RISK MITIGATION AND FINANCING CONSTRAINTS: TOWARDS THE DEVELOPMENT OF SUSTAINABLE ISLAMIC MICROFINANCE INSTITUTIONS IN BANGLADESH

Hameedah Muhammad*

I. INTRODUCTION

Studies on Islamic microfinance sustainability and its development are an important contribution to thought in the Islamic finance arena. The concept of Islamic microfinance is relevant given the global socioeconomic problems which have negatively impacted the Muslim ummah (community) and society in general and widened the gap between the poor and the rich. The Muslim ummah is in need of an economy that will bridge the gap between the various strata of society. Islamic microfinance is considered an alternative Sharī‘ah-compliant tool for Muslims to redistribute their wealth in a way that will make the nation productive.

This study tries to address two main issues that affect the sustainability of Islamic microfinance institutions (IMFIs), namely, the financing constraints faced by these institutions and the issue of customer default. Studies show that due to the lack of sufficient funds in IMFIs, the institutions have had limited reach to their target groups as compared to their conventional counterparts. In addition, this has also affected their financial performance (Ahmed, 2002; Abdul Rahman & Dean, 2013). On the other hand, borrowers may face unexpected circumstances such as illness, death, fire or theft that may cause setbacks in settling their debts. Such probable issues and risks are defeating the reasons for the establishment of IMFIs and affecting their sustainability (Siti Khadijah et al., 2013).

* Hameedah Muhammad has successfully completed a Master of Science in Islamic Finance at the International Centre for Education in Islamic Finance (INCEIF), Malaysia. She can be contacted at hameedah1@hotmail.com.
In view of the above, this paper proposes an innovative model for IMFIs in Bangladesh to obtain a source of perpetual funding and mitigate the risk of default by getting different financial institutions and other corporations to work together. These institutions are involved in activities relating to *waqf* (endowment), *zakāh* (charitable giving), *qarḍ hasan* (interest-free loan), corporate social responsibility (CSR) and micro-*takāful* (micro-insurance) (Mohsin, 2015; Alhabshi, 2016).

II. RESEARCH OBJECTIVES

The specific research objectives are:

(i) to utilise funding from cash *waqf*, *zakāh*, CSR and other charitable donations to create a perpetual source of funds that will overcome the financing constraints of IMFIs in Bangladesh; and

(ii) to integrate the concepts of *zakāh* and micro-*takāful* within the model to mitigate the risk of customer default.

III. RESEARCH METHODOLOGY

The paper primarily adopts the qualitative research methodology to achieve the abovementioned research objectives. The study undertakes a content analysis of the current literature as well as examines the annual reports of the two main Islamic banks in Bangladesh, namely Islami Bank Bangladesh Limited (IBBL) and Social Islamic Bank Limited (SIBL), for the period 2010 to 2015. These two were the first Islamic banks in Bangladesh to introduce cash *waqf* and CSR schemes, and they also began to offer Islamic microfinance in different parts of the country. The paper thus examines the current practice and performance of these two financial institutions and the challenges that they are facing. It also deploys a set of questionnaires to study the feasibility of applying the proposed model for IMFIs in Bangladesh.
IV. THE PROPOSED MODEL: DEVELOPMENT OF A CORPORATE *WAQF* TO PROVIDE PERPETUAL FUNDING TO IMFIs

The purpose of this model is to overcome the financial constraints of IMFIs and to mitigate the risk of customer default. Islamic microfinance in Bangladesh is mainly offered by two Islamic banks: (i) the Islami Bank Bangladesh Limited (IBBL), which introduced the Rural Development Scheme (RDS), a Sharīʿah-based microfinance programme; and (ii) the Social Islamic Bank Limited (SIBL), which introduced the Family Empowerment Islamic Microfinance Programme.

The abovementioned Islamic banks provide cash waqf and CSR schemes, and they also collect *zakāh* from clients, bank employees and other subsidiaries, which is used in funding microfinance activities. However, after analysing the banks’ annual reports, it is noted that each type of fund used for microfinance activities is managed separately by the banks. The proposed model suggests institutionalising the funds obtained from cash *waqf, zakāh, CSR* and other charitable donations (if any) and investing it to generate a perpetual fund to support Islamic microfinance schemes offered by the banks.

It is proposed that the Islamic banks invite their clients, employees, subsidiaries and other corporations to contribute their cash *waqf, zakāh* and CSR funds and establish a main foundation or trust which will act as a trustee that will be responsible for managing and investing the accumulated funds. This structure is known as a corporate *waqf*. The Islamic banks will be known as the main founders of the foundation/trust fund, and other parties such as subsidiaries or other corporations that contribute to the trust fund will be known as the co-founders (Mohsin, 2015). Figure 1 below illustrates how the foundation is set up through a collection of funds from different parties.

