

'CASH WAQF' AND ISLAMIC MICROFINANCE

UNTAPPED ECONOMIC OPPORTUNITIES

*Norma Md Saad and Azizah Anuar**

Abstract: The success of microfinance programmes in alleviating poverty in many countries has spurred the development of faith-based microfinance institutions. Muslims have combined certain elements in Islamic finance and microfinance to create a new programme called 'Islamic microfinance' and use it as a tool to fight poverty in their community. Even though microfinance is proven successful in fighting poverty, current microfinance practised by commercial banks in Malaysia has several shortcomings. Current weaknesses include stringent credit evaluation and missing the real target group, i.e., the poor and the needy. Furthermore, the mode of financing is mostly personal loan using *bay' al-ṭinah*, whereby the use of the loan is to fulfil personal consumption instead of income-generating activities. Given these shortcomings, the article explores the possibility of using 'cash waqf' as a new source of funding for Islamic microfinance and proposes a new concept and application of Islamic microfinance so that it is truly in line with the Islamic spirit of microfinance. It is hoped that with this new concept and application of Islamic microfinance, the use of microfinance genuinely caters for the needs of the poor as well as generating socio-economic growth of the Muslim *ummah*.

Introduction

Poverty is one of the major problems faced by most of the developing countries. According to the Rural Poverty Report 2001,¹ there are 1.2 billion people who are extremely poor surviving on less than US\$1 a day. Extremely poor people spend more than half of their income to obtain (or produce) staple foods. Most of these people suffer from nutritional deficiencies, and many even suffer from hunger at certain times of the year. Moreover, within this community, one child in five will not live to see his or her fifth birthday.² Considering the importance of resolving the poverty problem, the United Nations announced the Millennium Development Goals. One of its aims is to reduce poverty to half by 2015.

* Dr Norma Md Saad is Associate Professor in the Department of Economics and Management Sciences at the International Islamic University Malaysia (IIUM) and Azizah Anuar is Assistant Research Fellow at the International Institute of Advanced Islamic Studies Malaysia (IAIS).

According to Yunus and Abed,³ microfinance is an effective tool to alleviate poverty. This argument has been proven by many researches⁴ and through the success of several microfinance programmes around the world, such as Grameen Bank in Bangladesh, Bank Rakyat Indonesia in Indonesia, Amanah Ikhtiar Malaysia in Malaysia, CARD in the Philippines, FINCA and ACCION in Latin America, and other microfinance institutions all over the world. Considering the ability of microfinance to eradicate poverty, the United Nations has decided to include it in the list of potential contributions to achieve the Millennium Development Goals set for 2015 to cut by half the number of people living in poverty.

Among the developing countries, Malaysia seems to offer a success story as it demonstrates a commendable record in reducing its poverty level. In 1999, it was reported that 8.5 per cent of the population was beneath the poverty line. However, after only five years, i.e., in 2004, Malaysia managed to reduce the number of those living below the poverty level to only 5.7 per cent. Microfinance is one of the objectives of New Economic Policy (NEP) which was launched by the Malaysian Government to reduce poverty and income disparities in Malaysia. Malaysia offers several models as part of its microfinance programme.

The Malaysian 2005 Census of Establishment and Enterprise Statistics indicated the enormous potential and uptrend of banking contributions within micro-enterprise development in Malaysia.⁵ Although the reports revealed that only 13 per cent of micro-enterprises received financing from Malaysian banks, many banks are optimistic on the growth momentum and believe that the demand for microfinance schemes will continue as micro-enterprises represent a large segment of the growing business markets, operating in all sectors.

Malaysia's English-language daily *The Star* reported on 28 July 2008⁶ that in Malaysia, the outstanding amount of microfinance increased to RM271 million as at end of March 2008, with Agrobank's microcredit products, namely Modal Usahawan (MUST) securing 56.2 per cent of the bank's total financing outstanding, representing 66.8 per cent of the number of accounts for microfinancing in Malaysia.

By July 2008, Public Bank reported receiving more than RM100 million worth of applications for its microfinance package, while the number of applications received and approved for the previous six months increased by more than 40 per cent. Other banks, too, reported that the growth of microfinance is on the upward trend as micro-entrepreneurs provide strong foundations for the growth of small and medium enterprises, as well as strengthening existing ones. Overall, the demand for microfinance products by micro and small enterprises has risen steadily. This is due to the increased awareness of micro and small entrepreneurs of the availability and viability of the microfinance scheme.

In the following, we shall evaluate the current practice of microfinance in Malaysia and explore the possibility of using 'cash *waqf*' as a new source for

funding Islamic microfinance. We shall also propose new concepts and applications for Islamic microfinance, pointing out the 'Islamic spirit' of microfinance. Following an overview of microfinance in Malaysia, we shall provide a brief literature review on conventional and Islamic microfinance. We continue with explaining our methodological approaches and an evaluation of the current practice of microfinance in Malaysia. We shall close with suggesting new concepts and applications for microfinance.

The Development of Microfinance in Malaysia

The largest microfinance institution in Malaysia is Amanah Ikhtiar Malaysia (AIM) which can be seen as the biggest replication of the Grameen Bank model in Southeast Asia. Beside this institution, public institutions such as Agrobank (formerly known as Bank Pertanian) as well as the Credit Guarantee Corporation (CGC) scheme, too, provide lending to small and medium enterprises (SMEs). However, the loan-sizes of these institutions are somewhat above those of conventional microfinance.

