*Islamic Economic Studies*
Vol. 17 No. 2, January, 2010

**BOOK REVIEW**

Mohammed Obaidullah and Tariqullah Khan (2008), *Islamic Microfinance Development – Challenges and Initiatives* Jeddah, Kingdom of Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, Dialogue Paper No. 2, 81p.

Reviewed by: Muhammad Syukri Salleh
*IRTI, Islamic Development Bank / ISDEV, Universiti Sains Malaysia*

This is a book that discusses endeavours in alleviating poverty through Islamic microfinance. It holds to the premise that the major factor attributing to the poor's inability to participate in development process is their exclusion from the financial system. Microfinance, therefore, is seen as a powerful tool for poverty alleviation. It is due to this belief that, the authors argue, development of inclusive financial systems becomes a central goal of policy makers and planners across the globe.

This book actually aims to form the basis for a dialogue among various stakeholders, including scholars, academicians, regulators, policy makers, the Islamic Financial Services Industry (IFSI), the Islamic Development Bank (IsDB) and other multilateral institutions. It arises subsequently from the development of two key strategic objectives of the IsDB, namely poverty alleviation and development of the IFSI, as reflected in the IsDB Vision 1440H, the OIC 10-Year Work Plan, and refined in Islamic Research and Training Institute (IRTI) lead initiative "Ten-Year Framework and Strategies (TYFS) for Development of the Islamic Financial Services Industry" (jointly prepared with IsDB Group and Islamic Financial Services Board (IFSB)). It is generated by the lacking of IFSI in addressing the challenge of poverty alleviation by making financial services accessible to the poor, though Islamic Microfinance Development has been considered as top priority initiative in order to align IFSI development with poverty alleviation.

The book highlights, *inter alia*, at least four important insights.

1. The importance of microfinance to fight poverty, especially through the "best practices" models and the consensus principles of microfinance industry.

2. The needs of the poor for interest-free micro-credit.
3. Introduction and division of the three levels of Islamic microfinance, namely micro-, meso- and macro-level, with policy suggestions for each.
4. The stance that multilateral institutions have a major role in strengthening the Islamic microfinance industry at all the three levels.

*Firstly,* the importance of microfinance to fight poverty, especially through the "best practices" models of microfinance and the consensus principles of the microfinance industry. The authors highlight four models of mainstream microfinance system, namely the Grameen Bank model originating in Bangladesh, the Village Bank model practiced widely in Latin America and Africa, the Credit Union model that has been popular in Asia notably Sri Lanka, and Self-Help Groups model originating in India.

It is observed that the mainstream system adopted by models such as above has experienced a paradigm shift, from the traditional donor-based approach to a for-profit approach, or in simple words, from charity to profit. To the present reviewer, this is not surprising indeed. Inclusion of the poor into the financial system is equal to the inclusion of the poor into the dominant capitalistic profit-oriented system. Detachment from the urge for profit is thus peculiar. But the interesting curiosity is, how could the Islamic microfinance system overcome this problem?

The answer to this perhaps lies in the belief of the authors that building inclusive financial systems certainly requires integration of microfinance with Islamic finance. The following nature and principles of Islamic finance seems to have elements that could safeguard such a problem. The said elements are: ethics, morals, social orientation, religious duties, equality, fairness, risk sharing, individual rights, individual duties, property rights, sanctity of contracts, entrepreneurship, developmental and social goals, partnership, and participation by the poor.

The *second* important insight highlighted in this book is regarding the needs of the poor for interest-free micro-credit. The authors refer their examples to *qarḍ al-ḥasan* with recovery of actual costs of service, *murābaḥah* with *bayʿ-bithaman-ājil*, *ijārah*, *bayʿ-salam*, et. cetera; micro-savings with high returns and guaranteed safety, security and liquidity; micro-transfers especially for the benefits of migrant-workers, as well as for domestic and international transfers among the poor; and micro-insurance such as *micro-takāful* to lighten the burden of the poor resulting from shocks such as the death of a family breadwinner, severe illness, or loss of an asset including livestock and housing.

These are explained in more details when Sharīʿah-compliant instruments of microfinance are discussed, namely the instruments for mobilization of funds, the instruments of financing, and the instruments for risk management.

The authors divide the instruments for mobilization of funds into three types, that is charity (such as *zakāh*, *ṣadaqah*, *awqāf*, gifts that include *hiba* and *tabarru*), deposits (in the form of *wadīʿah*, *qarḍ al-ḥasan* and *muḍārabah*), and equity (in the form of classical *mushārakah* or the modern stocks). Instruments of financing are divided into four types, that is participatory profit-loss sharing modes such as *muḍārabah* and *mushārakah*, sale-based modes such as *murābaḥah*, lease-based modes or *ijarah*, and benevolent loans or *qarḍ* with service charge. Instruments of risk management and insurance are divided into three, that is guarantee (*kafālah*), collateral (*ḍamān*), and micro-*takāful*.

However, the authors have made a fair and right caution relating to these financial services. They note that the microfinance is not the sole solution for poverty reduction. The poor need to have access to such services, and the destitute such as those who go hungry or without a cash income are not usually appropriate for the financial services, especially credit since credit means loans, hence debt. Without a cash flow essential to repay the loans, the destitute could become poorer. In such a condition, other basic needs such as food, shelter, and employment are said to be more urgently needed than the financial services. The authors urge government and donors to fund these basic needs more than the financial services. Similarly, microfinance is argued as not a substitute for investments in basic education, health, and infrastructure.

