TRUE ECONOMY PROSPERITY THROUGH POVERTY ALLEVIATION – ISLAMIC MICROFINANCE AS COMMERCIAL VENTURE

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ABSTRACT

"Lasting peace cannot be achieved unless large population groups find ways in which to break out of poverty."True/ethical Economy Development in Sri Lankacan be ***achieved through the combination of Lasting Peace plus Economy prosperity plus Business Prosperity plus Poverty Alleviation (Missing point).*** *Poverty alleviation in Sri Lanka is a big challenge due to the unequal distribution of income. The microfinance is used astool to alleviate poverty worldwide using number of diffident model. However, all the models used in all over the world are based on the traditional banking concept of interest. The interest based microfinance system has not yet been fully achieved the aim of microfinance, such as alleviating poverty, increase the quality of life, improve the self-employment, and self-sufficiency, questioning on whether microfinance is without collateral, high recovery performance of microfinancial institution and increasing the women empowerment. Based on these criticisms, this study is aimed to evaluate the impact of Islamic microfinance model in all aspect of the objectives of microfinance in Sri Lanka using case study methodology. The finding of the study shows that the beneficiaries are having their own income generating activities which has increased their income, purchasing behaviour, change their standard of living and they are happy and confident in their life. This study is further proposing the Islamic microfinance as a commercial venture. This model can be practiced by both government and non-government financial institutions and banks.*

Keywords: *Poverty, Islamic Microfinance, Commercialisation, Musharaka Model, Mudaraha Model*

INTRODUCTION

The true economic development of a countryis totally impossible while deteriorating poverty level prevails. The Scheme of Micro-finance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy. With some effort substantial progress can be made in taking MFIs to the next orbit of significance and sustainability. There is a need of designing financially sustainable models and increase outreach and scale up operations for poor in Sri Lanka. People belong to villages are still unaware about banking policies and credit system. So NGO should communicate to them and share their view with villagers. Banks should convert and build up professional system into social banking system for poor. Government should also provide support for capacity building initiatives and ensure transparency and enhance credibility through disclosures.Thus, microcredit can be made an important instrument of permanent poverty alleviation, provided the MFIs dedicate themselves to poverty alleviation with full sincerity, proper fund management, accountability and transparency.

Further, alleviating poverty is viewed as governmental or charitable responsibility. This view can be changed by breaking this barrier and proposing commercial Islamic microfinance venture. This can be developed by the best practices of existing microfinance can be combined with the principles of Sharia to create a model that equitably allocates risk between investors and the entrepreneurs without subjecting the micro-entrepreneurs to disproportionate risk. Islamic finance is predicated upon charging the relationship between borrowers and lenders to reduce inequality between the provider and recipient of capital. An interest-based financial system places the burden of repayment upon the borrower, who is obliged to repay principal plus interest (often compounding interest) whether the business for which the fund were borrowed is successful.

The major objective of this study is to evaluate the Islamic micro-financial system available in Sri Lanka and to evaluate the impact of such system on the wellbeing of the beneficiaries. Further, this study proposes such model as a commercial venture to establish in Sri Lanka.

What is Microfinance?

The supply of loans, saving, insurance, transfer services and other financial products to people who are traditionally excluded from the traditional banking system, mainly because they lack the guarantees that can protect a financial institution against a loss risk. Microfinance has been widely accepted as one of the effective and best tools to eradicate poverty.

Microfinance in Sri Lanka

The microfinance movement in Sri Lanka dates as far back as 1906 with the establishment of Thrift and Credit Co-operative Societies (TCCSs) under the Co-operative Societies Ordinance introduced by the British colonial administration. Around 65% of microcredit in Sri Lanka is provided through the government (50% of loans and over 45% of deposits). The Samurdhi Development Programme which was introduced in 1995, replacing the previous Janasaviya Programme, is the largest of these initiatives. There are 1,036 Samurdhi banks with 5 million depositors and 500,000 microloans outstanding (December 2004). Tsunami – NGO MFIs, achieving an outreach of 75,000 microfinance clients in just 4 years.

