Integrating Financial and Non-Financial Programs for Sustainable and Empowering Islamic Social Finance

Dr. Salman Ahmed Shaikh
PhD, UKM, School of Economics
Director, Islamic Economics Project

Universiti Sains Islam Malaysia
Pusat Wakaf dan Zakat
Universiti Sains Islam Malaysia
Presentation Outline

- Institutions in Islamic Social Finance
- Economics of Islamic Social Finance Institutions
- Common Microfinance Structures
- Islamic Microfinance Structures: Cases & Illustrations
- Designing Incentives for Effective Targeting in Hybrid Models
- Operational Structure of a Hybrid & Integrated Model
- Q&A
Institutions in Islamic Social Finance

- **Islamic Social Finance**
  - **Non-Market Based**
    - Zakat
    - Charity Based MFI
  - **Market Based**
    - Waqf
    - Wirasat
    - Credit Based MFI
    - Integrated MFI
Economics of Zakat

- Targeted Intervention through redistribution from rich to poor.

- Empowerment through asset ownership.

- Funding consumption and productive needs.

- Boosts spending and thus aggregate demand and reduces wealth concentration.

- Encouraging investment and discourages keeping wealth idle.
Economics of Waqf

- Private funding of public goods.
- Reduces private concentration of wealth.
- Builds social safety nets.
- Funding source for skills enhancement and capacity building.
- Transfer of financial resources and beneficial services beyond markets.
Economics of Islamic Inheritance Law

• Instead of fractional transfer of productive wealth alone, it transfers all types of wealth including personal wealth wholesomely.

• Transfer from one person to many persons disperses wealth and reduces wealth concentration.

• Intertemporal distribution of wealth in every family unit for every family member.
Common Microfinance Structures

- Individual Lending at High Interest Rate ($r_{\text{bank}} < r_{\text{mfi}} < r_{\text{loan shark}}$).

- Group Lending at High Interest Rate ($r_{\text{bank}} < r_{\text{mfi}} < r_{\text{loan shark}}$).

- Rotating Credit and Savings Association.
  - Pooling money and providing peer-to-peer lending on rotation basis.

- Credit Unions
  - Owned by and for participants to provide limited banking services.
  - Work on non-profit basis.

- Tax exemptions
Islamic Microfinance Structures

Islamic Microfinance

Not for Profit
- Charity Based MFI Providing Credit
- Charity Based Integrated MFI with F+NF Program

For Profit
- Credit Based MFI
- Hybrid MFI
- Equity Based MFI
- Integrated & Hybrid MFI
Akhuwwat Qard Based Microfinance Program

- **Institutional Donors**
- **Donations**
- **Akhuwwat**
- **Qard-e-Hasan**
- **Clients**
- **Repay + Service Charge**

- **Individual Donors**
Crowdfunding for Provision of Public Goods

Institutional Donors

Donations

Akhuwwat

Build and Operate Schools & Universities

Individual Donors

Donations
Ihsan Trust Education Finance

**Indigenous Charity of MBL**
- Donations

Ihsan Trust
- Qard-e-Hasan
  - Repayment in Installment
  - University Students
- Donations

**Donors**
Financing Education Using Qard-e-Hasan

Charity Funds with IBs + Corporate CSR

Donations

University Cash Waqf

Qard-e-Hasan

University Students

Donations

Repayment in Installment

Alumni Funds
Financing Start-ups Using Qard-e-Hasan

Charity Funds with IBs + Corporate CSR

Donations

Alumni Funds

University Cash Waqf

JVs

MFB / IBs

Murabaha, Ijarah, DM

Price + Rents

Qard-e-Hasan for Setup

Repayment

Qualified Business Proposals

Phase I

Phase II

Mature Businesses

Islamic Economics Project
Financing Start-ups Using Mudarabah

Charity Funds with IBs + Corporate CSR

Donations

University Cash Waqf

Donations

Alumni Funds

MFB / IBs

Mature Businesses

Murabaha, Ijarah, DM

Price + Rents

Seed Capital + Sell Equity (Phase II)

Qualified Business Proposals

Profit + Equity Purchase (Phase II)

Phase I

Phase II

JV

Islamic Economics Project
Financing Start-ups Using Musharakah

Charity Funds with IBs + Corporate CSR

Donations

University Cash Waqf

Partial Capital + Sell Equity (Phase II)

Donations

Alumni Funds

MFB / IBs

Murabaha, Ijarah, DM

Price + Rents

Qualified Business Proposals

Profit + Equity Purchase (Phase II)

