



Advancing financial access for the world's poor

Building a Successful Business Model for Islamic Microfinance

New York, October 21, 2011

Agenda

- The Demand/Supply Gap for Islamic Microfinance
- Islamic Banking/Finance: Background
- Why it did not reach scale yet?
- Islamic MF challenge 2010
- A new Business Model

CGAP: At a glance

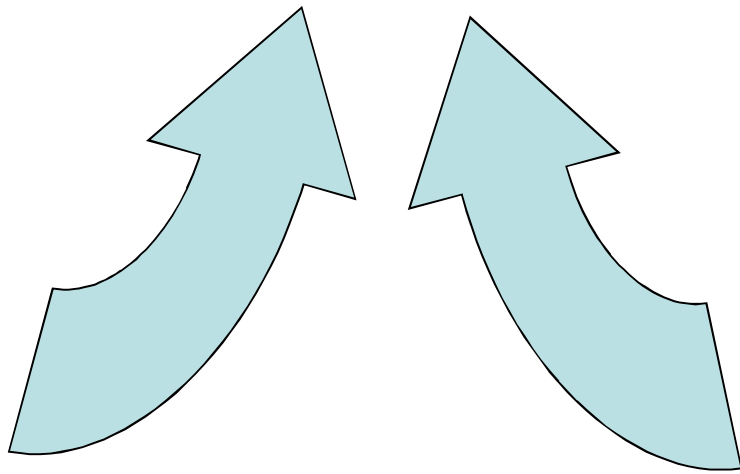
- **An independent policy and research organization**
- **Dedicated to expanding access to finance for poor people**
- **Housed at the World Bank, but operates as an independent entity**
- **Reports to its 33 members** – membership is composed of bilateral and multilateral development agencies, regional development banks, private foundations and international financial institutions
- **Composed of 50 staff, with an annual budget of \$28 million and work in over 70 countries**
- **Has offices in Washington DC and Paris, with 5 regional representatives** based in Abidjan, Nairobi, Dhaka, Moscow and Jerusalem

Convergence of two growing industries

ISLAMIC MICROFINANCE An Emerging Market Niche?

- Grameen Bank Bangladesh
- 44% of world's microfinance clients in Muslim majority countries
- Vibrant industries in Indonesia, Pakistan

- 500 Sharia compliant institutions
- 75 Countries
- \$500.5 billion in assets (2007)
- 100 largest enjoy growth rate of 27% (19% for conventional)

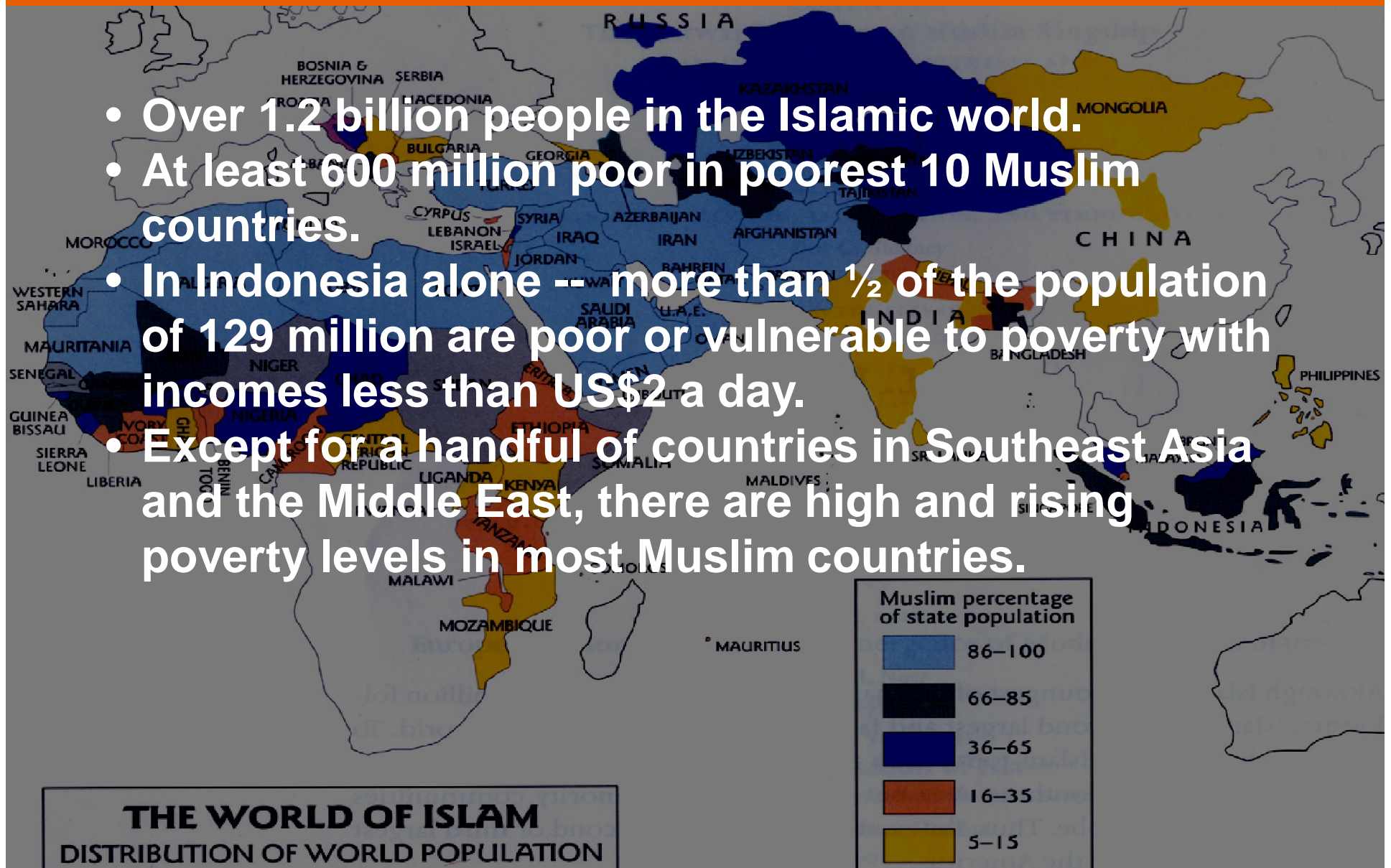


MICROFINANCE

ISLAMIC FINANCE

Poor in Islamic World

- Over 1.2 billion people in the Islamic world.
- At least 600 million poor in poorest 10 Muslim countries.
- In Indonesia alone -- more than ½ of the population of 129 million are poor or vulnerable to poverty with incomes less than US\$2 a day.
- Except for a handful of countries in Southeast Asia and the Middle East, there are high and rising poverty levels in most Muslim countries.