Initially, the banking sector in Malaysia did not put much emphasis on microfinance. According to McGuire, Conroy and Thapa,⁷ the Central Bank of Malaysia (Bank Negara Malaysia, BNM), restricted the spread between base and maximum lending rates in the commercial banking system to 4 per cent, less than would be required to cover the extra costs associated with microfinance lending. In the case of some loans guaranteed by CGC the permissible spread was only 2 per cent, reinforcing this effect.

Therefore, getting involved in microfinance activity is difficult for commercial banks as well as other institutions. However, AIM, as a government-linked institution, has been successful in helping the Government alleviate poverty in Malaysia. Grants from the Malaysian Government were some of the factors that made AIM successful in assisting poor people in Malaysia. As of September 2006, AIM had 157,787 members and disbursed a total of RM1.8 billion in loans. AIM's activities have been directed almost entirely, but not exclusively, to the alleviation of poverty among poor Malays. In 1994, AIM had some 6,100 Grameen-like groups in operation with a total membership approaching 30,000 borrowers.

All impact studies conducted on AIM in 1989,⁸ 1990–91,⁹ 1991–93 and 1994–95¹⁰ show that borrowers were able to increase their income after receiving loans from AIM. The latest impact study conducted by AIM in 2005 shows that borrowers would be out of poverty after four loan cycles with an average of RM3,500 per loan. The study also reports that 31 per cent of borrowers hire family members as workers and another 31 per cent of borrowers hire non-family members as workers. Therefore, we can conclude that microcredit is a powerful tool in alleviating poverty and generating employment.

The Role of Bank Negara Malaysia (BNM) in the Growth of Microfinance

In line with the Government's initiatives to support and drive the growth of micro-enterprises and small and medium enterprises by improving their access to financing for productive purposes, BNM, in 1972, established the CGC scheme. The function of CGC is to provide guarantees on funds disbursed to SMEs through financial institutions, especially those SMEs that do not qualify to have access to normal credit facilities due to lack of collateral.

Initially, BNM's policy *vis-à-vis* financial institutions (based on the BNM guidelines issued in 1985) had an adverse impact on the microfinance programmes and indirectly sidelined the emergence and growth of microfinance as a niche market in Malaysia. However, the policy required all banks as well as their board members to provide banking services and facilities that are conducive to a well-balanced economic growth and particularly to the priority sectors at a reasonable cost. All banks adopted prudent credit-scoring standards and followed stringent policies in ensuring that their financial institutions are soundly managed at all times.

In 1986–87, BNM launched its first microfinance scheme, a microcredit popularly known as under 'Loan Fund for Hawkers and Petty Traders (LFHPT)', ranging from RM5,000 to RM10,000. The scheme was flexible, as it did not require the usual investigations on customer background or the search for a guarantor. This scheme received tremendous response from local hawkers and petty traders. However, the scheme had also caused the non-performing loans portfolio of banks to increase up to 40 per cent in the early 1990s. Therefore, in 1993, a new credit policy was introduced by BNM, replacing LFHPT with the Association Special Loan Scheme (ASLS). However, only 291 applications met the commercial bank credit-scoring standard.

Due to the high rate of defaulters on the microcredit scheme, BNM restructured its microfinance lending policy and allowed commercial banks to impose their own credit-scoring standard on new applications and, in 1996, discontinued the microcredit scheme to hawkers and petty traders.

BNM's microfinance policies and schemes in general have not been able to outreach to the 'really' poor borrowers. This failure in the late 1990s is mainly due to the following factors:

- Low demand on banking facilities from low-income borrowers as their salary scale could not meet the monthly repayment requirements.
- Existing bank facilities and services were not bankable, because most of the poorer entrepreneurs were the home cottage industry players, located in rural areas.

- Commercial banks need to cover extra costs that are associated with microfinance lending of which the transactions are small and costly.
- Inadequate human capital to monitor and supervise the scheme.
- The loan approval was too stringent and the scheme operated in an unclear regulatory landscape.
- No promotion, advertising, or support came from the Government.

LFHPT and ASLS microfinance schemes failed to reach poor borrowers as banks only accounted for high repayment rates, thus leaving only non-profit organisations and cooperatives offering microcredit facilities.

An Overview of the Literature on Conventional and Islamic Microfinance

Conventional Microfinance

Research on economic and social impacts of microfinance has been increasing and some studies have even analysed the methodology of assessing the impact of microcredit programmes in selected countries. With regard to the economic and social impact of microfinance programmes, previous studies came to a variety of results. Some studies found positive economic/social impacts from the programmes, whereas others highlighted negative impacts. Afrane,¹¹ for instance, studied the impact of two microfinance interventions in Ghana and South Africa: the Sinapi Alba Trust (SAT) in Ghana and the Semeto Microfinance Development Programme (SOMED) in South Africa, in 1997 and in 1998, respectively. *Ex ante* and *ex post* analysis was adopted for the two case studies. Afrane used four broad impact indicators or domains: economic access to life-enhancing facilities, and social, as well as spiritual and psychological domains. Using data collection from four main survey instruments – questionnaire-interviews, case studies, focus-group discussions, and field observations – the results of this study showed that microfinance interventions have achieved significant improvements in terms of increased business incomes, improved access to life-enhancing facilities, and empowerment of people, particularly women. On the other hand, results on the social and spiritual domains contained mixed positive and negative effects, as compared with the other two domains. The positive impacts included enhanced public respect and acceptance, self-esteem, participation in community activities, monetary contributions to social projects, and empowerment of women. On the other hand, the negative impacts of the microcredit programme included pressure of time, resulting from increased business activities, worsening family-relations, poor church attendance and poor participation in church activities.

