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The role of Islamic Microfinance in Poverty Alleviation: Lessons from Bangladesh Experience

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ABSTRACT: In the People’s Republic of Bangladesh, the poverty has been a main challenge since the last decades and its alleviation is one of the country’s strategic goals to achieve MDGs by 2015 to fight poverty and improve the standards of living of underprivileged population. Micro and SME financing have been playing important role in poverty reduction by creation a gainful employment opportunities. The Islamic banks and the Islamic windows of conventional banks in Bangladesh should pursue vigorous promotion of Islamic micro and medium scale enterprise (SME) finance, in step with the country’s concerted efforts for faster poverty eradication with deeper, wider financial inclusion. This paper determined the role of the Islamic microfinance in poverty alleviation efforts in Bangladesh and how this role can be enhanced. It was intended to establish and recommend Islamic microfinance and its principles that could raise poverty reduction and economic development in the country. Especially, this paper tries to answer the following questions: Can Islamic microfinance help alleviate poverty? Should Islamic finance “innovation” include innovative ways to alleviate poverty? Because an institution is “Islamic” does this mean it has a particular obligation to invest in economic or community development? How does the concept of Islamic microfinance operate to serve the goal of poverty alleviation in Bangladesh? For this purpose, this paper tries to give some possible reflections that help us to develop the analytical tool that may help us to improving the way towards the amplification of the analysis paradigm.

KEYWORDS: Microfinance, Islamic Microfinance, Poverty, Shari’ah & IMs, Bangladesh.

1 INTRODUCTION

Poverty prevalence dates back to the existence of human being and today it has occupied foremost place on human development agendas of virtually all countries of the world. Islamic microfinance (IM) is becoming an increasingly popular mechanism for alleviating poverty, especially in developing countries around the world. The concept of IM adheres to the principles of Islam and is a form of socially responsible investment. In this perspective, many economists think that there is a common goal in Islam and microfinance which can be summarized in making people self reliant, enterprising and self respecting. A solution to achieve the target of poverty eradication is by practicing microfinance in an Islamic way. Islamic microfinance which involves Shari’ah-compliant way of financing and providing credit without collateral or any property for guarantee to the marginally poor for their business, is one of the most popular tools employed as part of a poverty reduction strategy, empowering and increasing the productivity of poor, giving social benefits to them in a sustainable way, and aiding economic development.

People living in poverty need permanent access to the same type of financial services we all need: a safe way to save for life cycle events and to reduce vulnerability to shocks; access to appropriately designed credit for business opportunities, ways to transfer money, etc. For the poor these financial services often make the difference between continued poverty and

moving out of poverty. These results are what the United Nations Millennium Development Goals (MDGs)¹ is all about-reducing poverty, increasing education, and nutrition. It will require financial systems that do not exclude the poor, who have not access to the formal financial services. This means building financial systems that are inclusive, and this is the new vision for microfinance that is attractive to donors and financial institutions that interest to help the poor alike.

However, conventional microfinance services do not meet the needs of majority of Muslim population in developing countries like Bangladesh. The reason is that conventional microfinance institutions charge interest on their loans provided to small and medium enterprises as well as women entrepreneurs. In addition, a vast majority of Muslim population refrains from availing conventional microfinance services due to the element of interest that is considered repugnant or Haram according to Shari'ah.

The purpose of this paper is to investigate the impact of the shari'ah-compliant microfinance (or simply Islamic microfinance) on poverty and how it contributes to the wider efforts to alleviate and consequently eliminate poverty in low income individuals and households in Bangladesh.

The overall aim of this paper is to investigate how the Islamic Microfinance System and its products contribute to the provision of financial services to the poor, alleviating poverty, empowering the poor and consequently to the efforts of sustainable development.

The specific objectives of this paper are:

- To examine the nature of the institutions offering IMF services, their mission and their main target groups.
- To identify the kind and variety of both the financial and non-financial services the institutions provide and to ensure their Shari'ah-compliance.
- To evaluate the institution' lending schemes, microfinance model, client' satisfaction level, screening of fund usage and repayment schedules.
- To investigate their contribution on the social capital, poverty reduction and empowerment of their client members.

This paper has been organized in such a logical manner that the first part examines the Islamic Microfinance background. The second part is about population and poverty distribution of different regions. The third part is about the Islamic vision of poverty reduction. The fourth part is discussion and analysis section which is the result of the research on Bangladesh poverty and Islamic microfinance. The final part is an empirical issue on poverty alleviation with special reference based on the activities of two institutions: the Islami Bank Bangladesh Limited (IBBL) and Al- Arafah Islami Bank Limited (AIBL).