Islamic Microfinance: Why?

72% of people living in Muslim-majority countries do not use formal financial services.



Islamic Microfinance: Supply

Islamic microfinance makes up $\frac{1}{2}$ of 1% of microfinance outreach

- 300,000 individuals
 - 1/3 of which located in Bangladesh
 - 80% in Bangladesh, Indonesia & Afghanistan
 - An additional 80,000 served by Indonesian cooperatives
- Small percentage of microfinance market
 - Syria 3%, Indonesia 2%, Bangladesh 1%

The Demand/Supply Gap

Demand for Islamic finance by the poor:

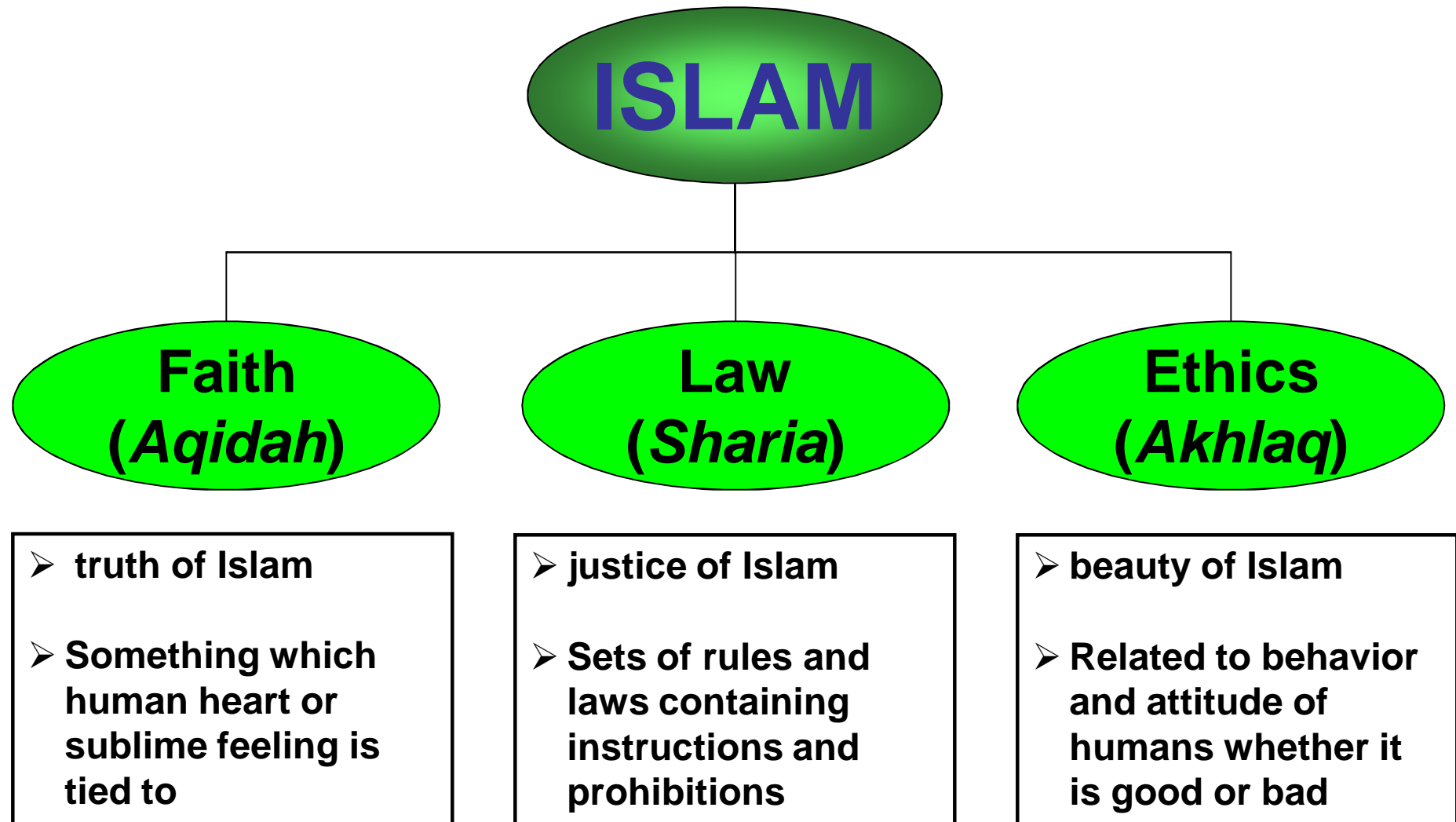
- In Algeria and Jordan, approximately 20% of the poor cite religious reasons for not seeking conventional microfinance,
- In Yemen and Syria, this percentage rises to 40%.
- Local practitioners and key informants suggest similar demand trends in Indonesia, Afghanistan, Pakistan, and the Palestinian territories, and also in Muslim majority areas of India, Sri Lanka, Brunei, Cambodia, and the Philippines.

