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**Integrating Zakah, Awqaf and IMF for Poverty  
Alleviation: Three Models of Islamic Micro  
Finance**

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**Abstract.** The objective of this paper is to present theoretical proposals for institutional structure in the context of Islamic Microfinance by first comparing Conventional and Islamic microfinance institutions and then by highlighting some of the pioneering work of conventional microfinance models that paved the way for Islamic Microfinance. In this paper, we review the literature of micro finance models that simultaneously deals with several facets of poverty by combining Waqf and Zakah principles together or individually. There are three models examined in this paper. Waqf-Based Islamic Microfinance Institutions, a Model of Zakah and Awqaf-based MF Organizations and an Integrated Awqaf and Zakah Model of Microfinance. Both Zakah and Waqf mechanisms are considered for Islamic microfinance not only because of their frameworks that are in accordance to the Shariah but they are the original concepts provided in Islam that serve people in need i.e the poor. In tandem with the doctrine of microfinance, Zakah and Waqf are seen as tools best suited to assist the poor who require financing and ultimately could be effective for poverty reduction. The paper derives recommendation for integrating microfinance models into the overall economic policy.

**Keywords.** Awqaf Funds, Monetary waqf, Zakah, Microfinance, Islamic Microfinance and Poverty.

**JEL.** G21, I31.

## 1. Introduction

The eradication of poverty is considered an important objective of an Islamic economic system and the overall financial sector should depict this goal. The Islamic financial sector is still in its infancy state and not much literature is available on the success of the Islamic microfinance sector in general. A method through which the social role of the sector can be manifested is by providing microfinance to poor entrepreneurs.

Microfinance<sup>1</sup> is a branch in finance that deals with providing financial assistance to the poor and needy people. Microfinance services can be provided by various institutions such as rural banks, cooperatives and Non-Government Organizations (NGOs)<sup>2</sup> which can also be famously termed as Microfinance Institutions (MFIs). Legally, these MFIs are treated as separate

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entities with the key role of providing grants to small businesses and entrepreneurs. Many literatures investigated have all agreed that microfinance is the best noted tool so far that is considered by governments and institutions for combating and eradicating poverty. By this, microfinance initiative is widely acclaimed as a new approach for poverty alleviation. However, microfinance is not to be considered as the sole means for poverty reduction. There should be complementary factors i.e combining other effective programs which can achieve desired outcome by providing assistance to potential entrepreneurs who are in need of funding. Ultimately, this can help to reduce to a smaller-scale of poverty problems (Chowdhury, 2009).

Poverty cannot be completely removed but with cumbersome efforts of all agents poverty can be minimized to a certain extent (Slausi, 2011). The lack of access to financial services, affect the ability of active poor people to take advantage of economic opportunities, increase their earnings, finance the education of their children, satisfy basic services and protect them against financial crash. Hence, not having the financial means triggers individuals to never leave the realms of poverty.

Be that as it may, it is concurred that microfinance is the supply of banking or financial services to people who experience difficulties in accessing the banking system (Brugnoni, 2011). The author further stated people are unbankable because of two states. Firstly, they are in the situation that need of means, collateral or even the simplest form of financial literacy. This state is mostly prevalent among poor Muslim countries. Secondly, conventional financial brokerage system contravenes percepts deemed to be compulsory which mostly found in affluent Muslim or Western countries (Brugnoni, 2011).

In order to minimize the gap that exists in the microfinance industry it is best to understand that microfinance is still in its infancy with less than 1% of total global microfinance outreach. Clearly a few hundred thousand customers are managed by a couple of hundred institutions (mostly NGOs) operating in not more than 20 countries.<sup>3</sup> Interestingly, during the last couple of decades, microfinance industry has witnessed a tremendous up-hill climb. It is used as in channeling pro-poor financial assistance from the most-abled to the least-abled or otherwise known as the productive poor. The method of assisting them is by ensuring that their build the livelihood assets by satisfying the life cycle consumption and by protecting their assets against future risks.

Microfinance services are aimed to provide for the poor whose low economic status prevents them from accessing formal financial systems. It is a powerful poverty alleviation tool that allows them access to services including, venture capital, credit, insurance, savings and remittance on a micro-scale. This helps to increase household income, economic security and assets, while creating demand for other goods and services such as education, nutrition and healthcare and stimulates local economies.

## 2. Poverty and Microfinance

Like all remedies, microfinance is on the tools that nations and institutions use to eradicate and reduce poverty. This means of poverty reduction was first institutionalized in the year 1944 with the erection of the World Bank. With the establishment of the International Monetary

## Journal of Economic and Social Thought

Fund and GATT have been the tasks of stabilizing the world's economy and promoting free trading since the 2<sup>nd</sup> World War.

The earliest work of the World Bank to reduce poverty was centered on large global organizations where credit was distributed to developing countries and the followed the policies prescribed by the World Bank. According to (Leikem, 2012) the main focus of poverty reduction from the 1950s-1980s was to integrate poor populations into the economy through better macroeconomic performance. It has been observed that the attempt to reduce poverty seemed hopeless. These programs were called structural-adjustment programs, and they were highly unsuccessful. Nevertheless, there are many models used for microfinance emulating each other and enhance some features.

### *2.1. Conventional Models of Microfinance<sup>4</sup>*

Generally, conventional microfinance has witnessed enormous growth during the last couple of decades. It has created vast innovation in order to create and provide free credit access to the very poor sections of the society (Hassan, 2010). Microfinance assumes that, to the micro-entrepreneurs, lack of collateral is the most important obstacle in availing formal credit and it hinders the overall investment and profitability of the business. Hence, microfinance is a tool that aims at providing risk free financial services to the needy in order to help develop micro or small scale businesses.