As the microcredit programme is aimed at fighting the problem of poverty in underdeveloped and developing countries, some studies are looking at the end-results of the programme by analysing the impact of it on reducing the poverty level. Chowdhury, Gosh, and Wright¹² pointed out the two main findings from their study on Bangladesh: first, microcredit is associated with both lower objective and subjective poverty and, second, the impact of microcredit on poverty is particularly strong for about six years with some levelling off after that point. Another study on Bangladesh, conducted by Amin, Rai, and Topa,¹³ found that while microcredit is successful in reaching out to the poor, it is less successful in reaching out to the vulnerable. These results also suggest that microcredit is unsuccessful in reaching those most prone to destitution, those who are both poor *and* vulnerable.

Coleman¹⁴ conducted a study to investigate the impact of a group-lending programme in Northeast Thailand, addressing the issue of self-selection and endogenous programme placement, thus leading to biased estimations of impact in previous microfinance impact assessment studies. To overcome this problem, Coleman conducted a quasi-experimental impact study and collected detailed data on household and village characteristics. The data was analysed by using Tobit regression and the results show that group-lending has an insignificant impact on physical assets, savings, production, sales, productive expenses, labour time, and on most measures of expenditure on healthcare and education. The only variable on which impact is significant is the reduction on expenditure for men's healthcare. Perhaps, the impact is somewhat more significant and positive on women's high-interest debt because a number of the group members had fallen into a vicious circle of debt from moneylenders in order to repay their village bank-loans. However, the impact is significant and positive on women lending out with interest because some members engaged in arbitrage, borrowing from the village bank at a relatively low interest rate and then lending the money out at a mark-up rate. These results are consistent with those of Adams and von Pischke who noted that "debt is not an effective tool for helping most poor people to enhance their economic condition".¹⁵

Kabeer and Noponen¹⁶ studied the social and economic impact of the PRADAN Self Help Group (SHG) microfinance in Jharkhand, one of poorest states in India. This study used interviews as tools for qualitative research and applied descriptive statistics as the tool for quantitative research. The result of the study showed that PRADAN's SHG-bank linkage model has had a significant and positive impact in improving livelihood base, savings and debt position, as well as the living and consumption standards of the participants. PRADAN participants have been able to secure their primary livelihood source through their own agriculture, supplemented by labour, livestock and non-farm enterprise activities, in comparison to more marginally positioned non-members who must still rely on unskilled labour

activities as their primary source of income. The access to financial services and the strengthening of participants' agricultural activities are associated with less vulnerability in terms of higher savings, less onerous debt and less crisis-related borrowing and more investment in productive activities and fewer months of seasonal migration. They are also associated with significant household welfare gains, especially shelter, food security and education. Despite the positive results, this study also showed that empowerment is not an automatic outcome of targeting women for financial services. While gains in terms of women's knowledge, awareness and skills were clearly discernible, impact in terms of participation in decision-making within the home and in the public domain were far more modest.

With regard to the economic impact of microcredit programmes in Malaysia, a few studies have been undertaken to determine the effectiveness of AIM's microcredit programme on poverty reduction. The first was an impact assessment study conducted in 1988. The objective of the study was to evaluate the effectiveness of AIM in replicating the Grameen Bank microcredit programme in increasing the household income of the poor who were involved in the pilot phase of the programme. The study was based on a sample size of 283 members. The major finding of the study showed that 70 per cent of the AIM members involved in the study experienced a significant increase in their monthly household income, from an average of RM142 per month to RM220 per month.¹⁷ The second internal impact assessment study done by AIM resulted in a similar major finding and concluded that access to microcredit facilitates an increase in the household income of AIM members.¹⁸

In mid 1990, the Socio-Economic Research Unit (SERU) of the Malaysian Prime Minister's Department initiated an impact assessment study on the AIM microcredit scheme. Among the objectives of the study were an evaluation of the AIM credit delivery mechanism to their members, AIM's achievement in poverty reduction, and the cost-effectiveness of AIM's microcredit scheme in alleviating poverty. SERU had opted to take samples from the northern state of Kedah, which at the time was an underdeveloped and agricultural-based region whose population comprised many of the poor employed in the rubber and rice sectors. The study found that AIM, by applying rigorous tests, has ensured that only the poor are eligible to access to the microcredit scheme. In addition, the study also concluded that the monthly household income of its members more than doubled, from an average of RM198 before becoming an AIM member to RM457 with access to the microcredit scheme. With regard to cost-effectiveness, the study concluded that with a total operating cost of RM1,757,019 AIM was able to uplift 249 poor households from the clutches of poverty.¹⁹

The latest impact assessment study conducted internally by AIM was carried out in 2005. The study found that the AIM microcredit scheme was able to increase the

client household income from RM326 prior to joining the programme to RM932 per month after having received a loan from AIM – an increase of 186 per cent!²⁰

In conclusion – even though the results of the previous studies on the economic and social impacts of microcredit or microfinance programmes are mixed – it can be stated that studies which have analysed the impact of those programmes on poverty alleviation found that the microcredit or microfinance schemes did achieve their objectives. Moreover, the studies referred to above have also shown that microcredit or microfinance programmes are not only able to lift poor families out of poverty, but that those programmes have also brought positive improvements in other areas, such as child-education and health, as well as the empowerment of women in household decision-making.