Supply of Islamic finance for the poor:

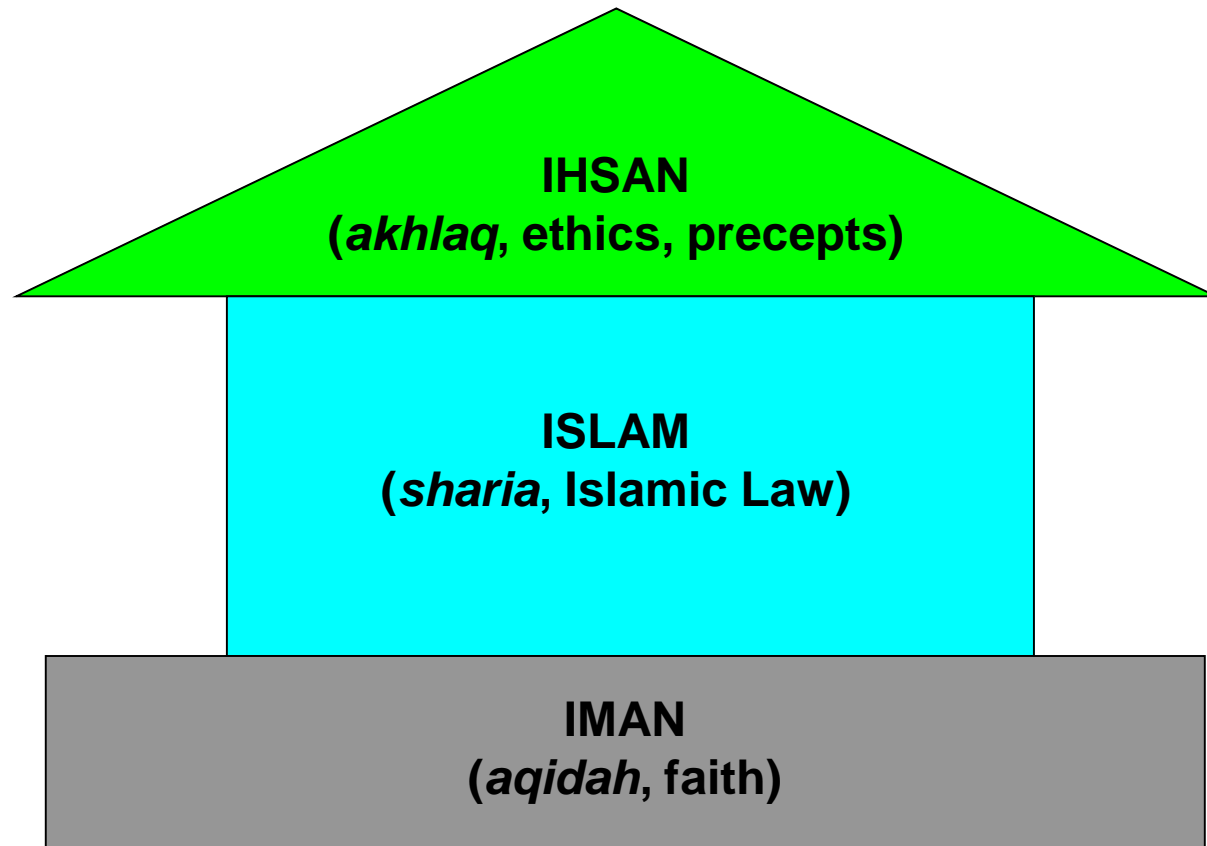
- Islamic microfinance makes up ½ of 1% of microfinance outreach
- Islamic mf is concentrated in only a few countries (80% of the 380,000 clients of Islamic microfinance worldwide are in Bangladesh, Indonesia, and Afghanistan)

This large gap in demand and supply gives rise to an acute need for the industry to develop viable business models