The *third* insight that has been highlighted by this book is the introduction and division of the three levels of Islamic microfinance, namely micro level (microfinance institutions, contracts/products and resources), meso level (financial infrastructures) and macro level (policy and regulatory framework), with the following suggestions. At micro level, the authors insist, there should be a move towards collective resolution of Sharīʿah issues, enhancement of product range through research and financial engineering and increased participation of banks in microfinance through provision of credit guarantees and safety nets. At meso level there should be provision of education and training, better coordination and networking, technical assistance through *Awqāf* and *Zakāh* Funds, provision of rating services specific to Islamic microfinance institutions in view of their unique risks through creation of a rating fund. At macro level there should be development of an enabling regulatory and policy environment.

A chapter each has been devoted to the detailed discussions of these levels.

For the chapter on the micro-level, discussions are concentrated on the informal microfinance providers (such as individual informal providers, collective forms of informal service providers), member-based organizations, non-government organizations and formal financial institutions. In addition, Islamic microfinance providers across the globe are also deliberated. They are, *inter alia*, the *Mit Ghamr* project in Egypt, the *Jabal al Hoss "Sanadiq"* (village banks) in Syria, the *Mu'assasat Bait Al-Māl* in Lebanon, the *Hodeidah* Microfinance Program in Yemen, Islami Bank Bangladesh, Social Investment Bank Bangladesh, and *Al-Falah* and Rescue in Bangladesh, *Akhuwat* in Pakistan, AICMEU and *Bait-un-Nasr* in India, *Tabung Haji* in Malaysia, *Baitul Māl wal Tamwīl* in Indonesia, and FINCA in Afghanistan.

These are followed by a discussion on challenges faced by the microfinance system at this micro-level. They are diverse organizational structures, the need for Sharīʿah compliance (including Sharīʿah Board, *Fiqhi* issues, and divergent perceptions), lack of product diversification, and the importance of strong linkages between microfinance with banks and capital market. In order to face these challenges, the authors propose four strategic responses, namely collective resolution of Sharīʿah issues, diverse range of products, bank's participation in microfinance, and capital market participation.

For the chapter on the meso-level, the pattern of the discussions is similar to the chapter on the micro-level, concentrating on the challenges and strategic response. For the former, three challenges are highlighted, namely the payment systems, the transparency and information infrastructure, education and training, and networking. For the later, the problem of the payment systems is proposed to be overcome by working through the larger finance institutions by forging alliance with them; the problem of transparency and information by using conventional rating agencies that are willing to develop rating methodology for Islamic microfinance instruments with the help of institution like Islamic Development Bank; and the problem of education and training by imparting training to persons with diverse experiences such as in banking, finance, investments, entrepreneurship development, community development, accounting and management; the problem of networking by establishing a coordinating body dedicated to development of the Islamic microfinance sector. In addition, the authors also suggest technical assistance to be created through *awqāf* and *zakāh* funds so as knowledge and skills in entrepreneurship development among the poor could be imparted, and their status as "unbankable" group could be eliminated.

For the chapter on macro-level, emphasis has been given to the discussion on the Islamic microfinance regulatory and policy framework. Taken into consideration the challenges in sustaining macroeconomic stability, liberalized financial market rates, banking sector regulation and supervision, issues in prudential regulation and supervision, and issues related to dual system, the authors suggest development of a regulatory system for the Islamic microfinance sector in three stages. In the first stage, the Islamic microfinance institutions have to be made appreciating the need for certain common performance standards. Subsequently, is to make it mandatory for the Islamic microfinance institutions to get registered with identified or designated institutions. Lastly, is to encourage development of network of Islamic microfinance institutions which could function as quasi Self-Regulatory Organization at a later date or identifying a suitable organization to handle the regulatory arrangements.

The *fourth* and final insight that this book has highlighted is the stance that multilateral institutions (donors and development financial institutions) such as IDB has a major role in strengthening the Islamic microfinance industry at all the three levels of microfinance categorized above – the micro-, meso- and macro-levels. A chapter of its own has been devoted to this. It is mentioned that in the domain of Islamic microfinance, the IDB is perceived to be the most important player. Others that have been instrumental in initiating Islamic microfinance programs include United Nations Development Program (UNDP) in Syria and Palestine, Kreditanstalt fur Wiederaufbau (KfW) in Northern Mali, and FINCA in Afghanistan. These are made possible through a variety of mechanisms such as policy support, technical assistance, grants, loans, quasi-equity, equity investments and guarantees. These mechanisms are *Shari'ah* compliant and more diverse and inclusive of those directed at the extremely poor and the destitute. In addition, the authors provide a list of specific initiative that would strengthen the Islamic microfinance at all the three levels.

All in all, with its informative though brief nature, this book has accomplished its objective in providing the foundation not only for a dialogue among various microfinance stakeholders, but also for all people who are interested in the development of the *ummah*, in particular in alleviating poverty. It would be more interesting if, before getting into the discourse on the microfinance, the poverty that is meant to be alleviated by the Islamic microfinance system could be conceptualized from an Islamic perspective. It is definitely the problem of poverty that has been understood from the Islamic perspective that what is trying to be overcome by the Islamic microfinance system here. In addition, though this book is a result of an empirical research, it would be helpful, especially for those who are interested in pursuing into the dialogue, to list down relevant references or bibliographies, as well as to include all the missing acronyms such as AICMEU and FINCA into the list of abbreviations. These suggestions, however, do not indicate serious deficiency of the book, as they are not only minor in nature, but also might be out of the scope of the book, especially pertaining to the conceptualization of poverty.