Islamic Microfinance

Islamic microfinance is rooted in a desire for economic growth and prosperity of socio-political systems based on Islamic principles and includes the same principles that have been applied to trade, business, investing and mortgages within Muslim communities. Islamic principles of equal opportunity, advocacy of entrepreneurship, risk-sharing, and disbursement of collateral free loans, as well as the participation of the poor are supportive of microfinance principles.

Recently, Karim, Tarazi, and Reille²¹ reported that the Muslim demand for microfinance products based on *sharī'ah*-compliance has led to the emergence of Islamic microfinance as a new market niche. They furthermore argued that Islamic microfinance has the potential to expand financing to unprecedented levels throughout the Muslim world.

As early as 2002, Ahmed²² conducted a study to provide empirical evidence from three Islamic microfinance institutions (IMFIs) operating in Bangladesh. The study found that IMFIs appear to have performed even better than Grameen Bank, the largest conventional MFI operating in that country. Ahmed²³ states that one possible explanation for this is that perhaps the IMFIs benefit from the social capital derived from Islamic values and principles. The study, however, also states that all three IMFIs reported that the expansion of their activities was held back by lack of funds. Another finding from this study indicates that IMFIs have not yet tapped the sources of funds from Islamic institutions – including *waqf*.

A global survey conducted by the Consultative Group to Assist the Poor (CGAP), an independent policy and research centre based in Washington DC, on Islamic microfinance in 2007 found that the outreach of Islamic finance is very limited.²⁴ According to the survey, IMFIs serve 300,000 clients through 126 institutions operating in 14 countries. The survey found that Bangladesh has the largest Islamic microfinance outreach serving 100,000 clients. However, the survey also found that Bangladesh has also the largest conventional microfinance outreach serving almost

8 million clients, and that Islamic microfinance represents only 1 per cent of the microfinance market. The survey concluded that in all Muslim countries Islamic microfinance still represents a small percentage of the total microfinance outreach. Finally, the CGAP survey found that IMFIs lack product diversification, offering only one or two Islamic financing products and over 70 per cent of the products offered are *murābahah*, a particular kind of *shari'ah*-compliant sale, where the seller expressly mentions the cost he has incurred on the commodities to be sold and sells it to another person by adding some profit or mark-up thereon which is known to the buyer.

Research Methodology

In Malaysia, there are many financial institutions offering microfinance services, such as commercial banks, cooperatives, credit firms, and money-lending institutions. Figure 1 shows the various financial institutions offering microfinance services. Our study, however, evaluates only microfinance offered by commercial banks. There are nine commercial banks offering microfinance services in Malaysia. These banks are:

- Alliance Rakan
- CIMB Bank
- Public Bank
- AmBank
- United Overseas Bank (UOB) Malaysia
- EONCap Islamic Bank
- Bank Pertanian Malaysia (AgroBank)
- Bank Rakyat
- Bank Simpanan Nasional (BSN)

In this study, we evaluate the features of microfinance offered by all the nine commercial banks, that is, product type, loan size, eligible economic sector, eligible customers, eligibility criteria and documents required.

An Analysis of the Current Practice of Microfinance in Malaysia

Financing Modes

Under their microfinance programmes, Alliance Bank and CIMB Bank offer both Islamic and conventional banking products, while Bank Rakyat and EONCap Islamic Bank offer only Islamic banking products and Public Bank, AmBank, UOB, Agrobank and BSN offer conventional banking products. Our survey revealed a

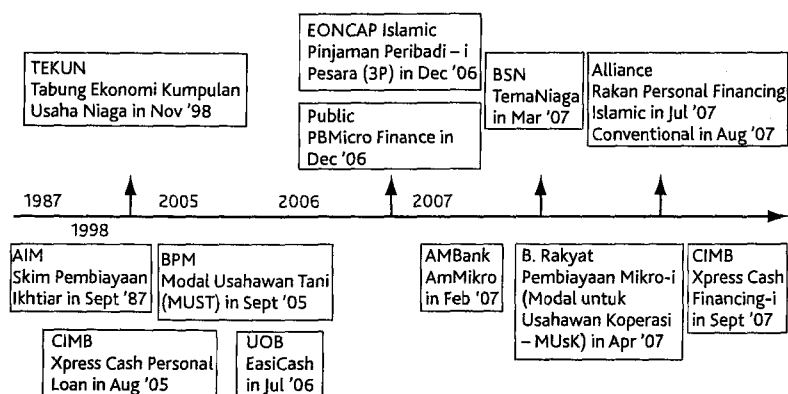


Figure 1 Financial Institutions Offering Microfinance in Malaysia

Source: Bank Negara Malaysia

lack of product innovation and an over-reliance on *bay' al-ṭnah* (sale and buy-back agreement) for microfinance schemes in Malaysia. Of the four banks which offer Islamic microfinance products – Alliance Bank, CIMB, EONCap Islamic and Bank Rakyat – only the *bay' al-ṭnah* concept has been applied. Financial product developers should not rely too much on *bay' al-ṭnah* alone as there are other types of *sharī'ah*-compliant instruments which comply with the definition of microfinance, such as *qard al-ḥasan*.