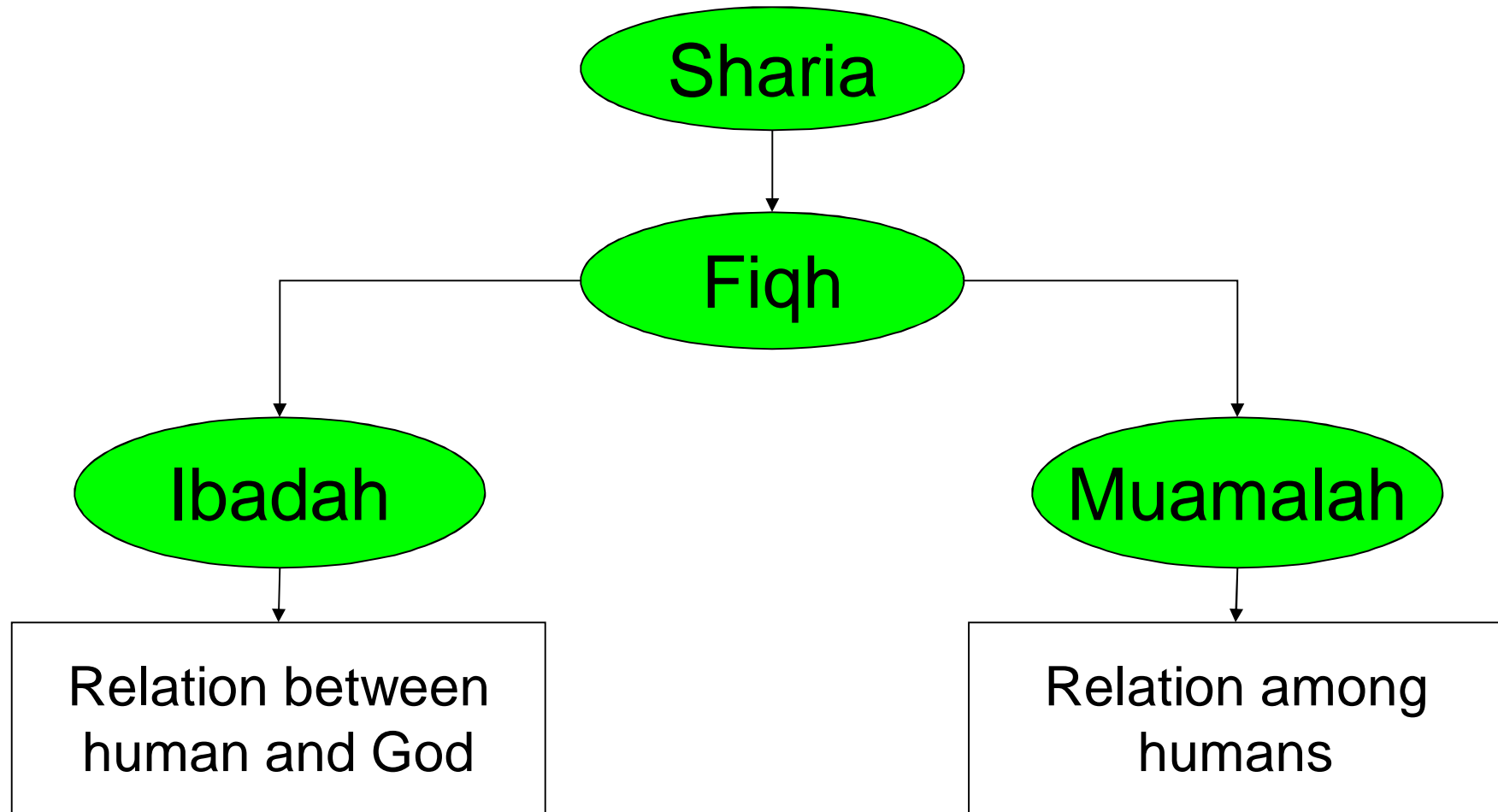
Coverage of Islam



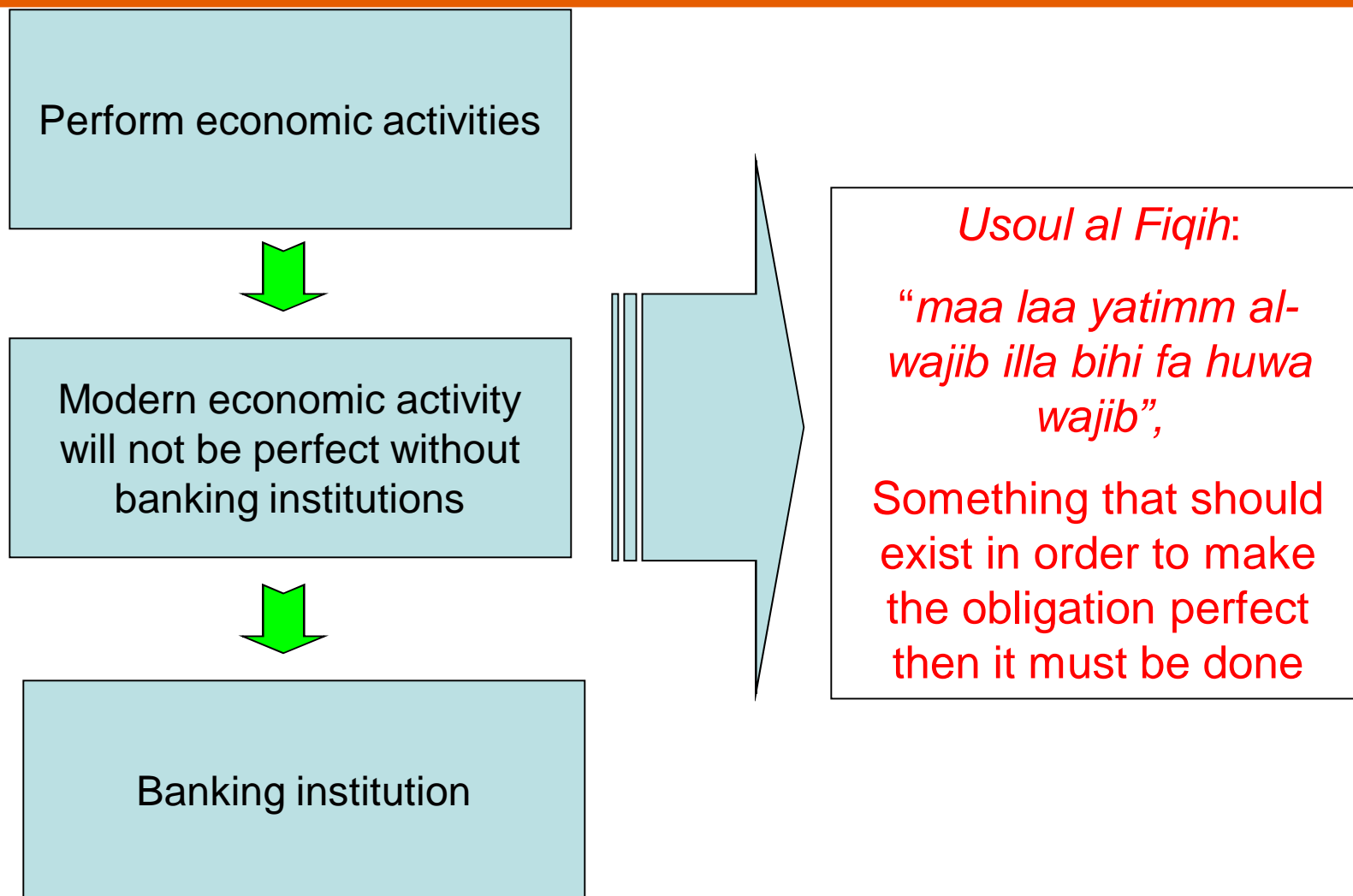
Foundation of Islam



Sharia and Fiqh Relationship



Islamic Banking

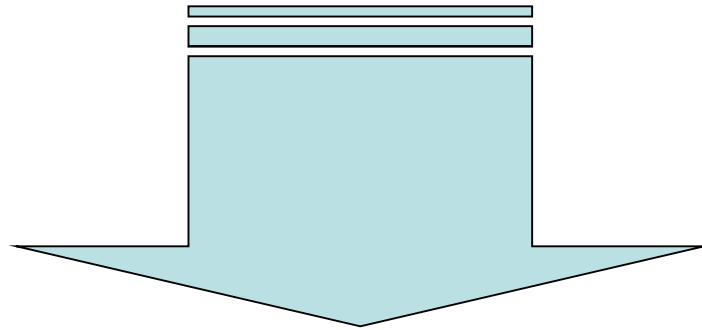


Islamic Banking

is part of **muamalah**, Alqur'an and Sunnah doesn't give detail instruction about this issue and only states:

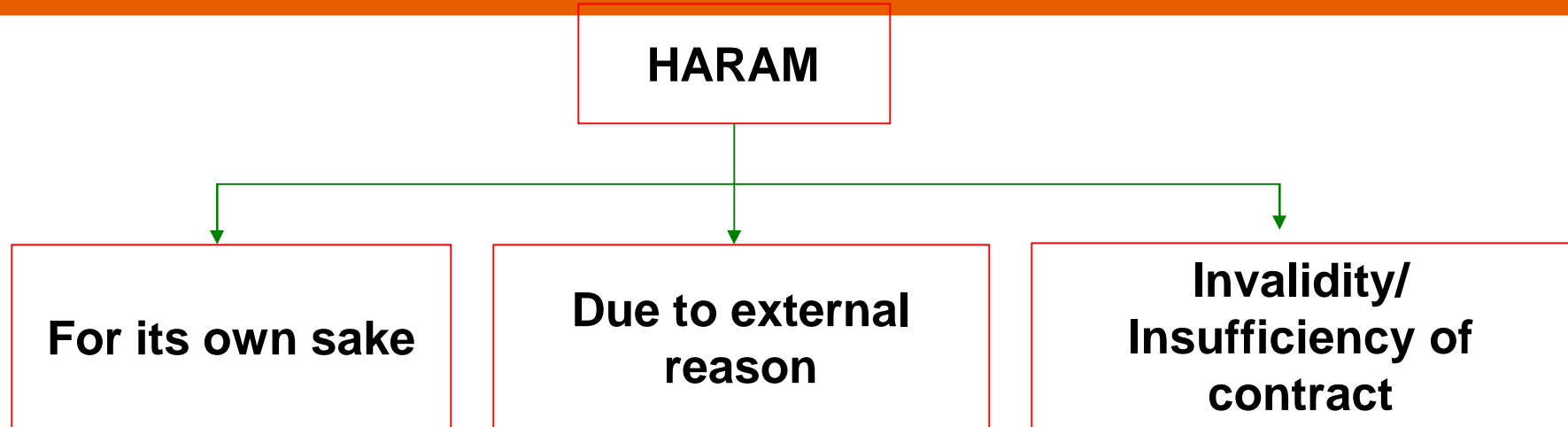
- **Principles and basic philosophy, and**
- **Forbidden actions**

“antum a'lamu bi umuri dunyakum”

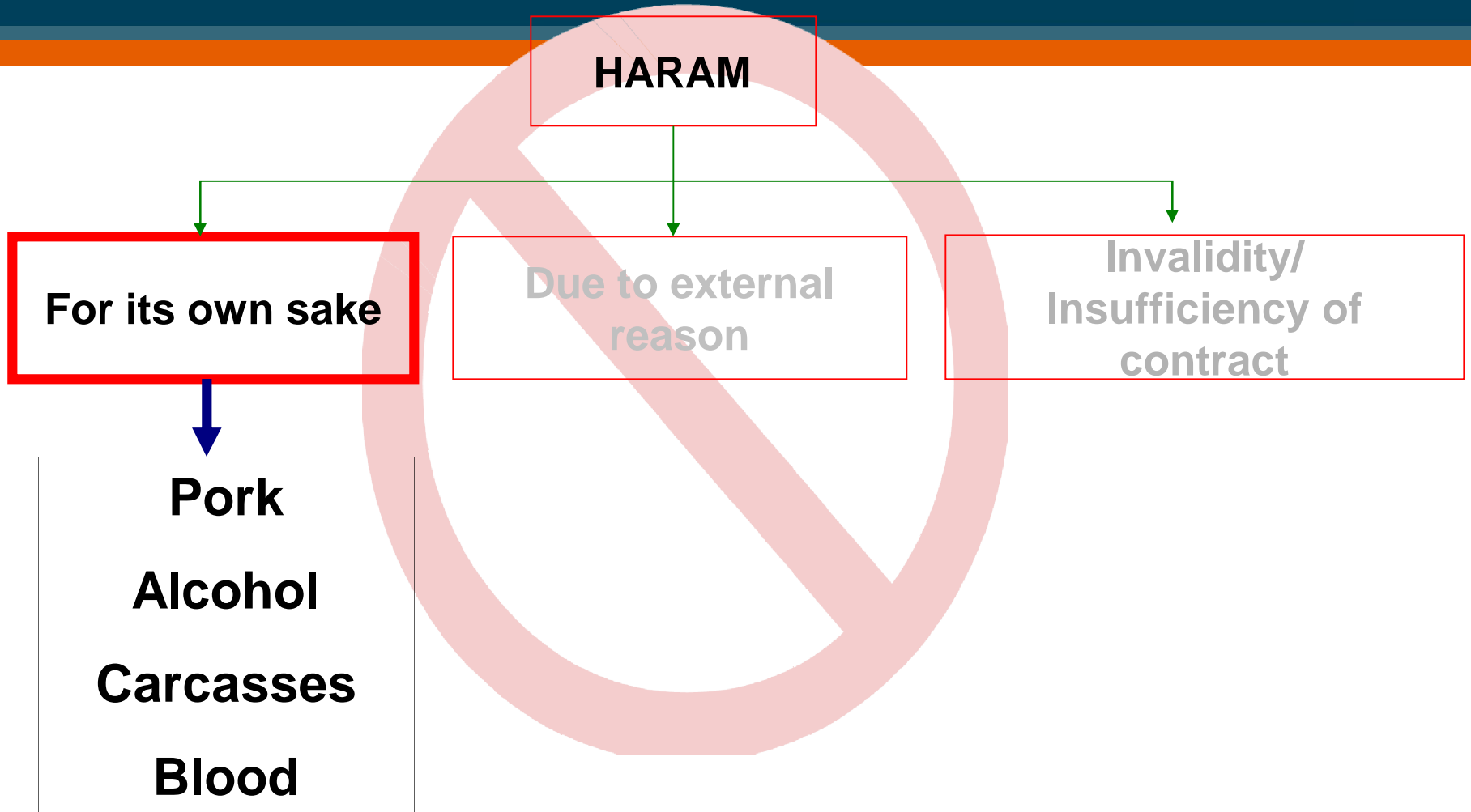


It is our job to **identify** things which are **prohibited** by Islam,
while for other things, we can be **innovative** and **creative**