To obtain this perpetual source of funds, the trustee needs to invest the accumulated fund rather than channelling it directly to the IMFIs to finance microfinance activities. In addition, the trustee needs to ensure that maximum profit is generated by investing the funds in Sharīʿah-compliant investment schemes.
Figure 1 further illustrates how the profit generated from the investment of the fund would be allocated:

(i) Ten percent would be considered as the management fee for the trustee. This would help the trustee to cover the processing cost and any other applicable costs;

(ii) Twenty percent would be re-invested to ensure the income-generation process; this is known as a Self Financing Device (SFD); and

(iii) The remaining 70 percent would be channelled to the IMFIs to finance the Islamic microfinance programmes operated by the two banks.

The Sharīʿah-compliant microfinance programme would have two categories of beneficiaries from the fund:

(i) The poor and needy (known as the non-bankable). This category would receive the funds in the form of *qarḍ ḥasan* (interest-free loans). Since this category is more eager to receive such loans, the Islamic microfinance programmes can allocate 40 percent from the amount being channelled from the profit to support this group of people. However, it is important to ensure that the loans received by the clients are for the purpose of generating income and not for consumer purposes. The loans, for instance, can be used to purchase machines or cattle or any other asset based on the skill-set of the loan recipients.

(ii) Micro, Small and Medium Enterprises (MSMEs). The purpose of integrating this group is to improve their socioeconomic conditions. Meanwhile, it helps low-income families to obtain additional financial support to expand their existing small enterprises as they are generally not qualified to obtain such financing from SME banks. This category of beneficiaries would receive the financing through Islamic investment modes such as *murābaḥah*, *muḍārabah* or *mushārakah*. 
To address the issue of customer default in microfinance programmes, the concept of micro-takāful and the share of debtors from zakāh can be used to overcome such constraints. For the first group of beneficiaries (the poor and needy), the main founder can instruct the trustee to keep aside a portion of the zakāh fund (the share of debtors) and channel it to the Islamic microfinance scheme in case of customers’ default.

However, in the case of MSMEs, micro-takāful schemes can be introduced to mitigate the risk that clients are vulnerable to. The clients, however, need to provide a small premium from the profit generated from their investment for the micro-takāful operator to cover the risk elements.
V. POTENTIAL BENEFITS AND CHALLENGES OF THE MODEL

The successful implementation of this model can bring forward immense potential to generate income, reduce the risk of default and support social welfare activities. Among these advantages are:

(i) Humanising financial services: The lower income people and the non-bankable would be able to get access to credit. In addition, they would be empowered through the scheme of qarḍ ḥasan to initiate their own start-ups.

(ii) Lending through qarḍ ḥasan: Generally, it is unlikely that there would be a successful implementation of qarḍ ḥasan in IMFIs. This is due to the risk that banks are unwilling to bear in the case of default of the participants; it is also due to the shortage of funds faced by IMFIs to provide such loans. This model, however, makes it possible to lend at zero interest as the element of zakāh would mitigate the risks faced by the banks.

(iii) Clients under the MSME scheme would avoid the huge risks they are vulnerable to by participating in micro-takāful schemes.

While developing the model, Islamic banks and IMFIs might face the following challenges:

(i) The Bangladesh Waqf Act (ordinance of 1962) is considered a poorly drafted law in the face of the present day need. Many of its important provisions do not incorporate the modern practice of waqf.

(ii) While analysing the case of Islamic banks in Bangladesh, it was observed that one of the sources of CSR in SIBL came from Sharīʿah non-compliant earnings. Thus, banks need to purify their sources of funds and ensure that such elements are not included in the corporate waqf model.

(iii) The concept of cash waqf is not acceptable to many Muslims in Bangladesh. This is due to the belief that waqf is limited only to religious sectors. Awareness needs to be created among Muslims on the potential benefits of cash waqf to the economy.
(iv) The trustee should have knowledge not only in Sharīʿah but should also include people who are well aware of finance, investment, CSR, waqf, microfinance, marketing and management. Extensive training and knowledge should be provided to the trustee to be able to manage, invest and distribute the fund efficiently and effectively.

(v) Micro-takāful in Bangladesh is not regulated; thus, there is a need to establish guidelines or rules for the operators to follow.

VI. CONCLUSION

Financing constraints faced by IMFI s and the issue of customer default might defeat the overall purpose of IMFI s in empowering people and eradicating poverty. The purpose of this research is to address these two main issues that affect the sustainability of IMFI s and present a model of corporate waqf by getting different financial institutions and other corporations to work together to overcome the constraints of offering Islamic microfinance. The model presented in this paper incorporates sources of social funds which are economically free and dedicated to empowering the poor and eradicate poverty. By institutionalising funds generated from cash waqf, zakāh, CSR and other charitable donations, a perpetual source of funds can be established to support IMFI s. Furthermore, to mitigate the risks faced by MSMEs, the model proposes the use of micro-takāful while the risk of default arising from the poor and needy can be mitigated by the utilisation of zakāh funds.

References