However, Islamic banking products such as *tawarruq* and *qard al-ḥasan* are yet to be made available under microfinance schemes. In view of the great demand for Islamic microfinance it is also recommended that financial product developers conduct in-depth research or have strategic alliances with research and academic institutions to develop innovative microfinance products that are in line with the *sharī'ah*. One must bear in mind that Islamic law stipulates that microfinancing should be offered free of charge in order to meet contingency needs, and that creditors should not take advantage of poor borrowers, in this context the micro-entrepreneurs. Another principle that should be followed is that there should not be any rewards without taking the risk, which means there is no reward for the capital rendered to micro-entrepreneurs unless it is exposed to business risk.

Loan Sizes

The microfinance scheme currently offered by commercial banks in Malaysia comes in the form of term-financing under personal and business enterprise categories, ranging from a minimum of RM500 to RM50,000, depending on the purpose of

the application. The individual borrower and the board of directors of the applying company or entity must be Malaysian citizens and between 18 and 65 years old. The tenure of facilities is within one month to five years for micro-enterprises and six months to ten years for personal financing, with repayment-options either on a fortnightly or monthly basis.

Eligible Economic Sectors

From the nine banks offering microfinance services, four banks – Alliance Bank, CIMB Bank, United Overseas Bank, and EONCap Islamic Bank – extend loans in all economic sectors. Public Bank, Bank Rakyat, Bank Simpanan Nasional, and AmBank specify that agriculture, retail, services and trade, as well as manufacturing economic sectors are eligible for microfinance services. Bank Pertanian (Agrobank), however, limits its microfinance products to agriculture and agro-based industries only.

Eligible Customers

Personal loans are made available to army pensioners or salaried workers with an earning between RM800 to RM3,000 per month or self-employed individuals with an income not less than RM30,000 per year. Individual borrowers must have a permanent job or plans for a project, a permanent residential address, an open savings account with the loan-granting bank and must have signed up for credit protector insurance. However, the salary scale imposed, for instance, by Alliance Bank, i.e. a minimum of RM2,000 per person, makes it rather difficult for low-income earners to qualify for a micro personal loan which falls under the microfinance scheme.

The Malaysian Poverty Line Index states that a household income below RM1,500 is considered as 'beneath the poverty line', thus making such a household eligible for microfinance. This means that an Alliance Bank personal loan (Islamic as well as conventional) under the microfinance programme *does not* fulfil the definition by the Asian Development Bank (ADB) concerning microcredit. Their salary criteria of having a minimum pay-cheque of RM2,000 per month does not meet the poverty line index and should not be made eligible to enjoy the microfinance benefit established by the Credit Guarantee Corporation. Meanwhile, the CIMB Bank, UOB and EONCap Islamic Bank salary criteria of a minimum of RM800 and RM1,500, respectively, *do* comply with the Malaysian poverty line index, and therefore borrowers should be allowed to be reported under the microfinance sector.

In addition, the Alliance Bank criteria on micro-enterprise turnovers of a maximum of RM1 million per annum definitely *do not* meet the objectives of the microfinance scheme to be made available for poor people. The business criteria should be reviewed in line with microfinance credit standard and not banking credit standard. The Rakan personal financing scheme of Alliance Bank should fall under

the Small and Medium Enterprises financing scheme instead of the microfinance scheme.

Eligibility Criteria and Required Documents

The requirements for micro-enterprises are that they are either sole-proprietors, partnerships or private limited companies, or individuals operating his/her business on a full-time basis for a period of six months to three years, furthermore that they have a permanent business location and a tenant agreement or have a stall or shop-lot, hold a valid company registration and a business licence required by local authorities. The business sectors allowed for the microcredit programme encompass agriculture or agro-based industries, as well as retail, wholesale, manufacture, service, trade or other productive sectors.

Interest Charges

The interest rate charged is as low as the Base Lending Rate plus 1.5 per cent or as high as 15–17 per cent per annum rest²⁵ or a minimum 1.25 per cent per annum to a maximum 3 per cent per month with a rebate of 20 per cent cash refundable for prompt and early payment within the tenure of facilities granted. The flexibility given to this scheme is such as no collateral or individual guarantor is required, plus an exemption from the usual stamp duties. BSN imposed an additional condition according to which a mortgage insurance and a three months deposit are deducted from the total loan and three months' interest is levied for early settlement. However, all borrowers are subjected to CRISS (Central Credit Reference Information System) or CITOS (Credit Tip-Off Service) compliance.