2 CONCEPTUAL FRAMEWORK OF THE ISLAMIC MICROFINANCE

2.1 THE MICROFINANCE REVOLUTION

Microfinance is usually defined as the provision of financial services and products to those whose low economic standing excludes them from conventional financial institutions or programs. These can include microcredit, small scale venture capital, savings, and some forms insurance. Access to each of these services is provided on a micro-scale allowing those with severely limited financial means to participate.

The microfinance revolution, begun with independent initiatives in Latin America and south Asia starting in the 1970s, has so far allowed 65 million poor people around the world to receive small loans without collateral, build up assets, and buy insurance. Idea of microfinance programs has come from Dr. Yunus who began a microfinance program among women in Bangladesh in 1976, however the concept is relatively simple and enjoys a long tradition in many developing countries.

According to Bucciferro, 2007, microfinance have rapidly spread worldwide on the promise that they help to eradicate poverty and create economic growth.

¹ Target to be achieved in 2015 for development in the world as a whole with special emphasis on poorer countries, and are viewed as a key indicator of and reference for socio-economic development.

Microfinance refers to making small loans available to poor people (especially those traditionally excluded from financial services through programs designed specifically to meet their particular needs and circumstances (Khan, 2008, p.6).

The application of Islamic finance to microfinance was first discussed in depth by Rahul and Sapcanin (1998). They demonstrate that Islamic banking, with its emphasis on risk sharing and, for certain products and collateral-free loans, is compatible with the needs of some micro-entrepreneurs. Viable projects that are rejected by conventional lending institutions because of insufficient collateral might prove to be acceptable to Islamic banks on a profit-sharing basis.

Dusuki (2006) has presented the idea of Islamic microfinance initiative in the perspective of Ibn Khaldoun's concept of Asabiyah or social solidarity that emphasizes group efforts and loyalty over self-interests of individuals. He argues that Islamic microfinance can be promoted through group lending to the poor who are normally denied access to mainstream banking services.

Micro finance institutions are established to maximize social benefits as opposed to profit oriented motives of businesses concerned. The purpose of Micro Finance is to create sound financial institutions that can offer effective and efficient financial services even at grassroots levels (Harran, 2010).

Access to services such as credit, venture capital, savings, insurance and remittance are provided on a micro-level to enable participation of those already marginalized in the formal financial sector. According to Obaidullah (2008), the provision of financial services to the poor helps to stem up aggregate household income and economic security, as well as create demand for other goods and services such as nutrition, education, and health care; and thus stimulating the local economies.

2.2 ISLAMIC MICROFINANCE

To understand Islamic microfinance, we need a minimal understanding of the principles on which Islamic finance is based. Four principles which are derived from the Shari'ah laws (Islamic jurisprudence) and are seen by most scholars to form the core of modern Islamic finance are important also for the Islamic microfinance:

- The prohibition of interest
- Risk-sharing: lenders share in the profits and the losses of the business they fund.
- Calculations of the time-value of money and sheds light on the wisdom behind banning riba.
- The prohibition of Gharar: gharar means uncertainty or ambiguity created by the lack of information or control in an economic transaction.

The concept of IM adheres to the principles of Islam and is a form of socially responsible investment. Investors who use their wealth for IM projects only involve themselves in halal projects which benefit the community at large. Such projects include zakat, which is charity based, or trade and industry projects to develop a country's economy.

Islamic Micro Financial institution is at the central of economic growth and development of most societies today because of its key roles in developing human resources. It also makes significant contributions towards poverty alleviation and bridging the gap between the rich and the poor. The debates were mostly centered on interest charge, saying that if the interest was removed, there would be nothing to balance out demand and supply in the economies.

2.3 ISLAMIC MF PROVIDERS: MICRO LEVEL

Islamic microfinance providers who offer services at a micro-level directly to poor and low-income clients constitute the backbone of the system. In the Islamic countries, current and potential providers of Islamic MF are likely to be either the conventional MFIs expanding the scope of their services to include Islamic MF or the Islamic FIs expanding the scope of their services to include MF.

Recent development in the word: outreach of Islamic microfinance by countries

Islamic banking is in a phase of growth and change. On one hand, Islamic finance is being celebrated as a promising financial industry. Its assets currently exceed \$400 billion (compared to \$160 billion in 1997) and the market is estimated to be growing at 10-15% per year.²

² The Economist (2008).