Hatton National Bank's "Gami Pubuduwa" ("Village Awakening") oldest microfinance programme among the licensed commercial banks, having been established in 1989 and disbursing over Rs. 3.5 Bn (approximately US$ 35 Mn) to around 70,000 micro-entrepreneurs over the years. For many commercial banks and finance companies, microfinance is more a Corporate Social Responsibility (CSR) or image building activity. *(Microfinance Industry Report, SRI LANKA, 2009).*

The predominance of government providers of microfinance has resulted in an inefficient system where interest rates charged are not sufficient to cover costs and repayment rates are significantly lower than non-governmental MFIs in other countries. *(Feroz, and Goud 2008).*

Type of institution	No. of outlets
RDBs	215 branches
Other licensed specialized banks Sanasa Development Bank	36 branches
Samurdhi Bank Societies	1,038 societies
CRBs & Women's Development Co-operatives	1,684
Sanasa/TCCSs	3,794 active societies
Other MFIs (NGOs/Limited liability companies/companies limited by guarantee)	2,500[10]
Total (excluding banks & other financial institutions)	**9,267[11]**

Shariah Principles in Islamic Banking

The Sharia principle in Islamic banking are (1) Prohibition of Riba (Interest or Usury), (2) Application of Trade and Commerce ('al-bay) in all transactions to ensure the Profit & Loss sharing, (3) Avoidance of Speculation/Uncertainty (Ghar) (**i.e.** Un-ripened fruits, Cultivation, Fishing etc), (4) Prohibition of Gambling (Maisir), (5) Disengagement from financing; interest banking/ Alcohol/ Tobacco/ Pork/ Drugs/ Weapons/ Porn/ Gambling/ Activities deemed offensive to Islam/ Environmentally harmful products

Why Islamic Microfinance in Sri Lanka?

There are 34% of population of Sri Lanka live below the International Poverty Line of $2/day *(World Bank PovCalNet October 2008)*. Western province accounted 50% of GDP in 2006, while remaining eight provinces contributed less than 10% of GDP *(Microfinance Industry Report, SRI LANKA, 2009)*. Further, 70% of island's population concentrated outside the western province. 88% poor live in rural whilst, urban poverty level is lower. This has resulted more unequal distribution of income than countries such as India, Pakistan or Bangladesh*(2007 Key Indicators, Asian Development Bank).*

Microfinance has certainly aimed at poverty alleviation, it can also; improve **nutritional** status (Chowdhury, 1996), create positive impact on **borrowers income** (Hulme and Mosley, 1996), positively impact on gender issue - **women employment** (Khandaker, 1997; Zaman (2000), producing significant 'Spill over effect' from individuals with access to microfinance to other members of the village.

However, study shows little evidence for borrowers/clients progressing from conventional microfinance. Islamic finance models seen tremendous success during global financial crisis and is one of the fastest growing industry in the world. A Musharaka model is very innovative and diversifies risk between client and MFI unlike conventional microfinance. It enables to find the best clients based on repayment, record keeping for getting eligible for the next level of financing. Islamic finance is predicated upon changing the relationship between borrowers and lenders to reduce inequality between the provider and recipient of capital. An interest-based financial system places the burden of repayment upon the borrower, who is obligated to repay principal plus interest (often compounding interest) whether the business for which the funds were borrowed is successful.

The Musharaka Model

Musharaka is an equity partnership contract between two partners as like as Mudaraba contract, but the basic difference being that in the former both the partners participate in the management and the provision ofcapital, and share in the profit and loss. Profits are distributed between the partners in accordance with the ratios initially set, whereas loss is distributed in proportion to each one's share in the capital. (Dhumale, 1999; Obaidullah, 2008; Dusuki, 2008). A brief on how the Mushraka model can work is described below.

Table - 1

Musharaka financing model

Week	MFI outstanding investment	Client ownership	MFI Profit and loss sharing ratio	Profit	Total Payment	Client Profit-share	MFI Profit-share
0	LKR20000	0%	75.0%	LKR800			
1	LKR18000	10%	67.5%	LKR800	LKR2600	LKR200	LKR600
2	LKR16000	20%	60.0%	LKR000	LKR2000	LKR000	LKR000
3	LKR14000	30%	52.5%	LKR800	LKR2480	LKR320	LKR480
4	LKR12000	40%	45.0%	LKR800	LKR2420	LKR380	LKR420
5	LKR10000	50%	37.5%	LKR800	LKR2360	LKR440	LKR360
6	LKR8000	60%	30.0%	-LKR200	LKR1925	-LKR125	-LKR075
7	LKR6000	70%	22.5%	LKR800	LKR2240	LKR560	LKR240
8	LKR4000	80%	15.0%	LKR800	LKR2180	LKR620	LKR180
9	LKR2000	90%	7.5%	LKR800	LKR2120	LKR680	LKR120
10	LKR000	100%	0.0%	LKR800	LKR2060	LKR740	LKR060
				LKR6200	LKR22385	LKR3815	LKR2385

Number of payments	10
Initial profit-sharing ratio (% to MFI)	75%
MFI profit rate	11.9%
Client profit rate	19.1%

Practice of Islamic Microfinance Model in Sri Lanka

MFCD, a NGO has implemented a project called "Improving Access to Productive Means of *Livelihood through Microfinance Support for the Poor people in Ampara District, Eastern* province of Sri Lanka". The goal of this project is to enhance widows with suitable livelihoods and to keep her children (the orphans) on their studies and avoid school dropouts.