In spite of the merits of microfinance as highlighted in the preceding section, it also has a quite number of shortcomings. Micro-financers have been promoting non-firm activities among the rural poor to encounter against the inherent seasonal trend of agro-economic activity that generates irregular cash flows. However, in many cases the borrowers start up taking loans for micro-business but end up with fulfilling immediate consumption needs turning micro-finance into a merely consumption-smoothing act.<sup>5</sup>

Previous literature has also stated that there are other aspects that can hinder the growth of the microfinance or microcredit industry. These aspects are related to asymmetric information that leads to moral hazard and adverse selection whereby MFIs focus on providing loans to women but there is fear that the loans will fall into the hands of the men. Another problem is associated to the economic viability of MFIs wherein they have to incur high operational and administrative costs. More often than not, they rely highly on foreign aid to run business operations.

The possibility of charging fixed interest rate could also pose a potential threat because MFIs usually charge the same BLR<sup>6</sup>. Despite offering the same lending rate, countries do not necessarily have the same demographics and population distribution. Rural areas in countries are sparsely inhabited and hence promoting a greater profits.

The basic principles of Microfinance can be found in the pioneering model introduced by Dr Muhammad Yunus. eGrameen Bank Model. More models were ensued later. It should be noted that good microfinance programs are characterised by small, usually short-term loans; streamlined, simplified borrower and investment appraisal; quick disbursement of repeat loans after timely repayment; and convenient location and timing of services. Despite the microfinance model is not based on Shariah principles, some of Islamic Development Bank (IDB) countries members have adopted such precedent for instance Bangladesh, Indonesia and Morocco have led the microfinance revolution. Countries that are non-IDB members but have large sizable Muslim population such as India and Sri

Lanka are also leading in this sector. These countries have witnessed some of the pioneering experiments to eliminate poverty. For the purpose of this research, only the precedent model is highlighted.

### 2.2. Grameen Bank Model

Grameen Bank Model is a conventional microfinance model that was first founded by Professor Muhammad Yunus in Bangladesh during the year 1983. It is a bank that is exclusively for the poor and owned by the poor. The model of this bank is to provide microcredit or “Grameen credit to the improvised poor without requiring collateral. (Khandker, 2006) indicated that by 1994 it had mobilized more than 2 million members, disbursed more than US\$1 billion, and mobilized US\$306 million from the poor. (Khandker, 2006), further stated that about 94 percent of Grameen Bank’s members are women. Its loan recovery rate has been consistently above 90 percent, an outstanding success for a rural-based financial institution compared with the dismal recovery rate of 25 percent or so for the country’s commercial and agricultural development banks.

The essence of this model is financing given based on mutual guarantees and trust by a group of five individuals without any collateral requirements like what the mainstream conventional banks are practicing. The size of the group can vary but stay limit in a very small size of not more than 10 members. An interesting fact is that women are also given an equal access and they turned out to be astute entrepreneurs (Fotabong, 2011).

The success of the Grameen model has attracted global attention and the model has been replicated both inside Bangladesh and outside Bangladesh. Hence, thousands of microfinance institutions sprang up around the globe, most of the models closely represented the classical model of Grameen Model. Other scholars have used words like “Flagship Model” to denote the work of Yunus. The model has been replicated by other institutions in about 4 continents. Ironically, the very development institutions that Yunus condemned began to incorporate microfinance in their development plans. Microfinance became a formal tool for global poverty reduction.

The main reason this model caters to the poor is the belief that the poor have the skills and knowledge but lack the financial aid and assistance to succeed in business ventures. When providing loans and extending credit, a group is formed in order to induce peer pressure. With pressure, recipients strive hard to succeed and hence create a positive environment for loans to be paid back. Interestingly, the entire group will be disqualified and will not be eligible for further loans, even if one member of the group becomes a defaulter (Fotabong, 2011). Because of Grameen’s innovative program design, outreach to women, and poverty reduction potential, development practitioners are increasingly interested in learning more about its potential, constraints, and replicability. An early Grameen replication that sought to offer Shari‘ah-compliant microfinance is Amana Ikhtiar Malaysia (AIM).

### 3. Islamic Microfinance

Microfinance is still in its infancy with less than 1% of the total global microfinance outreach. A few hundred thousand customers are managed by a few globally dispersed NGOs. These NGOs operate in not more than 20 countries in the world. (Riwajanti, 2013) highlighted that Microfinance refers to provision of financial services to the poor - more than just small loans, it also includes saving and micro insurance, as household might need credit but also they are able to save – with aim as a development tool for its

## Journal of Economic and Social Thought

clients. However, the biggest challenge for microfinance is in reaching a sustainable scale which is mainly due to the not-for-profit culture of the Islamic microfinance intermediaries.

Over the past three decades, Islamic banking has grown significantly at annual rate of over 15% with an overall capitalization of US\$1.3 trillion at present. Comparatively, Islamic microcredit is an evolving concept with an outreach in mostly the Arab/ Muslim world. This industry has grown vastly with more than 700,000 borrowers noted in the year 2003. (Mahaini, 2012) stated that Islamic finance has emerged from a market niche to a rapidly growing industry worldwide with more than 500 sharia-compliant institutions have been created in the past 30 years, spread across 75 countries, with a market size of US\$1.3 trillion which grows at about 15 per cent per year. Additionally, Islamic microfinance makes allowances for both financial and non-financial services which cater to the beliefs and teaching of the Quran and the hadith. These principles and concept promotes overall justice.

Islam promotes community based activities that shape the nature of microfinance institutions as they operate under the principles of group based lending and joint liability. Evidently, all the characteristics of microfinance denoted above clearly cover all the aspects required to facilitate the poor's needs. In due light, attention should be given to the implementation of the spirit of Islamic microfinance so that it is not just an empty theory; as the gap between the spirit and implementation is rather obvious.

Islamic and conventional microfinance both have similarities and differences. Both concepts mostly incline towards economic development and social objectives and their main aim is to provide better lives for people, give people support on additional income, promote entrepreneurship and encourage risk sharing. In fact, the basic elements of microfinance seem to be in consistent with the attributes of Islamic finance.

There are similar goals in both conventional and Islamic microfinance. Particularly when both models are expected to rely on providing wider access to the poor in order to ensure that people have a sustainable institution which can achieve "market based for profit approach"<sup>7</sup>(Riwajanti, 2013). To support the principles of this model an efficient system and transparency reporting is needed.

