Islamic Finance Project

Harvard Law School
Islamic Legal Studies Program

Islamic Microfinance Symposium
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Microfinance: Toward a Sustainable Islamic Finance Model: A Short Report

A workshop entitled "Microfinance: Toward a Sustainable Islamic Finance Model" was held on April 18, 2008, at Harvard Law School before the Eighth Harvard University Forum on Islamic Finance, entitled "Innovation and Authenticity." Despite the fact that Islamic finance is inherently social justice–oriented, Islamic financial institutions have not yet made significant forays into the area of microfinance. This workshop focused on how we could change this model and bring forth ideas that foster a more organic connection between Islamic finance and microfinance initiatives to alleviate poverty and stimulate economic growth.

Hosted by the Islamic Finance Project (IFP), a program sponsored by the Islamic Legal Studies Program (ILSP) at Harvard Law School, the workshop attracted leading international academics, *shari'a* scholars, and practitioners in the field of microfinance and IF generally. In his opening remarks Nazim Ali, the director of the Islamic Finance Project, reminded the audience that IFP is an academic project that encourages discussion and debate without endorsing any specific opinions or viewpoints. This workshop, he noted, was a departure from past initiatives because we would learn from practitioners who are building their own innovative pathways to development throughout the Muslim world. Mahmoud el-Gamal, Professor of Islamic Economics, Finance and Management at Rice University, opened the workshop by remarking on its timeliness, as microfinance is an emerging field with the potential to make a tremendous impact on developing and developed countries. The issue becomes how to balance the social benefits of microfinance with Islamic finance and its requisite structures.

<u>Microfinance as a Key to Poverty Alleviation</u>

This year's workshop marked a union of social and legal debates surrounding Islamic finance with an economic analysis of its future. Sameera Fazili, a lecturer at Yale Law School, began the first session, entitled "Microfinance as a Key to Poverty Alleviation," noting that economists have begun to seek innovative ways to help poorer elements in societies through alternative banking mechanisms. In the United States this is seen with community development banks, and in Muslim countries we see promising uses of micro-credit and micro-loans. Salih Gibriel Hamid Ahmed, the manager of research and planning for the Savings and Social Development Bank based in Khartoum, Sudan, then examined issues surrounding the use of micro-credit in four key industries: agriculture, livestock, small industries, and services. Few conventional banks lend to poor customers, and local and traditional money lending mechanisms are often detrimental to the borrower, who is subject to high interest rates. Ahmed contended that the installment-payment plans that are commonly featured as part of *murabaha* financing may provide a means for social development banks to lend to poorer clientele in a commercially viable manner that is beneficial to the customer as well. He gave examples of small textile companies that were able to open through *murabaha*-structured micro-loans and sheep-rearing projects that came to fruition with the aid of restricted *mudarabah* lending.

Nafis Alam, a lecturer and PhD candidate at Monash University in Malaysia, delivered his paper, entitled "Islamic Venture Philanthrophy: A Tool for Sustainable Community Development." Alam's paper asked whether using a *zakat* model for charitable philanthropic giving could prove a useful alternative to traditional bank-centered modes of financing. In his model, a network of Muslim investors and local business efforts would create an environment of shared risk and profits compliant with the principles of Islamic financing. Providing another alternative financing model, Tanim Laila, from the Institute of Hazrat Mohammad (SAW) in Bangladesh, proposed a *zakat* and *waqf*-based lending structure that uses these two traditional Islamic charitable endowments as income sources. Introducing new scope for participation in charities, she contended that there is a great deal of money that goes mismanaged in traditional *awqafs* and that it is imperative to distribute charitable monies to the poor more efficiently.

Kim Wilson, a lecturer at the Fletcher School at Tufts University, described microfinance projects in several Muslim countries that had met with varying degrees of success. She used examples of microcredit and microinsurance from Syria, Pakistan, and Indonesia. The challenge, she remarked, lies not so much in starting these programs as in scaling them up and building them from small projects to ones with greater reach.

Lastly, we aired a series of short video clips presenting the opinions of *shari'a* scholars regarding microfinance; these included Anas Zarka, Duad Baker, H. Hassan, Nizam Yaqubi, and Essam Haq. Most of the scholars agreed that *shari'a* welcomes innovations in IF that keep with the spirit of *shari'a*, and that microfinance is a good example of a financing methodology that shares the goals of Islamic finance's altruistic nature. The tension lies not in theory, but in managing the high interest rates that often accompany microfinance ventures.

The panels were followed by a lively Q&A session. Several attendees wondered what exactly was Islamic about Islamic finance in a microfinance model. Were the efforts described simply applying conventional microfinance models and giving them Islamic names or stretching the manner in which certain IF financing tools can be used? Other audience members responded to the tensions created by microfinancing's high interest rates by noting that perhaps it is best to look to the spirit of *shari'a* and the Qur'an rather than the black letter law of Islamic finance because the goals of microfinance are most important. These issues carried into the second session as well.

