sectors. The marketing opportunities, training requirements and management facilities can be made available through the associations dealing with IMFI to promote employment in the informal sectors.

Takaful: The word '*Takaful*' or Islamic insurance is derived from *kafala* which means guaranteeing each other. Microfinance that was considered giving 'credit only' is now recognized to include other financial services to meet the financial needs of the poor households and micro-entrepreneurs. During the pre-Islamic era the people of Aqila, used to donate contribution to compensate mishaps and pay for *diyyah* (reparation). This practice was confirmed as one of the best practices of the period. It is stated in the Qur'an "*help each other in obedience and piety and do not help each other in sinful act and enmity*".

In the early 2000s, income inequality in the Arab world was found to be one of the lowest in the World. This is due to the existence of strong cohesive system of social responsibility operationalized through takaful, zakat and waqf practices. However, recently, the gap between the rich and the poor is widening mainly because of increase in population and high overall unemployment. While the rich can access formal credit, poor and micro entrepreneurs are deprived because of lack of credit record and collateral. Risk protection mechanism can

mitigate the vulnerability of the Muslim population. According to [28-35] “*reducing vulnerability, with all its debilitating consequences is central to improving material well-being (or preventing reversals) and empowering poor people and communities*” For the poor people, a mild increase in prices or a drop in income can cause adverse effects on their health, expenditure and standard of living.

Patel (n.d) concludes that “insurance is an effective mechanism for reducing the vulnerability of the poor from the impact of disease, theft, disability and other hazards as well as safeguarding the productive use of savings and credit facilities.” Since conventional insurance is prohibited for committed [36-52] Muslims, Islamic insurance or *takaful* has a great potential in absorbing the risk suffered by the poor through Islamic microfinance. The *takaful* here has two dimensions i.e. self *takaful* and *takaful* for others. It was reported from the Prophet (pbuh) that Allah says "My slave continues getting closer to me by performing voluntary deeds until I love him". [al_bukhari]. This will come through contributions from all members and the money be invested to yield returns. The clients remain the shareholders and in case of any business failure, the money will be used to mitigate the loss.

CONCLUSION

Poverty dominates the agenda of developing countries. Poverty was and still is one of the major impediments of human progress and societal development. Its existence is as old as human history while its alleviation is attributed to effective and successful economic policies. Various approaches/policies are offered towards reducing poverty. This evolves from society to society and from time to time. However, its reduction is the major goal of many economic systems as stated by the Millennium Development Goals. This study explores the challenges facing microfinance industry as well as the high poverty in Muslim countries. The research also sheds light on the preference of Islamic finance over its conventional counterpart in Muslim countries and communities. The study further developed an integrated waqf based Islamic microfinance model (IWIMM) for poverty reduction in OIC member countries. This is expected to overcome the challenges of conventional microfinance such as, high cost of capital, low quality of human resource, vulnerabilities of poor borrowers due to lack of

sustainable *takaful* and limited products for the clients with different occupational backgrounds. Specifically, the lack of finance and business training requires institutional support to unleash the potentials of micro-entrepreneurs and to establish viable micro-enterprises. However, further studies should be conducted to test the model using quantitative techniques such as structural equations modelling (SEM).

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