Some prevalent features that differentiate these two models are the sources of fund whereby conventional microfinance only confined to external funds and savings of the clients. Whereas for Islamic microfinance, it extends beyond by also utilizing charitable means such zakat, sadaqah and waqf. As for mode of financing, it is evident that the backbone for conventional microfinance is interest-based while Islamic microfinance observes compliance to Shariah principles at all times (Abdelkader & Salem, 2013).

Interestingly, it has been pointed out that the main difference between Islamic and conventional approach is that the Islamic approach emphasized on the important points of provision of financing and non-financing services to improve microenterprises, transparency, understanding and cooperation (Riwajanti, 2013).

It is important to highlight that Islam has essentially provided guidelines and tools to address poverty issues. The tools prescribed by divine rulings to help the poor are through charitable means ie. Zakah,

## Journal of Economic and Social Thought

sadaqah and Waqf.<sup>8</sup> These charitable means particularly Zakah and Awqaf are examined as their characteristics and goals entailed share the same purpose as microfinance in general. To appreciate further the differences between Islamic and conventional microfinance and its effectiveness, three Islamic microfinance models which use charitable sources are explored in the subsequent sections. Reviewing these three models is mainly because of their original concepts that underline the fundamental objective to alleviate poverty. Mechanism of Zakah is considered as a compulsory charitable tool and thus, a group of people who are poor and needy is in the priority to receive the funds. On the other hand, Waqf is not compulsory but it is a perpetual charitable tool that aims to improve the non-economic aspects of the poor such as health and education (Sadeq, 1995). In essence, the three models have incorporated the principles of Zakah and Waqf to create a robust framework for Islamic microfinance that ultimately designed for economic well-being as a whole.

### 4. Waqf-Based Islamic Microfinance Institutions

The quest for a competitive solution to all problems has become a major concern for all. Many of the problems we face everyday are associated with a bureaucratic society. Hence, the need arises for gauging alternatives in the current prevailing economic system. According to (Man & Abdulwaheed, 2011), some scholars are considering the option of charity in form of philanthropy as it is stated in the Quran. The Quran states that God created, and owns everything on earth. Man, therefore, holds on trust for God and must carry out his duties as trustee in the manner prescribed by God. We hence, look into the aspects of Waqf- Waqf in Islamic terms is voluntary act of charity that comes under the context of sadaqah and infaq. "waqf means stand still, hold on and not let go. Waqf in another meaning is holding of assets for consumption or future sale."<sup>9</sup> Waqf based Islamic Microfinance is slightly different than other microfinance institutions. It is a model unlike other models that follow a mechanism of group based lending solutions. (Ahmed, n.d.) Stated that these institution of waqf has historically played a vital role in extending social services and improving the overall welfare in Muslim societies.

(Hassan, 2010) Additionally, stated that perpetual (Awqaf), is used to improve non-income aspects of the poor such as health and education as well as increasing their access to physical facilities, resources, and employment. Previous literatures have defined waqf in their own terms, however all have collectively agreed that it is funds meant to serve poor sections of the society not just in terms monetary but also in terms of distribution of resources and non-financial aspects. The primary goal of waqf based institution is to provide sustainable Shariah compliant microfinance to the productive poor in today's setting. This must be on terms that sustain the Waqf but favour the recipients in all other ways.

The waqf mechanism can be enhanced by adopting an innovative element suited to the contemporary surrounding. It does not only improvise the overall economic development in Muslim countries but able to address poverty issues critically encountered in these nations. The innovative element is referred to the Monetary Waqf<sup>10</sup> in which could overcome some of the problems revolving in the administration of waqf in terms of its cost, collection of funds and risk of loss due to default by recipients. The Monetary Waqf utilises "philanthropic resources" and monies granted by

## Journal of Economic and Social Thought

donors in order to carry out projects for the overall sustainability of the society. Therefore, it enables even people of ordinary means to help the poor through microfinance. Monetary waqf promises lenders instant liquidity if they want to withdraw, and protects them from potential defaults. The mechanism of this waqf is delineated in the following subsection.

### *4.1. Financial Aspects of Waqf-Based Islamic MFIs*

In a waqf based Islamic financial institutions, financial records and data are distributed based on assets and liability. The items in the assets are cash and loans that are based on qardh al Hasanare forms of non-interest bearing contracts. On the other hand, items in the liability side usually constitute of capital waqf, saving deposits and items like takaful reserves.

The basis of the waqf based model is that the resources are given away as waqf and need to be utilized rightfully for those who need them. Hence, Waqf-based Islamic MFIs receive financing from Waqf endowment fund and the costs are much lesser than the conventional MFIs. Also, no returns are expected as these are donations. While Islamic MFIs do pay returns on funds from deposits and beneficiary savings, the Waqf funds will decrease the financial costs and improve the economic viability of the MFIs. Apart from that, the financing provided should be based on QardhHasan(benevolent loan), to people who are extremely poor and thus no return of loan is expected.

### *4.2. Monetary Waqf*

Monetary Waqf was created by a pool of money that is meant to meet administrative and maintenance needs. Funds are provided as interest-free loans or loans given during on-call or when needed the most. Since, need is extended to the needy, this creates a mechanism for repayment. This money is also given out in the form of loans to entrepreneurs and they money is usually paid back when the business progresses. (Zarke, 2007) suggested that for monetary waqf funds to prevail waqf institutions need two philanthropic donors, namely guarantors of liquidity and guarantors of losses. It is to be borne in mind that MonetaryWaqf can be one of the major sources of fund subject to terms and conditions stipulated under the Shariah. The cost involved waqf mode of fund raising is limited to protecting and maintaining original amount and the remaining amount of money can be given to poor micro entrepreneurs who have the potential to succeed and can achieve self-sufficiency and sustainability in short period.