Models of Islamic Microfinance

The second session, "Models of Islamic Microfinance," was moderated by Mahmoud el-Gamal. Ali Adnan Ibrahim, adjunct professor of law and an SJD Candidate at Georgetown University, began with a on "Incentivizing Microfinance for Islamic Financial Institutions." Ibrahim examined the tension within the IF field in which the development of Islamic microfinance is highly desirable but IF models are forced away from microfinance. While doctrinal injunctions for fighting poverty encourage IF institutions to move toward Islamic microfinance, the pressures of doing Islamic finance in the international markets discourage such expansion. Ibrahim sought to resolve this tension by proposing a new model for the Islamic finance industry to profitably conduct Islamic microfinance. His model separates for-profit and non-profit activities by introducing an incentivized actor that assumes the non-profit side to enhance the economic efficiency of microfinance transactions; this new hybrid model encourages a partnership between IF institutions and philanthropic organizations.

Providing a different Islamic model of microfinance, Moid Uddin Ahmad presented a paper he co-wrote with Athat Mahmood, both of whom are lecturers at Northern Indian Engineering College in Lucknow. Ahmad asserted that venture capital initiatives modeled with Islamic financing may provide a useful tool for social and economic development. Providing a model that also looked at ways to re-appropriate existing financing methods for Islamic ends, Asad Kamran Ghalib, a doctoral research fellow at the University of Manchester, presented a paper entitled "Re-thinking Leasing from an Islamic Perspective: The Prospects of Islamic Micro-Leasing for Poverty Alleviation." According to Ghalib, basic principles of leasing from an Islamic perspective can be applied by microfinance institutions to enable poor micro-entrepreneurs to gain access to the use of assets that would otherwise be too costly and therefore unattainable. In this manner, we can provide collateral-free facilities to the destitute to encourage micro-enterprises and ideally to alleviate poverty.

Turning to more traditional microfinance models Ehsan Feroz, Blake Goud, and Mohammad Rahman, of the Institute of Halal Investing in Portland, Oregon, presented a paper entitled "The Development and Implementation of a Shari'a Based Microfinance Model Using the Gremeen Group Financing Methodology." Echoing concerns voiced by earlier panelists, they asked how we can move productive models forward by expanding their scope and impact. Using *murabaha* and *mudaraba* contracts akin to the Grameen model in Bangladesh they presented the initial findings of a pilot study in Sri Lanka. Putting forth a universalist perspective, they argued that IF models have the potential to benefit the Muslim and non-Muslim world. They see greater room for synergy between IF models of microfinance and more traditional models because non-interest-based microfinance is based on Islamic principles, and both Islamic finance and microfinance are business ventures guided by concerns for ethics, morals, and social outcomes. Outlining future challenges in the field of Islamic microfinance, Goud noted it is important to expand product offerings to include consumer and education financing, to develop *salam* financing for agricultural production, to provide takaful options to protect clients against business failure, and to use charitable grants and training to expand a client base for microfinance ventures.

The final paper of the day, "An Islamic Non-Banking Financial Institution for Accelerated Poverty Eradication," was delivered by Hossain Monowar, director of the Institute of Hazrat Mohammad (SAW) in Bangladesh where he is developing a project on accelerated poverty eradication using *zakat, waqf,* and *mushuruka* investments. Monowar began with two criticisms of microfinance: first, it charges excessively high interest rates; second, for Muslim clients it is not *shari'a* compliant. He then examined two controversial alternatives. One involves reinterpreting the microcredit interest rates as *shari'a*-compliant and using *zakat* or *awqafs* to subsidize microfinance institutions' overheads so as to reduce interest rates. Another approach, using *murabaha* or *bai-muazzal*, seems too close to conventional interest-based products. Monowar explored another methodology that draws from the *sunnah* by combining *zakat* and *musharaka* investments on a non-banking platform. He asserts that this methodology provides a way to ensure a steady stream of dividends and employment income to the poor.

The remarks of the workshop's final speaker, Ibrahim Ali Hussein, a manager at the London-based Muslim Aid, provided a perfect complement to Monowar. Hussein used examples from Muslim Aid's initiatives to illustrate the successes and limitations of Islamic finance models in the Muslim world. Hussein explained that the goal of Muslim Aid is to reduce poverty and make the beneficiaries self-reliant by building the capacity of the poorest communities and providing them interest-free capital support on soft terms and other support services. Although micro-loans have significantly improved the lives of recipients, he stressed that we must develop stronger monitoring mechanisms to determine who the client-base is, what exactly is done with loan money, and how, in real and quantifiable ways, the loan money changes their lives.

Upon the conclusion of another lively question and answer session, Baber Johansen, the director of ILSP and Affiliated Professor of Law at Harvard Law School, thanked the presenters and organizers of the conference. He remarked on the relevance of this discussion to global trends as we explore the possibilities of making Islamic finance a model for growth and development that works with the world's poor to alleviate poverty through microfinance models.