Credit Evaluation Standards

Similar to other normal-term financing schemes, the disbursement of the microfinance facilities is subjected to full evaluation to be conducted by a particular bank upon receiving the full set of documents, such as identity card, proof of business registration/licence/permit, proof of income, utility bills, or a recommendation letter from panel cooperatives and self-help group members, or any additional supporting document as and when required by the disbursement banks. Even though the microfinance scheme is guaranteed by the CGC scheme, the borrowers are subjected to CRISS or CITOS compliance and each bank's credit-scoring standard. The stringent conditions imposed, such as CRISS and CITOS, do not benefit the micro-entrepreneurs as the policy restricts them from applying for various loan facilities.

However, the implementation of microcredit schemes will put more burden on the banking industry, in terms of operational costs. Some banks foresee that the microfinance schemes might increase their loan default position due to the relaxed

condition concerning collateral guarantors. Furthermore, the previous results concerning microfinance activities have shown a deteriorating trend in terms of repayment since microfinance is a high-risk return portfolio. Most banks report that they have adopted stringent and prudent evaluations of lending policies in order to mitigate unexpected losses.

Approval Periods

Our survey revealed that the success of Agrobank's microfinance scheme, for instance, which is mainly intended to cater for the needs of agro-based businesses, is collateral-free. It also offers straightforward and convenient accessibility. Loans are processed and approved within an average of five working days. Loan approval and disbursement are also fast to ensure that the financing needs of the micro- and small enterprises are met in a timely manner. According to Agrobank and Public Bank, loans could actually be processed and disbursed within 24 hours once the relevant terms and conditions are fully met.

Toward New Concepts and Applications of Microfinance

Malaysian banks usually define micro-enterprises as business entities with fewer than five full-time employees and annual sales of less than RM250,000, which is similar to the definition of microfinance brought forward by ADB. Bank Negara Malaysia defines microfinancing as small business loans not exceeding RM50,000 that are made available for micro-enterprises for business purposes only and not for personal loans.

These definitions do not actually fulfil the true spirit of microfinance, which is providing for a small loan in order to help the poorest people out of poverty and, in some cases, to assist them in fulfilling their basic needs. By using the above definitions of microfinance, commercial banks and Bank Negara are not aiming at the *original* target group – the hardcore poor – to offer them access to credit. The *current* definitions of microfinance, instead, include population segments that are not considered as poor to be eligible customers for microfinance products. The 'real' customers, i.e., the real poor, could be deprived from benefiting from the microfinance services if the current definition is applied, because a loan given to someone who is better off means that a poor person, in turn, would be deprived from having such a loan.

Therefore, we would like to offer a different definition of microfinance. Our definition of microfinance is a provision of a wider range of financial services for the purpose of socio-economic development as well as catering for the needs of unfortunate individuals or entrepreneurs who are not able to access the normal banking facilities or who fail to meet the standard of normal credit scoring.

During a period of crisis – such as the current global financial crisis – funds are diverted away from microfinancing purposes in order to give loans to big corporations.²⁶ The preference of banks and financial institutions to do business with big companies could mean that there will be fewer funds channelled for microfinance purposes. Since micro-entrepreneurs have to compete for credit from the commercial banks against the stronger big corporations and since commercial banks are increasingly adopting stricter credit evaluation standards in giving loans to micro-entrepreneurs, we propose the use of ‘cash *waqf*’ as an alternative and an additional source of capital for microfinance to promote the growth of Islamic microfinance in Malaysia in particular, and in Muslim countries in general. According to Amadou Cisse, the Vice President of the Islamic Development Bank, the amount of ‘cash *waqf*’, as well as that of *zakāt* funds throughout the Muslim world reaches hundreds of billions dollars a year, and the capacity for mobilising these resources is huge.²⁷

The institution of *waqf* is said to have originated as early as the time of the Prophet, but it reached particular significance during the Seljuk and Ottoman periods. It entails the use of cash, land, and real estate for charitable purposes. There are certain conditions governing *waqf*, but the objective is to serve the poor and the community. The presence of *waqf* and charities on the liability side of IMFIs is compatible with the social financial intermediation role of MFIs – especially the creation of ‘cash *waqf*’ as a source of income for Islamic microfinance.

Figure 2 shows how cash *waqfs* could be used as a source of funds for Islamic microfinance. Cash *waqfs* can be sourced from potential donors who want to donate their money to help the poor to venture into income-generating activities. The sourcing of this fund can be done by an Islamic microfinance institution (IMFI) which will act as a trustee of this fund. The IMFI will then identify eligible beneficiaries of the cash *waqf* which will be the poor or needy micro-entrepreneurs. Loans given to these micro-entrepreneurs can be based on profit-sharing (*muḍārabah*) or cost-plus (*murābahah*), so that when the micro-entrepreneurs repay their loans, the money can be used to replenish the cash *waqf* pool and in turn become the source of funds for other micro-entrepreneurs.