Islamic banking is emerging from its history of being primarily politically driven (especially in Iran, Pakistan and Sudan) and increasingly motivated by market forces. Islamic banks have been established in non-Muslim countries with Islamic minorities (e.g. the Islamic Bank of Britain) and Islamic branches of western banks have begun offering Islamic-compliant products (for instance, HSBC Amanah, the global Islamic finance services arm of the HSBC Group). However, Islamic banks have not typically been involved in microfinance³.

3 POPULATION AND POVERTY DISTRIBUTION OF DIFFERENCE REGIONS

3.1 THE MEANING OF POVERTY

Poverty is a complex phenomenon, a consequence of lack of growth and inequality. Effective policies require technical and empirical understanding of poverty that is combined with efficient institutions and supportive system of social values

Poverty is one of the vital concerns in most countries whether developed, developing or less developed. Some of the basic issues that need to be identified before discussing poverty alleviation in general or according to the Islamic faith are: what is meant by poverty, why there are poor people, and how they can be identified.⁴

Poverty has been identified at various levels. The most popular types of which are: extreme, overall, and human poverty. Extreme poverty (or absolute poverty) refers to lack of income necessary to satisfy basic food needs-usually defined on the basis of minimum calorie requirements. Overall poverty (or relative poverty) is defined as the lack of income necessary to satisfy essential food and non-food needs such as: clothing, energy, and shelter. Human poverty refers to the lack of basic requirement to sustain basic human capabilities such as: illiteracy, malnutrition, abbreviated life span, poor maternal health, illness and lack of access to goods, services; and infrastructures (UNDP 2000).

3.2 POVERTY DISTRIBUTION

The poverty index across the world is on the rise, challenging the holy doctrine of the World Bank's aims to eliminate poverty from the face of the earth. On the other hand as the Islam is the complete code of all mankind. It might be applicable in every sphere of life whether business, service or any other parts of human life.

Table 1: Population and Poverty Distribution of Difference Regions

Region	% in \$1.25 a day Poverty	Population (millions)	Pop. in \$1 a day poverty (millions)
East Asia and Pacific	16.8	1,884	316
Latin America and the Caribbean	8.2	550	45
South Asia	40.4	1,476	596
Sub-Saharan Africa	50.9	763	388

³ In part, we believe this is due to a lack of research and innovation in how Islamic microfinance might look, in the absence of subsidies and charitable motivations.

⁴ A wealth of literature focuses on discussing the meaning of poverty, and identifying the most appropriate indicators which can be used to measure its magnitude on the national and international levels. However, it is indicated that there is no optimal definition to describe poverty, or a measurement technique to compare poverty across countries or among different parts of a countries (Sirageldin, 2000).

Total Developing countries	28,8	4673	1345
Total Developing countries	0.04	473	17
Middle East and North Africa	0.04	305	11
Total		5451	1372

Source: World Bank, 2010.

3.3 POVERTY LEVELS IN THE ISLAMIC WORLD

The Islamic world is enormous with over 1.2 billion people, stretching from Senegal to the Philippines – comprising six regions: North Africa, Sub-Saharan Africa, the Middle East, Central Asia, South Asia, and Southeast Asia. Except for a handful of countries in Southeast Asia and the Middle East, there are high and rising poverty levels in both urban and rural parts of most Muslim countries.

Poverty levels have also been associated with high inequality alongside low productivity. In Indonesia alone with world's largest Muslim population, over half of the population - about 129 million are poor or vulnerable to poverty with incomes less than US\$2 a day. Bangladesh and Pakistan account for 122 million each followed by India at approximately 100 million Muslims below poverty line.

While poverty is widespread, access to financial services in the Islamic world is either inadequate or exclusive. In an attempt to measure access to financial services some studies have made use of sample surveys of households or individuals.

4 THE POVERTY REDUCTION IN THE ISLAM

4.1 DIFFERENT FINANCIAL PRODUCTS OF IM

A number of financial instrument have been devised to adapt the principles of Islamic finance to modern banking. Instruments of financing may be bradly divided into

- i. Participatory profits-loss-sharing (PLS) modes, such as, *mudaraba*⁵ and *musharaka*⁶;
- ii. Sale-based modes, such as *murabaha*⁷;
- iii. Lease based modes or *ijara*;
- iv. Benevolent loans or *qard-hassan* with service charge.