The beneficiaries of the Monetary Waqf include needy people who are expected to repay loan from their future earnings. These kinds of individuals are also called the productive poor. In Waqf based model, collateral is not a requisite to receive funds because this would then eliminate the weakest and neediest that have little or no collateral and are denied finance in conventional finance. Therefore, the beneficiaries of this waqf are the (i) Donors who are individuals that donate real resources which enables wider public participation and pool of resources, (ii) Lenders who give benevolent loans (based on QardhHassan), (iii) Guarantors of liquidity: are guarantors of liquidity are willing to extend money when the waqf funds are required. The form of loan given is in the form of qardHasanand (iv) guarantors of losses: these guarantors extend monetary waqf in case of loan default.(Zarke, 2007)Added that an innovative feature of this waqf is that also it employs in micro financing some of the temporary financial resources that it had received as

qardhHasanfromlenders. Therefore,it opens a large untapped source for microfinance from demand deposits.

The operations of overall modus operandi of microfinance based on waqf-model which essentially underpins the mechanism of monetary waqf are illustrated in the following figure:

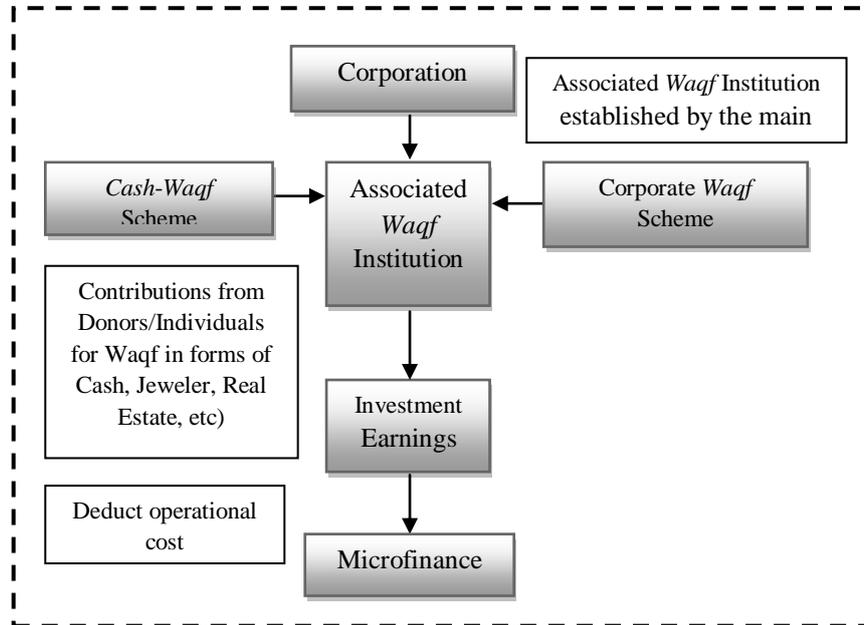


Figure 1. Monetary waqf microfinance-based

The contributions made by individuals can generate profits and these dividends will convey on to an associated waqf institution dedicated only for microfinance purposes. The institution is given the authority to manage and invest the accumulated the monetary waqffund. The revenue earned thereafter will be channelled to enterprises or individuals who are in need in the course of microfinance purposes. This model is still considered new and there could have been flaws in its implementation.

#### 4.3. The Future of Monetary Waqf

Previous literatures have asserted that there is nothing outside the realms of rational thinking in the fiqh of awqaf. Except that its objective is that of attaingoodness (birr). Hence, most fund providers will typically donate money to a Monetary Waqf fund once it establishes its integrity, effectiveness and financial soundness. One should note that the waqf essentials must be observed in order to preserve the authenticity of Shariah principles of awqaf. Hence, the individuals cum donors who give contributions for monetary waqf purposes must explicitly mention their intention especially the amount given after deducting expenses for waqf management. Otherwise, the whole operation of waqf renders invalid (Khademolhoseini, n.d.). However, there are two constraints for the Waqf in doing this. Firstly, good managerial talent is not available to justly check potential beneficiaries, distribute funds efficiently and recover funds. The second constraint is lack of the innovative talent in business and engineering to assess the viability of the project that the potential beneficiary may propose and the capacity to develop micro projects for other beneficiaries that are well suited to the skills and local environment of the poor. Overall, it should be reiterated that this model is indeed

acceptable and in accordance with Islamic jurisprudence but the concern is with lack of efficient system in its management and operations, which still needs to be explored and improvised further.

## 5. Zakah and Awqaf-based Model MF Organisations

During the early eras of time, Muslims created institutions based on needs and requirements. Omar- The companion of Prophet Mohammad (PBUH) created an archive department where documents and records could be stored. Hence, Muslims can create microfinance institutions to curb the issues of poverty if the need arises. (Khaf, n.d.) stated that,

In order to eradicate poverty, there is a need to create a Zakah-cum-Awqaf based micro finance organization that provide financing to the poor at either the market rate or by establishing a cash waqf which will give a charge free or subsidized financing to the poor or establishing a Waqf whose revenues are to be used to finance the poor supportive programs and to subsidize the rate of financing charged to the poor; allocating part of the proceeds of Zakah to provide grants for initial investment to the poor as a substitute of micro- financing; etc. a short description of one of these scenarios may be useful.

The below suggested model is a micro-financing Zakah based microfinance model that is worth penning down. The experiment took place in the year 2003 and 2004 called the “Diwan al Zakat” this experiment ordained to support segments of the not so poor but productive producers in order to keep them from declining in terms of status.

A case study on such a model of microfinance is from Sudan. In the Sudan model, revenue from Diwan al Zakah was used to help a group of non-poor farmers who were frequently affected by drought and shortage of fertilisers by providing them no-interest loans. The finance was provided to improve their production, raise Zakah revenue and to prevent them from becoming a part of the poor segment, and losing their self-esteem. It provided a total loan amount of \$336,500 to 8,000 families with an average land area of 2.4 acres or 2.7 Feddan per farm. The average loan didn't exceed \$42.1 per family for six months. A 70% increase in the cultivated area during the winter season. An increase of more than 150% was considerably noted in the productivity per Feddan. The total value of cash crops reached around \$5 million, which was about 15 times the amount of loans. The amount of Zakah collected from farmers was \$250.5 million or 74.4% of the loans. In addition, the loans were also fully repaid by the farmers (Khaf, n.d.).