In the case of extreme poverty, the *qard al-ḥasan* principle can be applied to extend credit to the poor to enable them to fulfil their basic needs. The term *qard al-ḥasan* means beneficial loan, benevolent loan, gratuitous loan, or interest free loan. It is a kind of gratuitous loan given to poor people for a fixed period without charging the payment of interest or profit. The borrower of *qard al-ḥasan* is only required to repay the original amount of the loan. Scholars argue that the administrative fee or service charge for loan transactions is not against Islamic principles. For example, Irfan Ul Haq in his doctoral dissertation entitled “Economic Doctrines of Islam” states that “Banks are permitted to charge a minimum service fee to cover

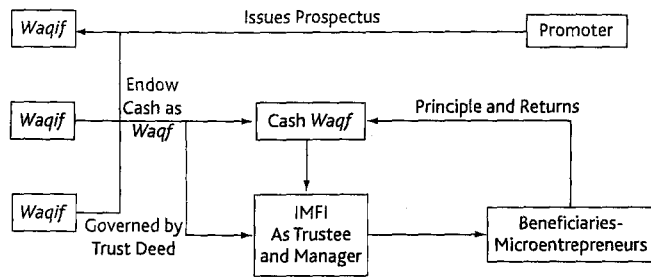


Figure 2 Cash Waqf as a Source of Funding for Islamic Microfinance

Note: English spellings and transliteration of Arabic terms have been maintained.

Source: D.M. Abdullah, "Offshore Trust and *Awqāf*", paper presented at the "International Seminar on *Awqāf*", organised by the Department of Awqaf, Zakat, and Hajj (JAWHAR), Johor Bahru, 11-12 August 2008.

the cost of administrative fee."²⁸ The Islamic Development Bank in Jeddah, for instance, recovers a service charge of 2 per cent to 3 per cent on interest free loans. Therefore, if *qard al-hasan* is given by any financial institution, the imposition of a service charge or administrative fee would be permissible.

In other circumstances, if microfinance is given for personal financing, banks should extend credit based on *tawarruq* instead of relying on *bay' al-'inah*, since an *al-'inah* contract is questionable and not accepted by many banks in the Middle East and Europe. With the context of an 'Islamic transaction', *al-tawarruq* means buying goods or assets in instalments and then selling them for cash at a lower price to a third party who is not the original seller of the commodity or asset.

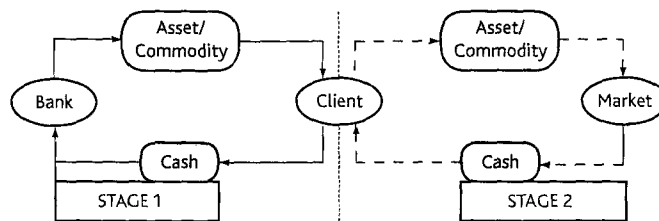


Figure 3 The Concept of *Tawarruq*

Source: Abdul Mumin Abdul Ghani and Ahmad Sufian Che Abdullah, "*Tawarruq*: Inovasi baru produk perbankan Islam dalam pembiayaan peribadi", paper presented at the "Seminar Perbankan Islam dan Anda: Era Globalisasi", organised by the Academy of Islamic Studies, University of Malaya, Kuala Lumpur, 27 June 2005.

Figure 3 illustrates how the concept of *tawarruq* operates as a means to obtain a personal loan through two stages. In stage 1, a client who wishes to obtain a personal loan (of, for example, RM10,000) goes to a financial institution. The financial institution will sell its asset, whether physical or financial, at a mark-up using the *murābahah* principle (for example, at RM15,000) on an instalment basis. In stage 2, the client, who is now the owner of the asset, will sell the asset to any interested party on a cash basis at the market price (let's say, at RM10,000). This process involves a transaction of real assets and is thus acceptable in terms of an 'Islamic transaction'.

Conclusion and Recommendations

In this article, we have aimed at critically examining the current practice of microfinance in Malaysia. We evaluated the features of microfinance offered by all the nine commercial banks, i.e. product type, loan size, eligible economic sectors, eligible customers, eligibility criteria and documents required to support loan application. Our study found several shortcomings in the current practice of microfinance in Malaysia. These weaknesses are, among other things, stringent credit evaluation standards, and missing the real target group, i.e., the poor and the needy. In addition, the mode of financing is mostly personal loan, using *bay' al-īmah*, whereby the use of the loan is to fulfil personal consumption instead of income-generating activities. Given these shortcomings, the article suggests the possibility of using cash-*waqf* as a new source of funding for Islamic microfinance and proposes new concepts and applications of Islamic microfinance, thereby putting it in line with the true Islamic spirit of microfinance. Furthermore, the article also proposes the use of other modes of financing such as *muḍārabah* and *murābahah*, as well as *qarḍ al-ḥasan* and *tawarruq* in extending credit to the poor.

As reported by CGAP in their survey of Islamic microfinance in 2007,²⁹ the outreach of Islamic microfinance is very limited and represents only a small percentage of the total microfinance outreach in all Muslim countries. With this new concept and application of Islamic microfinance, it will be able to further enhance the growth of microfinance to reach millions of poor Muslims, whether in Malaysia, other Muslim countries, or among Muslim minorities in non-Muslim countries. In addition, with this new concept and application of Islamic microfinance, we are convinced that the use of microfinance would genuinely cater for the needs of the poor and the needy and as a means to combat poverty as well as generating socio-economic growth in the Muslim world.