FACTORS CAUSING HARAM



FACT REASONS CAUSING HARAM



FACTORS CAUSING HARAM

HARAM

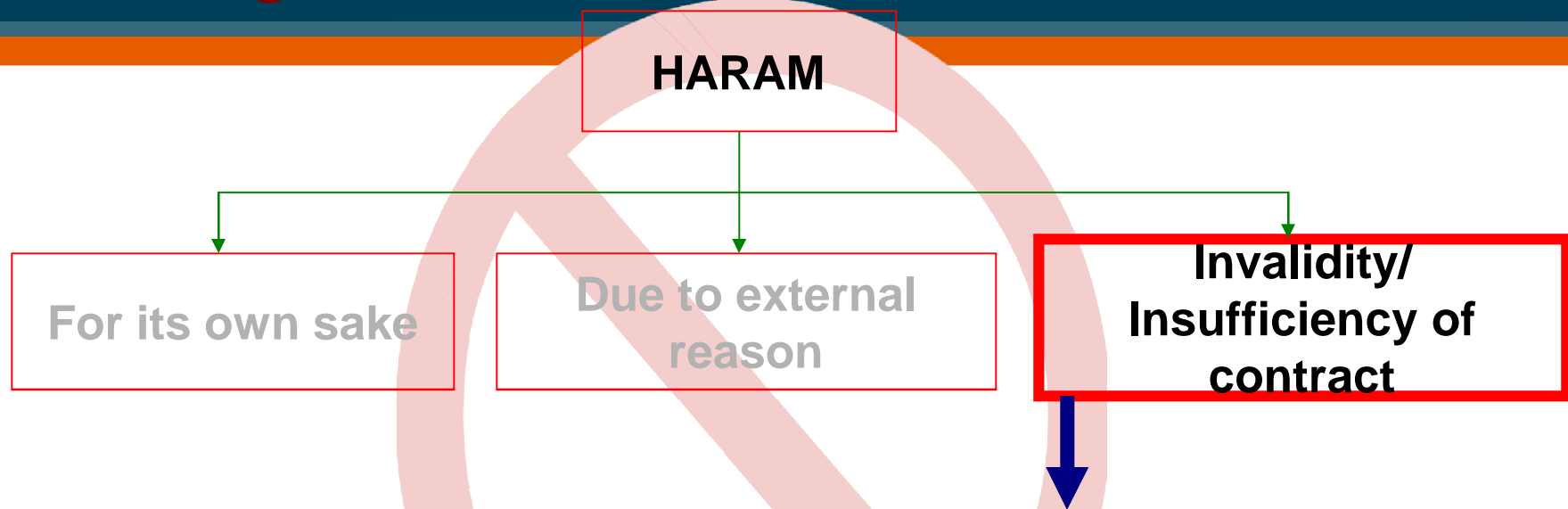
For its own sake

Due to external reason

Invalidity/
Insufficiency of
contract

- **Tadlis** - Concealing
- **Taghrir (Gharar)** - (certain → uncertain)
- **Ihtikar** - market fraud on Supply side
- **Bai'Najash** - market fraud on Demand side
- **Riba** – usury in goods or lending
- **Maysir** – gambling
- **Rishwah** – Bribery or Corruption

FACTORS CAUSING HARAM



1. Non fulfillment of Rukun and Shorout

Rukun – must be - parties/doers, an object and mutual agreement

Shart – conditions of sufficiency legality of above

2. Occurrence of Ta'alluq

two related contracts such that application of 1 hinges upon the other

3. Occurrence of “two in one”

one transaction, two concurrent contracts arising in uncertainty (lease/Buy)

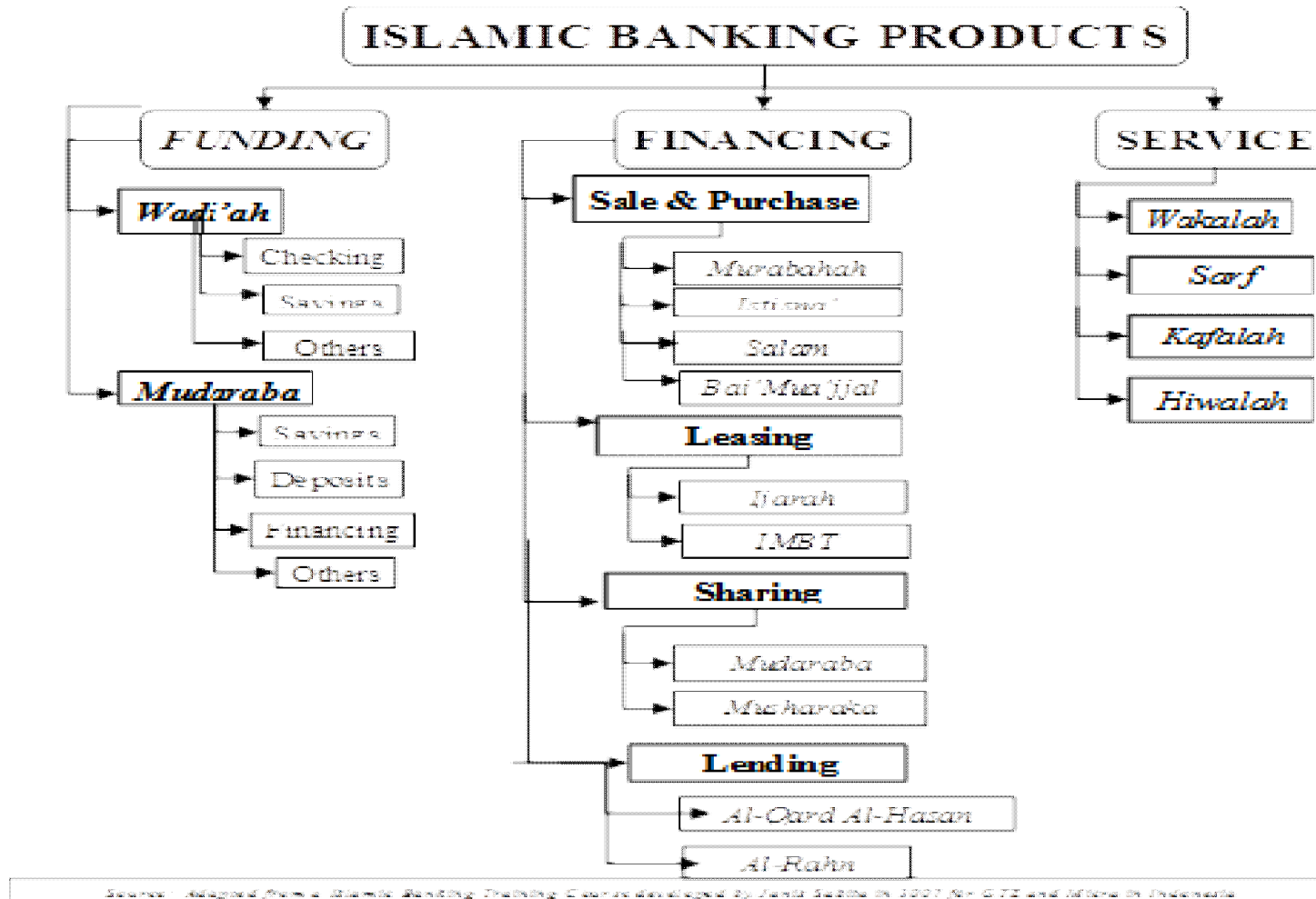
Islamic Finance System: Basic Principles