Like any other area of investigation, each model revolves around certain parameters of evaluation that is be used by microfinance models to assess the functionality of each model. In order to understand the Awqaf and Zakah based microfinance better, we will look at the organization and managerial structure of this model. We will also examine its financial structure, sources and uses funds of these models. Working principles of each model also are to be explored.

### 5.1 Organisational and Managerial Setting

It is first important to first understand that Zakah is mandatory and Awqaf is voluntary. Every model analysed is different from each other in one way or another. In this model, we understand that for both Zakah and Awqaf funds to succeed, the management and the company board should have members who value the organisation's success as well as the company's betterment. Members are selected in such a way that they have some underlying stakes in the company. Usually, in private corporations,

## Journal of Economic and Social Thought

the management comprises the primary stakeholders who own the corporations, receive the profits, bear the loss and therefore they have ultimate control on the management.

This model cannot be practiced in Zakah and Awqaf-based microfinance because the immediate stakeholders are the poor. In most instances, the poor are unable to cope with large amounts of money due to their idea of “money rationalisation”. Also they should be instructed on handling their investments. Although there might be suitable candidates, the solution is to select the management from two sections of society– the social environment and the donors.

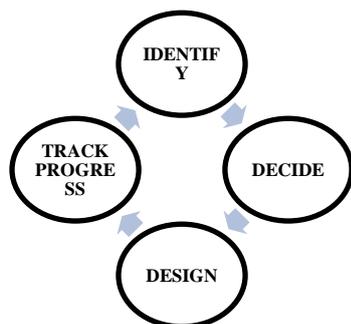
The social environment constitute of entities which are within close proximity to microfinance agencies or institutions. These agencies additionally conduct the same basic function which is mainly to manage funds of MFIs. Some examples of social environment are certain governments, affluent social leaders, NGOs and also some branches of government agencies whose main focus is on providing aid and relief assistance to the poor.

The donor section on the other hand, mainly deals with the providers of funds. Some of these are Zakat payers, Zakah agencies that collect and distribute Zakah in a designated area, the awqaf contributors and other charity givers.

In most likelihood, it is a requirement that the majority in the donor’s section would have a greater experience in running businesses and aiding the poor than the entities under social environment. Individuals in this sector constitutes of managers, Chief Executive Officers, Chief Financial Officers are others of high status quo. It is hence a requirement for these representatives to be affluent, highly educated and possess other credible attributes which mainly protect fundamental elements of corporate governance such as accountability and transparency. The donor groups are expected to have a bigger role in the decision making processes.

However, members from both the sections should comprise among members of the board of directors from zakah and awqaf-based corporations and would ideally choose the executive management team for a renewable 3-5 years’ period. After the 3-5 years, members can reshuffle and reelect a new team. In this manner, elements of transparency and independency can be maintained always.

However, to monitor and track progress of the management, the board of directors needs to identify, design and determine the selection criteria. They should also adopt evaluation and measuring tools that are used to assess and evaluate success of the donor section. Additionally, the board of directors who also constitute of donors and social environment also determine the tools needed to assess the success of the social environment.



### Process in designing the Evaluation tools

- Step 1:** Identify the types of tools and evaluation models.
- Step 2:** Decide on the tools to be used
- Step 3:** Design the agreed upon evaluation tools to be used
- Step 4:** Track progress of the tools and identify errors and areas of improvement

### 5.2 *Financing Methods*

Funding in microfinance is a mechanism where funds are channeled out either through means of borrowing, lending or giving away to charity in the forms of alms. The sources of financing are from both Zakah and Awqaf funds.

Stated that Zakah Fund is a source of funding that can be used for income generating activities where the unfortunate can be given these funds in order to ensure that they generate daily income to sustain life and day to day activities (Khaf, n.d.).

Awqaf on the other hand, aims at promoting networking with the private sector in the context of a solidarity Program mobilizing and operationalizing funds through profitable investment benefiting to poor people particularly women head of households and unemployed youth and handicapped persons.

According to (Khaf, n.d.) Zakah-cum-Awqaf model offers financing in three forms; (i) Financing of loanable money (ii) Financing the administration costs and (iii) Financing services to the poor.

#### 5.2.1 *Financing Loanable Money*

A certain amount of loanable money is established to provide repayable loans to the needy. Banks allocate a small portion of money to microfinance foundations similar to Awqaf. Loans are provided to client based on requirements.

Additionally, in IMF other sources of funds must be used to provide allowances for growth and to adjust losses due to defaulted loans. Unlike other types of financing that focuses on profits, this microfinance model should implement the principle of Zakah that the poor need to be subsidized irrespective of the cause of the poverty. This would be an example of applying the principle of Rahmah and Ihsan or mercy and goodness.

The cash Waqf funding could be requested based on the premise that they will be financed as charge-free loans and at a reasonable market rate but should only be channeled to the poor so that they can be rehabilitated. On the other hand, the revenue generated from Zakah funds can be used as loanable funds and as support fund recovery through the gharimin heading of Zakah distribution. It is important to highlight that Qard Hasan (benevolent loans) can be raised either as charity or short term-long term loans from wealthy people without any return. Giving loans to needy is considered as good deed in Islam but loan repayments to lenders need to be administered by a proper body of professional micro finance management team. Cost of Qard Hasan is limited to fund administration charges, thus it can be used as important tool for fund raising.

#### 5.2.2. *Financing the Administrative Expenses of the MF Organisations*

Financing the administrative costs of running business operations should not obtain source of financing from the revenue generated from Zakah instead these institutions must be financed from donations, grants and distinctive Awqaf revenues. There may be a conflict of Shariah principles for Zakah if its funds outsourced to the administrative expenses. This is because such expenses are not within the ambit of Zakah recipients as prescribed in the Quran. Therefore, expenses should be financed from other legit sources and in the context of this model (Zakah and Awqaf) for microfinance, Awqaf funds should be preferably used.