Notes

1. See Robert Peck Christen and Douglas Pearce, "Managing Risks and Designing Products for Agricultural Microfinance: Features of an Emerging Model", *CGAP* [Consultative Group for

- Assessing the Poor] *Occasional Paper* 11 (August 2005), available online at http://www.cgap.org/gm/document-1.9.2705/OccasionalPaper_11.pdf (accessed on 7 September 2009).
2. See Michael S. Barr, "Microfinance and Finance Development", *Michigan Journal of International Law* 26 (2005), 271.
 3. Muhammad Yunus and Fazle Abed, "Poverty Matters", in: Sam Daley-Harris, *State of the Microcredit Summit Campaign 2004* (Washington DC: Microcredit Summit Campaign, 2004), 16, available online at <http://www.microcreditsummit.org/pubs/reports/socr/2004/SOCR04.pdf> (accessed on 9 September 2009).
 4. Such as Shahidur Khandker, "Microfinance and Poverty: Evidence Using Panel Data from Bangladesh", *The World Bank Economic Review* 19, no. 2 (2005), 263–86, available online at <http://wber.oxfordjournals.org/cgi/reprint/1hi008v1?ijkey=JALcZTD7a55baue&keytype=ref> (accessed on 7 September 2009); Paul Gertler, David I. Levine, and Enrico Moretti, "Do Microfinance Programs Help Families Insure Consumption Against Illness?" *Health Economics* 18, no. 3 (July 2008), 257–73; A. Park and C. Ren, "Microfinance with Chinese Characteristics", *World Development* 29, no. 1 (January 2001), 39–62.
 5. Cited in "Banks Up-Beat on Microfinancing", *The Star* [Kuala Lumpur], 28 July 2008.
 6. Ibid.
 7. See P.B. McGuire, J.D. Conroy, and G.B. Thapa, *Getting the Framework Right: Policy and Regulation for Microfinance in Asia* (Brisbane: The Foundation for Development Cooperation, 1998).
 8. Amanah Ikhtiar Malaysia (AIM), Annual Report, various issues.
 9. Socio-Economic Research Unit (SERU), "Impact Evaluation Study of the Amanah Ikhtiar Scheme (Kuala Lumpur: Prime Minister's Department, 1991).
 10. AIM, Annual Report, various issues.
 11. Sam Afrane, "Impact Assessment of Microfinance Interventions in Ghana and South Africa: A Synthesis of Major Impacts and Lessons", *Journal of Microfinance* 4, no. 1 (2002), 37–58.
 12. M. Jahangir Alam Chowdhury, Dipak Gosh, and Robert E. Wright, "The Impact of Micro-Credit on Poverty: Evidence from Bangladesh", *Progress in Development Studies* 5, no. 4 (2005), 298–309.
 13. S. Amin, A.S. Rai, and G. Topa, "Does Microcredit Reach the Poor and Vulnerable? Evidence from Northern Bangladesh", *Journal of Development Economics* 70, no. 1 (2003), 59–82.
 14. Brett E. Coleman, "Microfinance in Northeast Thailand: Who Benefits and How Much", *World Development* 34, no. 9 (2006), 1459–666.
 15. Dale W. Adams and J.D. von Pischke, "Microenterprise Credit Programs: Déjà vu", *World Development* 20, no. 10 (1992), 1391–546.
 16. Naila Kabeer and Helzi Noponen, "Social and Economic Impacts of PRADAN's Self Help Group Microfinance and Livelihoods Promotion Program: Analysis from Jharkhand, India", *Institute of Development Studies Working Paper* 11 (March 2005), available online at http://www2.ids.ac.uk/impact/publications/working_papers.html (accessed on 9 September 2009).
 17. Sukor Kasim, *Impact of Banking on Rural Poor in Peninsular Malaysia: Final Report of External Impact Evaluation Study on AIM Active Borrowers, Non-Borrowing Members, Dropouts and Non-Participating Poor* (Penang: Centre for Policy Research, Universiti Sains Malaysia, 2000).
 18. Ibid.
 19. Socio-Economic Research Unit (SERU), "Impact Evaluation Study".
 20. AIM, Annual Report, 2008.
 21. Nimrah Karim, Michael Tarazi, and Xavier Reille, "Islamic Microfinance: An Emerging Market Niche", *CGAP Focus Note* 49 (August 2008), available online at http://www2.cgap.org/gm/document-1.9.5029/FocusNote_49.pdf (accessed on 7 September 2009).
 22. Habib Ahmed, "Financing Microenterprises: An Analytical Study of Islamic Microfinance Institutions", *Islamic Economic Studies* 9, no. 2 (March 2002), 27–64.
 23. Ibid.
 24. Karim, Tarazi, and Reille, "Islamic Microfinance".

25. 'Yearly rest', a term used in the banking industry, refers to interest that is calculated once a year based on the outstanding balance at the end of the year.
26. Cf. *Islamic Finance News* 6, no. 2 (January 2009), available online at <http://www.islamicfinance-news.com/> (accessed on 9 September 2009).
27. Mohammed Abbas, "Bankers See Large Profits in Islamic Microfinance", *Reuters*, 5 September 2007, available online at <http://in.reuters.com/article/companyNews/idINL0559309420070905> (accessed on 7 September 2009).
28. Irfan Ul Haq, *Economic Doctrines of Islam: A Study in the Doctrines of Islam and Their Implications for Poverty, Employment, and Economic Growth* (Herndon VA: International Institute of Islamic Thought, 1996).
29. Karim, Tarazi, and Reille, "Islamic Microfinance".