1. Prohibition of Interest (riba)
2. Risk Sharing
3. Money as “potential” capital
4. Prohibition of speculative behavior
5. Sanctity of contracts
6. *Shariah* approved activities
7. “Short selling” is impermissible

ISLAMIC BANKING PRODUCTS

SERVICE	FINANCING	FUNDING
Wakalah (Procuration)	Trade/Exchange -Murabahah (cost plus mark up) -Istishna -Bai' Salam and Bai' Salaf (forward sales contract) - bai' mua'jjal (differed payment)	<u>Wadiah</u> -Current/checking account, -Savings Account, -Others
Sarf (Money Exchange)	<u>Leasing</u> -Ijarah (Leasing) -IMBT(Lease to Own)	<u>Mudharabah</u> -Deposits Account, -Savings Account, -Other funding Account
Kafalah (Insurance)	<u>Profit Sharing</u> -Mudharabah -Musyarakah	
Hiwalah (money transfer)	<u>Qardul Hasan</u> (Benevolent Loan)	

Islamic Banking Products



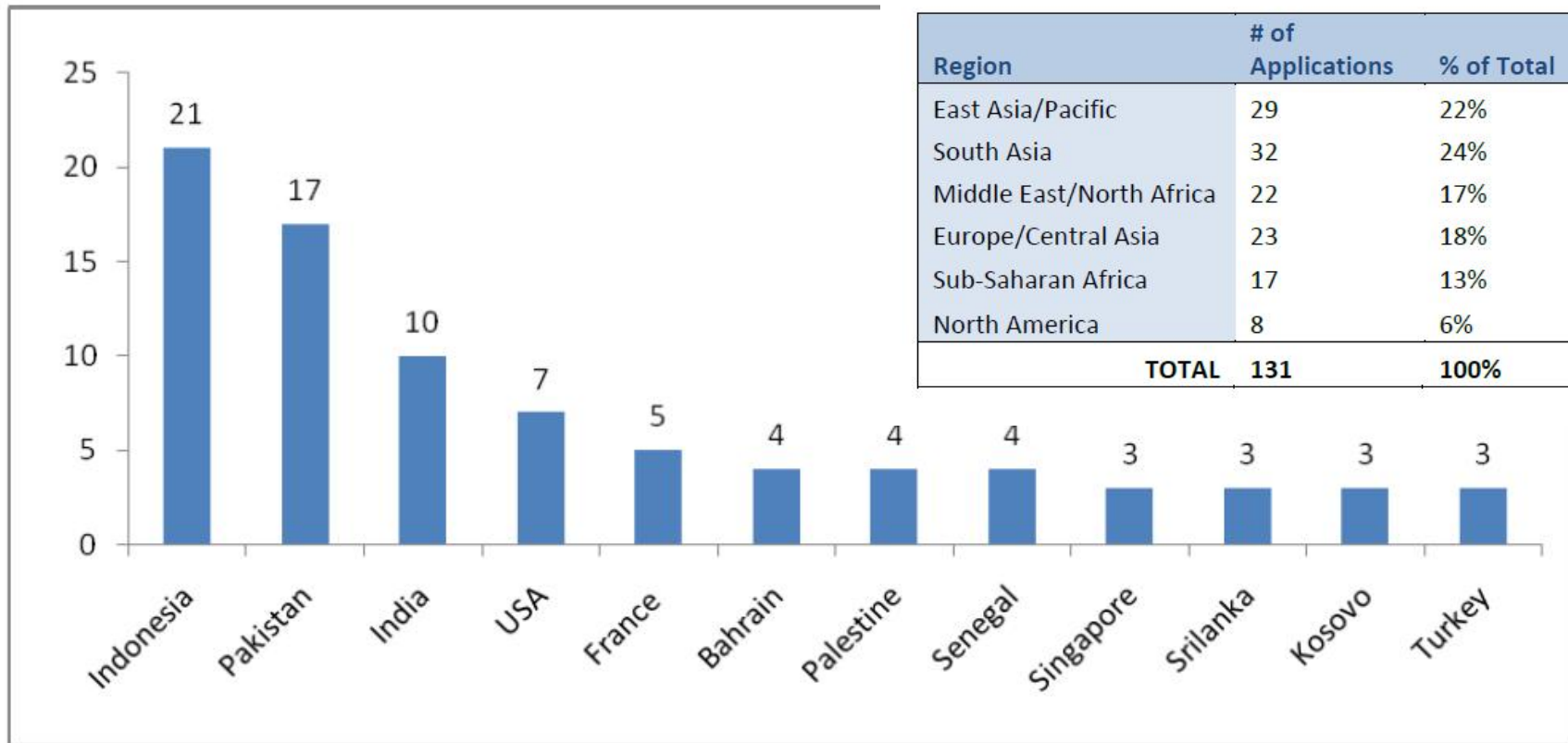
Background of Competition

The Islamic Microfinance Challenge 2010 is a joint project of CGAP, Deutsche Bank, Grameen-Jameel, and Islamic Development Bank

- Project Duration: February 2010 – February 2011
- Objective: Canvass the industry for ideas for sustainable, scalable, and authentic Islamic microfinance business models
- US\$ 104,000 prize funds announced for the winner, to be used towards piloting proposed model
- Open to applicants (institutions, groups, and individuals) from all geographical locations
- Applicants were required to have the capacity to launch a pilot project of their proposed business idea

Applications Summary

Top 12 Countries by Applications Received



Regional Distribution

Region	# of Applications	% of Total
East Asia/Pacific	29	22%
South Asia	32	24%
Middle East/North Africa	22	17%
Europe/Central Asia	23	18%
Sub-Saharan Africa	17	13%
North America	8	6%
TOTAL	131	100%

Winner - Al Amal Microfinance Bank Sana'a, Yemen



Institution type: Al Amal Microfinance Bank is the first microfinance bank in the Arab world to offer only Shariah-compliant products.