### 5.2.3. *Financing Services to the Poor*

Services to the poor that include providing education and training on business skills, investment/saving decisions, health, community and business related social services are targeted at enabling, dignifying and preparing them to become self-sufficient. These training activities are essential and are a prerequisite for providing funding to the poor.

The Awqaf revenues are essential for MF organisations so that they can then fund the Islamic MFIs. If Zakah is used to fund any of these services, it should be done without violating the principles of Tamlik (ownership). Additionally for the sustainability of this model, it is essential to have two types of Waqf funds for Awqaf-Zakah based model- one is Cash Waqf and other is Revenue Generating Waqf. Both requires dedicated assistance from the Zakah funds and efforts to raise donations and grants other sources such as the public, government and international sources.

### 5.3 *Uses of Funds*

According to (Khaf, n.d.), the essential premise of the proposed Zakah and Awqaf micro financing is to reduce the burden charged to the poor by involving the Zakah Institution and raising donation from the public. Consequently, all, or at least most, of the services provided to the poor shall not add cost to the financing operation.

It should be borne in mind that by incorporating charity-based funds via zakat and awqaf, the source of financing will be beneficial since this fund is non-interest bearing. This could complement the funding to finance any non-Investment activities such as assisting the poor in their basic needs, conducting training to enhance the skill and capability of the borrower, and other community development activities (Yumna & Clark, 2012). This could also reduce loans that are giving out to the poor.

These funds are used as Shariah compliant financing schemes given to the poor venturing into different modes of Islamic financing such as sale or partnership. For instance, adopting the Shariah principles of musharakah or mudharabah as financing schemes to cater microbusinesses and allow micro entrepreneurs to generate profits and at the same time be able to save (Goud, n.d.). Furthermore, services can also be provided to the needy by using micro financing schemes. Additionally, to cover administration cost and the cost of credit risk associated with Awqaf funds.

### 5.4 *Working Principles*

The main aim of the proposed MF organisation is to provide continuous support to the poor until they become self-sufficient. The beneficiaries should be educated on frugality, savings and productivity in addition to the financing. This training is necessary for performing different community activities. This supports the principles of Zakah and Awqaf and is crucial to the success of the proposed microfinance organisation compared with conventional interest-based microfinance organisations. In a microfinance organisation which adopts this model i.e. Zakah and Awqaf must observe various working principles in directing the operations.

These principles are, firstly by having good ties to ensure better allocation of funds be made and hence, close ties should be maintained between the Zakah and Awqaf providers. Secondly, funds given with no-charge or very low charge basis. However when a low mark-up rate is charged by an Awqaf and Zakah based MF organisation to the poor, a prudent team of professionals is required. Thirdly, loans granted from Zakah funds are temporary while Awqaf funds are redeemable. In this regard,

newly received cash awqafis used as loanable income while the income generating Awqaf is used as savings. Zakah on the other hand, is used in case of emergencies. Fourthly, all Islamic contracts should be linked with the principle of tamlik (ownership) and the intentions of Zakah wherein to assist the misfortunate.

## 6. An Integrated Awqaf and Zakah Model of Microfinance

Stated that, Awqaf and Zakah are incorporated with the Islamic microfinance into a single framework. Thus, the challenges of higher interest rate, diversion of micro-credit for borrower consumption and fund inadequacy of Islamic MFIS can be resolved (Hassan, 2010).

The Zakah fund may be used by the Islamic MFIs to disburse funds to meet the basic consumption needs of the extremely poor as it should be disbursed within one financial year. Awqaf funds are used in these micro-businesses as initial capital and working capital. The most beneficial aspect of this model is that the chances of loan default will be minimised since the basic human needs are met if at all the need arises.

It is noteworthy that by combining these two mechanisms resulted to combined sources of funds that could provide both commercial and social services (Yumna & Clark, 2012). Accordingly, financial services are provided to cater commercial needs and ultimately could elevate social and economic well-being.

### 6.1. Key Functions

The key function of Zakah-Awqaf microfinance institution is to collect and manage Zakah funds and Awqaf funds from potential Zakah donors and collect and potential Awqaf donors respectively. Subsequently, it is to provide micro-credit to the poor based on Shariah principles. In the early stages, the provisions of microfinance and collection of funds from other Zakah and Awqaf management institutions will be the priority. By integrating both Zakah and Awqaf mechanisms; it can strengthen the collected funds as there will be no issue of insufficiency of sources for the poor. After the collection of funds in the early stage, the management will use these funds to create a stable stream of income by providing various microfinance schemes services.

### 6.2. Credit Delivery Model

The integration model adapted the model of Amanah Ikhtiar Malaysia as a success model whereby the customer is studied, profiled and classified based on needs hence credit is extended. The selection process involves:

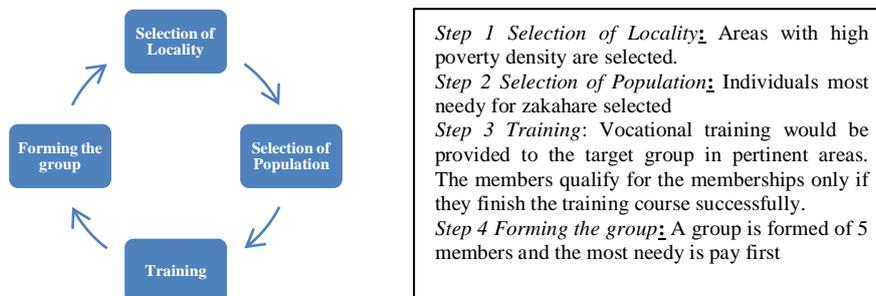


Figure 3. Selection Process for Credit Delivery Model

6.3. Organizational Structure

The organizational structure is different from previous Awqaf and Zakah model. In this integrated model, the NGOs are classified as units and each unit constitutes of unit managers. Each unit manager has a group of credit officers to run daily operations such as distributing funds and receiving repayment from borrowers. Apart from these credit officers, small groups of two to three other credit officers are to scrutinise the appropriateness and effectiveness of the credit delivery. This information is shared with the unit managers and the management to examine the functioning of the model.