The objectives of this project are to provide accesses to the poorest to credit facilities, to further improve their income generation activities, to generate employment through micro enterprises and to empower the community economically and socially through poverty alleviation.

The project was implemented by the Islamic Relief (IR) partner MFCD.Beneficiaries were selected from Ampara Districts, Eastern Province of Sri Lanka and selected as per the project mentioned criteria. Due to limited funding beneficiaries were selected via personnel interview.Money was handed over to the beneficiaries by end of June also a tri party agreement signed by the beneficiary, District Manager and a government servant. The District Manager and IR representative provided necessary helps to implement the project smoothly. Totally thirteen widows were selected for this Micro Finance project and at this date it has increased as 21 from the reimbursed money. The major areas of micro credit grant are listed below.

Table – 2: List of Activities of the Grant

No	Name of the Activity	Project Target
1	Grocery business	Focus on orphan studies and increase them incomes
2	Selling string hopers, Rice selling and Preparing mid-day meals for school children	Focus on orphan studies and increase their income
3	Poultry Farming	Focus on orphan studies and increase their income.
4	Textile business	To increase their family income and orphan studies.
5	Sewing	Focus on orphan studies and increase their income.
6	Weaving	Focus on orphan studies and increase their incomes

RESEARCH METHODOLOGY

This research is descriptive nature. The primary data for this study has been collected using case study. A sample of seven beneficiaries of Islamic microfinance program of Islamic Relief was considered for the data collection. The questionnaires and interview methods were utilized as necessary data collection tools.

FINDING OF THE STUDY

Employment creation of the working Area: This project has created new and expand the existing self-employment in the working area engaging beneficiaries in six difference IGAs with mudarabah microfinancing.

Income Generation: Beneficiaries have generated incomes with new projects receiving microfinance and increased their income. IR/MFCD will strive to make a positive change with this project and beneficiaries will be in a situation to full use of their opportunity. Initially, the credit was granted only to thirteen beneficiaries, later it was expanded to another eight beneficiaries from the recovery fund of the initial beneficiaries. So far twenty one beneficiaries engaged in their IG activities.

Change in the standard of living: After starting their own income generating activities their average net income pay day has been increased to Rs. 300 – Rs. 500. They are spending this income for purchasing nutritional food for their family, sending their children to evening classes, etc. The widows hope that their children also can perform well in their studies.

Knowledge level increase: The MFCD is continuously providing guidance and training for the beneficiaries through their field officers. With this closed monitoring & regular field visit of different IGAs beneficiaries will have the opportunity to have new ideas and increase their knowledge and skills.

CONCLUSION - PROPOSINGISLAMIC MICROFINANCE AS A COMMERCIAL VENTURE

The traditional microfinance in Sri Lanka is operated by government and, private the Islamic microfinance is operated by only two NGOs in Ampara, and Trincomalee districts of Eastern province of Sri Lanka in very small scale. Alleviating poverty viewed as governmental or charitable responsibility. This view of barrier should be brokenby proposing commercial Islamic microfinance venture. The best practices of microfinance can be combined with the principles of Shariah to create a model that equitably allocates risk between investors and the entrepreneurs without subjecting the micro-entrepreneurs to disproportionate risk. This can be achieved as keeping the Generic Objective:"Taking Sri Lankan poverty above all forms of poverty index by 2030". The targeting group can be specifically small business entrepreneurs among poor.

Islamic microfinance is still in its infancy, and business models are just emerging and no performance benchmarks have been established *(CGAP 2008)*. However, two areas are of particular importance

- Operational efficiency
- Risk management.

In order to implement the Islamic microfinance a Pilot Study in North, Eastern and North Central Province (to represent all communities) should be done. This can be administrated by community based organisation. The following two models can be implemented two phases.

- Phase one: Murabaha
- Phase two: Musharaka

However, in Sri Lanka the following entry barriers should be considered in implementing the new models. Firstly, the absence of a solid regulatory and supervisory system for the microfinance. Secondly, microfinance is currently classified as a money lending business and therefore restricted from obtaining offshore equity investment into such business. Thirdly, there is negative industry image. And finally, large number of NGO-MFIs which are entirely unsupervised and whose microfinance activities are not governed by specific regulations.

These challenges can be mitigated through the eengagement with government organisations and its microfinance institutions, communicating the message to poor of the power of microfinance, getting data and relevant information near accurate prior to pilot study, keeping very close eyes at legislature change on microfinance and regular meeting with industry experts.

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