Outreach: Operating for just over two years, the bank has 15,000 active borrowers and 20,000 savers, and has captured over 25% of the Yemeni microfinance market.

Business idea: Al-Amal Bank established the first microfinance investment fund, which provides investment bonds the bank utilizes to finance people with low income and small businesses. The bank is planning to have 100,000 active borrowers and 250,000 active savings accounts in 2013. The bank's proposal is to introduce Ijarah (Islamic leasing).

Explanation:

- The bank will offer the leasing option, by which it would purchase equipment and vehicles needed by various professionals and lease to them.
- In order to honor Islamic law, the contract will stipulate that the bank retains ownership and maintenance responsibilities and that at the end of the lease ownership is transferred to the client.
- The bank plans to self-fund its leasing product by relying on an Islamic investment funds product.
- The bank's menu of Islamic microfinance products include group and individual financing, project, corporate, and investment financing, savings, investment funds, and insurance.

Why Hasn't Islamic Microfinance Reached Scale Yet?

- 1) A Primary Focus on Murabaha, So Far**
- 2) Very Limited Experience with Profit and Loss Sharing (PLS) Schemes**
- 3) The Result was a Very Limited Outreach**
- 4) Very Limited Financing Resources Compared to Conventional MFIs**
- 5) A Business Model, Not Another Loan Product**

Why Hasn't Islamic Microfinance Reached Scale Yet?

1) A Primary Focus on Murabaha, So Far

- Higher Price (more work, no late payment fee)
- No cash
- Rebranding/repackaging of Conventional

Why Hasn't Islamic Microfinance Reached Scale Yet?

2) Very Limited Experience with Profit and Loss Sharing (PLS) Schemes

- Requires far more involvement from MFI re the visibility of the enterprise
- Considered risky as if the enterprise fails, the MFI/Bank would lose their investment
- Microentrepreneurs do not use books which makes it difficult to know costs and revenues

Why Hasn't Islamic Microfinance Reached Scale Yet?

3) The Result was a Very Limited Outreach

Table 1¹: Outreach of Conventional Vs Islamic MFIs in the Arab World

		Year Established	# of Active borrowers	Amount of Portfolio in \$	Average Loan Balance	Year of Data
Conventional						
Morocco	Alamana	1997	339,408	292,738,781	862	2010
	Fondep	1996	132,419	80,763,280	610	2010
	Popular Bank	2000	146,566	154,048,265	1051	2010
Egypt	Lead	2003	194,392	27,769,830	143	2010
	ABA	1990	174,569	47,934,744.50	275	2010
	DBACD	1998	105,691	25,929,354	245	2010
Tunis	Enda	1995	156,854	56,227,039	358	2010
Jordan	MFW	1999	62,408	20,184,855	323	2010
Islamic						
Syria	Jabal Alhus	1999	3,328	1,143,547	344	2010
Sudan	PASED	2001	3,947	883,639	224	2010
Yemen	Azal	2002	3,462	699,268	202	2010
	Al-Amal Bank	2009	14,730	2,610,799	177	2010

Why Hasn't Islamic Microfinance Reached Scale Yet?

3) The Result was a Very Limited Outreach

Table 1¹: Outreach of Conventional Vs Islamic MFIs in Pakistan

	Year Established	# of Active borrowers	Amount of Portfolio	Average Loan Balance	Date of Data
Conventional					
Kashf Foundation	1996	313,512	44,230,466	141	2008
FMFB-Pakistan	2002	167,193	29,846,110	179	2010
Khushhali Bank	2000	409,177	50,463,122	123	2010
ASA Pakistan	2008	170,116	20,270,687	119	2010
Islamic					
Akhuwat	2001	25,880	2,290,517	89	2010
Farz Foundation	2008	84	8,221	98	2009

Prerequisites for a Business Model

- Defining Success
- Recognising that there is a problem
- How to look at Conventional MF
- Sustainability
- Thinking outside the box
- Defining the Target Group
- Changing Terminology

Some Elements of the Proposed Model

1. Market Segmentation from Day One
2. An Investor and not only a creditor
3. BDS is back on the table
4. Takaful/Microinsurance
5. Savings
6. Use of Different Financing Instruments/Contracts

Potential Social Impact/Benefits

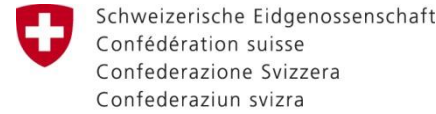
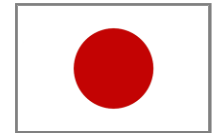
- The Ability to Target People Who Are More Impoverished
- Less Likelihood of Over Indebtedness
- More focus on productive economic activities
\Contributing to the GNI
- More Job Creation

What Else is Needed to Develop Such a Business Model?

- Deeper Market Research (demand)
- Capacity Building Activities
- Financing Pilots
- Global Financial Reporting Standards
- Benchmarks



Ministry of Foreign Affairs of the Netherlands



BILL & MELINDA GATES foundation



Swiss Agency for Development and Cooperation SDC



Advancing financial access for the world's poor

www.cgap.org

www.microfinancegateway.org



The MasterCard Foundation



MINISTRY FOR FOREIGN AFFAIRS OF FINLAND



Federal Ministry for Economic Cooperation and Development



FORD FOUNDATION