6.4. Financial Management Framework of the Integrated Model

The framework of the integrated model of microfinance comprises of three aspects i.e fund management principles, sources of funds and uses of funds. According to the integrated model of microfinance, the two major sources of funding are Zakah and Awqaf. The Zakah funds would be used to satisfy the essential needs and to provide initial investment for a member to establish a micro-business. Capital investment and working capital investments can be done with Awqaf funds.

After the initial phase where Zakah and Awqaf funds are collected, they will be allocated for financing that is compliant to the Shariah principles. More often than not, these Islamic MFIs would use the Mudarabah mode for capital investment. The profits generated will be given on a pro-rate agreed basis. Alternatively, the Murabahah mode is preferred for funding the working capital because then short-term credit is utilized in an appropriate way and consistent revenue can be gained through the fixed fee during the early years.

The uses of funds generated from the integration model are to provide credit to micro-businesses for capital investment and working capital. The Zakah funds can be used for non-redeemable capital investment with no return. The working capital credit is given based on the Murabaha model. This is only given when the institution has built its reputation, talent pool and accounting principles.

In some countries where they do not enforce on Zakah which has led to difficulty for collection in the initial phase, funds can be collected through Awqaf instead. Afterwards, Islamic MFIs may give higher attention on microfinance.

7. Critical Analysis between models

Table 1. Critical Analysis between Models

	ORGANIZATION AL AND MANAGERIAL STRUCTURE	Classification of Funds	WORKING PRINCIPLES
MODEL A: WAQF BASED MODEL	Follows the dynamics of a group based lending strategy	Awqaf Fund i.e monetary waqf fund	Islamic contracts are widely used in this model Clear repayment and disbursement techniques are used. The existence of people who are able to provide funds Availability of skilled professionals.

## Journal of Economic and Social Thought

MODEL B: ZAKAH AND AWQAF MODEL	MonzerKahf's model consists of donor and the social environment	Awqaf and Zakah funds, i.e two distinct accounts/source s of funds	Requires prudent staff Various Islamic finance contracts can be adopted but particularly pertaining to Awqaf and Zakah, they should follow the principle of tamlik combined with the spirit of Zakah.
MODEL C: INTEGRATI ON OF ZAKAH AND AWQAF MODEL	In Kabir Hassan's model the main providers and distributors of funds are privatized NGO's.	Zakah and Awqaf. funds	Require affluent prudent staff Require professional accountants and bankers Follow a defined selection process when customers are selected

It is clearly understood that all models have adopted a basic foundation taught in Islam for overall economic development i.e the distribution of wealth via means of Zakah and Awqaf. The common principles found in these models are envisaged from the frameworks of Zakah and Awqaf respectively, aside from the main principles underlined by the Shariah. The three models are concluded to address common issues which are creating economic stability, providing funds to the productive poor and ensuring funds to be channeled to those that need them the most.

The differences found evidently in these models are in terms of their structures and sources of funds. Waqf-based model appears to be appealing to a certain group of people as long as they can provide the funds. This model emulates the concept from based lending groups. However, its unique feature is by adopting the corporate method of utilising monetary waqf. Hence, the source of funds is from the monetary waqf fund and no Zakah fund is involved. The fund is to be invested and the returns to be given for the purpose of micro-financing.

The source of funds for Model B (Zakah and Awqaf) and Model C (Integrated model of Zakah and Awqaf) are the same i.e Zakah and Awqaf funds. However, in the latter model, the funds can be consolidated whereas for the former, there are two separate accounts dedicated for each Zakah and Awqaf funds. It is interesting that despite the two main mechanisms of Zakah and Awqaf are the same for these two models, the structures are clearly dissimilar. It appears that Model B is more flexible and an appeal to a wider group of contributors as they consist of donors and the social environment. In contrast, Model C is more confined to providers and distributors that are privatized. In other words, the organisations involved are from private sectors and not under auspices of any government bodies.

Apart from the common principles found in these models, the challenges are seen to be similar as well. The challenges faced are inter alia, the limited scope of knowledge among Islamic microfinance institutions and absence of proper guidelines. It is noteworthy to point out that the issue of acquiring talented workforce still remains a major test of time. From an organizational perspective, the use of accounting and auditing policies and procedures are very vital, hence the need for professional accountants, Islamic bankers and auditors are inevitable for the future sustainability of this industry.

More often than not, these Islamic micro financial institutions (MFIs) are not widely dispersed and do not reach or cater to a wider geographical reach. This might cause lack of proper distribution of funds and wealth and hence, creating economic instability. The lack of clear communication that channels

## Journal of Economic and Social Thought

both internally (between management and donor) as well as externally (between payers and payees) could pose potential threats in terms of contacts and agreements.

### *7.1. Islamic Microfinance and Poverty Alleviation*

One method in Islamic microfinance that can be used for poverty alleviation is by adopting existing successful initiatives introduced by NGOs and other private organizations in places like Syria, Sudan and Bosnia and Herzegovina where it has shown that the use of Islamic microfinance mechanism is not expanding in the Muslim world but also global regions. In order to make Islamic microfinance a better preference, institutions should follow the principle of risk sharing. This element underlies individuals sharing potential risks between investors and clients making Islamic microfinance more attractive for borrowers who will not carry larger risk as compared to many conventional products.

Additionally, Islamic microfinance promotes the principle of profit sharing whereby the lending institution is no longer a sole financier but becomes the co-owner of the business with a strong interest in its success. Moreover, Islamic microfinance products have a fixed repayment rate with no possibility of making profit through interest.

Islamic microfinance stipulates contracts with a fixed liability that is known to the customer upfront. Hence, the ultimate goal of Islamic microfinance modalities is to ensure growth with equity for social welfare and justice. In line with this principle, sharia-compliant financing foresees that, in a context of default, the penalty is limited to no more than 1 per cent of the outstanding instalment.