Mature Businesses

JV

Phase I

Phase II

Islamic Economics Project
Cash Waqf Based Micro Finance (CWBMF) Model

Donors

Zakat, Sadqa, Waqf

Savings

Return Distribution

CWBMF Institution

Qard-e-Hasan

Repay + Service Charge

Murabaha, Ijarah, DM

Price + Rents + Fee

Poor Clients

Non-Poor Clients

Savings Fund

Return Distribution

Indigenous Savings

Impact Investments

Impact Investors

Islamic Economics Project
Designing Incentives for Effective Targeting

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

<table>
<thead>
<tr>
<th>Poverty Groups</th>
<th>Income Support</th>
<th>Social &amp; Public Support</th>
<th>Market Based Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ultra-Poor</strong></td>
<td>Zakāt (1)</td>
<td>Bait-ul-Maal (1) Waqf</td>
<td>Mudarib in ME, PSR (2)</td>
</tr>
<tr>
<td><strong>Moderate Poor</strong></td>
<td>Zakāt (2) Qard-e-Hasan (1)</td>
<td>Bait-ul-Maal (2) Waqf</td>
<td>Mudarib in ME, PSR (3)</td>
</tr>
<tr>
<td><strong>Non-Poor with Zero Investible Capital</strong></td>
<td>Qard-e-Hasan (2)</td>
<td>Bait-ul-Maal (3) Waqf</td>
<td>Murabaha (1) Salam (1)</td>
</tr>
<tr>
<td><strong>Non-Poor with Investible Capital</strong></td>
<td>Not Applicable</td>
<td>Not Applicable</td>
<td>Murabaha (2) Salam (2) Musharakah Rabb-ul-Maal in ME, PSR (1)</td>
</tr>
</tbody>
</table>
Designing Incentives for Effective Targeting

- Ultra-poor will enjoy higher PSR than moderate poor people in microenterprise Mudarabah as Mudarib.

- They will not be provided with any debt with or without mark-up to avoid indebtedness before they reach a sustainable income and asset base to increase chances of poverty exit.

- They will have no incentive to underperform, shirk or free-ride. Their consumption needs can be fulfilled through Zakāt and Bait-ul-Maal.

- Their educational and health needs can be met through especially designed Waqf based educational and health centres.
Designing Incentives for Effective Targeting

- Moderate poor people will be provided with Qard-e-Hasan, but they will have lesser PSR in microenterprise Mudarabah.

- They will have lesser priority in Zakāt distribution and support from Bait-ul-Maal.

- They would want to show themselves as ultra-poor, but then they will not have availability of Qard-e-Hasan.

- If they want to access subsidized debt based modes of finance like Murabaha and Salam, they will have to show themselves as non-poor with zero investible capital. But, in that case, they:
  - Cannot remain Mudarib in microenterprise.
  - Will have lesser priority in access to Qard-e-Hasan.
  - Will have to make frequent rental or instalment price payments.

- Hence, the moderate poor people will have no clear incentive without any trade-offs to show themselves in any lower or higher poverty group.
Designing Incentives for Effective Targeting

• Non-poor people with income source, but without investible capital would qualify to obtain subsidized finance using Murabaha and Salam.

• They will not be able to invest in microenterprise Mudarabah with highest PSR unless they show themselves as non-poor with investible capital.

• In that case, they will not qualify for Qard-e-Hasan or any income support from Zakāt or Bait-ul-Maal. They will also be disqualified from debt based Microfinance at the subsidized mark-up.

• If they show themselves as poor, then they will not be able to obtain debt based finance at subsidized mark-up. They will also not be able to keep their existing income earning occupation intact if they enter Mudarabah as Mudarib.

• Hence, these people also will not have any incentive to show in a higher or lower poverty group.
Designing Incentives for Effective Targeting

- Non-poor people with investible capital will qualify for debt based finance at market benchmark linked rates. It will encourage them to use equity based finance using the mode of Musharakah.

- They could also use their investible capital to enter in microenterprise Mudarabah as Rabb-ul-Maal. They will enjoy the highest PSR in order to incentivize their participation for creating a sustainable loop of funding for the microenterprises.

- But, these people would have an incentive to show themselves as non-poor with no investible capital so as to avail subsidized mark-up financing. But, they will lose out on availing higher PSR on investible capital.

- Tax incentives can be provided to the investment made and profits earned from microenterprise Mudarabah so as to incentivize investment participation.
Integrated Cash Waqf Based Micro Finance (CWBMF) Model

Donors

Zakat, Sadqa, Waqf

Savings Fund

Return Distribution

Impact Investors

Impact Investments

Return Distribution

Indigenous Savings

CWBMF Institution

Retail Stores

Educational Institutes

Qard-e-Hasan

Murabaha, Ijarah, DM

Price + Rents + Fee

Takaful

Hospitals

Poor Clients

Non-Poor Clients

Discounts

Training & Volunteers

Repay + Service Charge

Subsidized Service

Micro-Takaful

JV

JV

JV

JV

JV

JV

JV

JV

JV

JV
## Operational Structure of the Integrated Program

<table>
<thead>
<tr>
<th>Supply Side</th>
<th>Demand Side</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Funding &amp; Contributions</strong></td>
<td></td>
</tr>
<tr>
<td><strong>External</strong></td>
<td>Social contributions via E-Crowdfunding to place Zakat, Sadqah and Waqf funds to IMFI.</td>
</tr>
<tr>
<td></td>
<td>Social impact investing via E-Crowdfunding platform.</td>
</tr>
<tr>
<td><strong>Internal</strong></td>
<td>Micro-savings using E-Wallet. Profit sharing ratio higher for micro-savers.</td>
</tr>
<tr>
<td><strong>Non-Financial Contributions &amp; Services</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Individuals</strong></td>
<td>Micro-volunteering in training programs by students and professionals.</td>
</tr>
<tr>
<td></td>
<td>Subsidized services from accredited schools, hospitals and retail stores.</td>
</tr>
<tr>
<td><strong>Institutions</strong></td>
<td>Micro-Takaful for health risks and accidents.</td>
</tr>
<tr>
<td></td>
<td>E-Wallets / Debit Card issued by banks.</td>
</tr>
</tbody>
</table>
Thank You

Questions & Feedback

salman@siswa.ukm.edu.my