These terms and conditions, aiming to safeguard social welfare and justice, make Islamic finance products a viable alternative to conventional lending (Mahaini, 2012) stated that,

In the Sudan, ABSUMI is scaling up the initiative by establishing six new units between 2012 and 2013 with the objective of reaching 150,000 households over five years and mobilizing US\$10 million of savings. In Azerbaijan, the Integrated Rural Development Project, cofinanced by IFAD and Islamic Development Bank (IsDB), is currently introducing sharia-compliant instruments in the regions of Agdash, Oghuz, Sheki and Yevlakh. IsDB provided US\$65 million under the *istisna'* a modality for irrigation schemes and US\$2 million in the form of *qard al Hasanto* support resources earmarked for microcredit services.

In view of the above, microfinance is widely accepted globally but there is still room for enhancement which could help to reduce poverty problems and eventually elevate the overall economic development. A large part of microfinance's notion is essentially not contradicting with the Shariah. There are only certain substantial differences need to be moulded with Islamic finance principles such as financing methods based on benevolent loans and not charge with interest. As such, a proper and equitable distribution can be materialized and ultimately able to address poverty issues encountered in many Muslim countries. Islamic microfinance is not only confined to reducing poverty but serves with greater purpose of protecting social welfare and justice. By complying with Shariah principles, bigger success and happiness (*al-falah*) as Muslims can be attained in the world hereafter.

### *7.2. Awqaf and Zakat funds as a tool for Overall Economic Development*

## Journal of Economic and Social Thought

As mentioned in the earlier section, poverty alleviation can adopt the mechanisms prescribed in divine revelations i.e. Zakah and Awqaf. They are not intended solely to alleviate poverty but to complement an effective system for overall economic development. It is to be noted that two-folds can be examined when Awqaf and Zakah-based funds are used as tools for economic development. It has been proven above that both models are designed to alleviate poverty. The first fold is through macro-economic development while the other is at a micro economic level. Both aspects must be dealt concurrently and they are very much inter-related.

At a micro-economic level, specialized companies should be created for collecting zakah and awqaf funds. Once these funds are collected, organizations should ensure that these funds are channeled properly. It is imperative for this level to be managed effectively by individual institutions (or could be referred to as the institutional level). This is treated as a pre-requisite before embarking on the bigger landscape at a macro-level. As such, a proper guideline or framework needs to be established so that there would be a uniform practice and operations done at different institutions. By addressing this fundamental stage, this would ease the overall system at the macro level.

On the other fold, macro level, policies, procedures and regulatory systems should be created in order to achieve national level cooperation's. The central organisation for Muslim countries such as Islamic Development Bank (IDB) and other Islamic Financial Institutions are responsible for decision making and policy development should create training and human development schemes where large pools of talented workforce can be induced into the economy hence creating a positive environment for microfinance agencies and institutions to develop and grow.

In addition, governments also must play their roles wherein they should create national strategies by embedding the principles of Awqaf and Zakah to eliminating poverty. Recently, it is observed that governments have intervened the functions and operations of most microfinance properties in order to protect them from corrupted individuals. Furthermore, governments are required to create an explicit link between the objectives and benefits of the models and the countrywide policy for comprehensive human development that sets measurable indicators and priorities.

The models are comply with the teachings of Islam and are hence Shariah compliant. Hence, a need for prudent Islamic finance experts is inevitable. Additionally, since all these funds are used for the overall development of the society, it is only recommended that these models be incorporated into the national comprehensive human development policy.

### 8. Conclusion

It is undeniable that development of the Islamic Microfinance sector is a paramount consideration to both developing as well as developed nations. The first phase is to alleviate poverty which is relatively rampant in most Muslim countries and followed by the enhancement of overall economic development. This study concludes that Islamic principles for microfinance are all-rounder which covers overall economic and financial aspects by providing various tools as prescribed in divine provisions. Zakah and Awqaf are essentially the tools to create economic stability by having a proper channeling of funds to people who are in need. As such, this can bridge the gap between the poor and the rich equitably.

## Journal of Economic and Social Thought

Nevertheless, there are many aspects of Islamic microfinance particularly devising Zakah and Awqaf models as sources of fund are still lagging. For instance, there is a need to establish microfinance global guidelines pertaining to governance for the credibility of MFIs and for supporting sustainability and scaling up operations. Hence, there is a need for an explicit link between the objectives and benefits of the models and the countrywide policy for comprehensive human development that sets measurable indicators and priorities. In general, most microfinance institutions are crippled because of high administrative costs which render the overall operations becoming more expansive and the purpose meaningless. One of the ways which could curb this problem is to ensure that some components of the costs are absorbed through subsidization. Alternatively, proper and comprehensive standards on Islamic microfinance can be prepared and implemented in order to bolster the efforts of the IDB for poverty alleviation and rural development creating room for economic and social development. This is in line with the suggestion made by the IDB president to the Islamic Financial Services Board, an international standard-setting for Islamic finance industry.

### Notes

- <sup>1</sup> Microfinance is also known as “Microcredit”
- <sup>2</sup> NGOs can be privately or publicly administered
- <sup>3</sup> (Brugnoni, 2011) “A gap wide open” page 37
- <sup>4</sup> Conventional microfinance is a non Islamic microfinance scheme used by non Muslims countries; It doesn’t satisfy the domain of Islam
- <sup>5</sup> M Kabri Hasan “Weaknesses of Conventional Microfinance pg:270
- <sup>6</sup> BLR stands for *Base Lending Rate*. This is rate is set by banks and monitored by the state bank
- <sup>7</sup> Market based for profit sharing is a terminology used by researchers to emphasis on a new model whereby institutions join partnership with customers
- <sup>8</sup> The plural of waqf is awqaf
- <sup>9</sup> Funds devoted purely for the sake of charity
- <sup>10</sup> Monetary Waqf for short is often abbreviated as MW and is also known as cash waqf
- <sup>11</sup> Adapted from Majid Khademolhoseini on Corporate-Cash Waqf Model

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