There are other forms of Islamic financial instruments that are also widely used in financial transactions. However, these contracts are analogous to well-known conventional financial contarcts. *Ijara* for instance is a leasing contarct, which is widely used for financing vehicles, machinery and equipment. Other contarcts are developed to provide money for sales

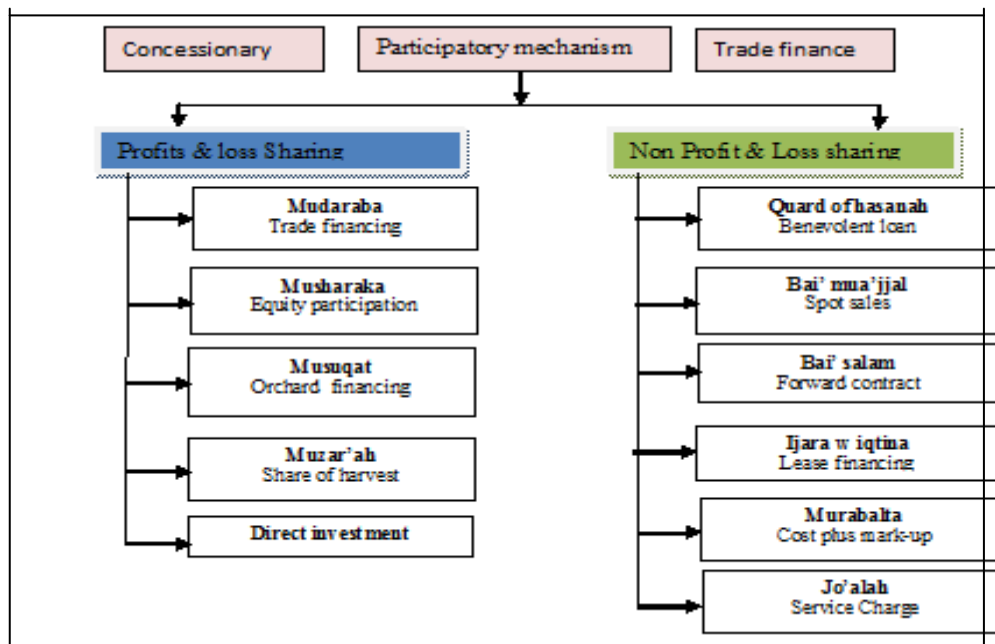
⁵ The financier provides funds to the entrepreneur to be invested in an economic activity (usually short to medium term projects) for an agreed-upon share of the profit. If the project returns a profit, the profit is shared as agreed. If the project incurs losses, the financier's loses her capital and the entrepreneur loses his effort and time.

⁶ *Musharaka* is a classic joint venture. This contract is a hybrid of partnership and *mudarabah*. The entrepreneur and the investor contribute to the capital and managerial expertise in agreed upon amounts and they also agree on the share of the profits and losses.

⁷ *Murabaha* is a trade with markup 'buyresell' used for purchasing commodities and other products on credit. Typically, banks use *murabaha* in assets financing, property, microfinance and commodity import-export.

(bay' mu'ajjal)⁸. Deferred-delivery sale (bay' salam) is similar to a forward contract, delivery of the product is in the future in exchange for payment in the spot market. These contracts are rarely relevant for the microfinance market.

Fig.1: Different financial products of IM



4.2 DIFFERENCE BETWEEN CONVENTIONAL AND ISLAMIC MFIS

The mechanism of lending in IM differs from conventional microfinance due to the prohibition of interest. Unlike conventional microfinance, IM offers an interest-free way to give small loans to people who are poor and in need.

IM gives the investor a chance to get involved in worthwhile projects which could essentially play a significant role in targeting poverty and alleviating it in many countries around the world. IM primarily relies upon the provision of financial services to the poor or developing regions which are subject to certain conditions laid down by Islamic jurisprudence. It represents the merging of two growing sectors: microfinance and the Islamic finance industry. It has the potential to not only be the solution for an increased demand to help the poor but also to combine the Islamic socially responsible principles of caring for the less fortunate.

Table 2: Difference between conventional and Islamic MFIs

Indicators	Conventional MFIs	Islamic MFIs
Source of fund	External, client's savings	External, client's savings, Zakat, awqaf
Financing	Interest-based	Islamic modes of financing
Financing the Poorest	Ultra poorest are left out	Ultra poor are targeted
Fund Transfer	In cash	In kind

⁸ In which delivery of the product is executed while delivery of an agreed-upon payment is delayed for an agreed period.

Target Group	Women preferred	Any member of family
Targeting objective	Women empowerment	Family empowerment
Deduction at inception of contract	Yes	No
Work incentive	Material	Material and spiritual
Social development program	Secular	Religious

4.3.1. Concepts and view of poverty

In conventional approach poverty is defined as any individual having per day income less than US\$ 1.0 while in nutritional aspect the definition of poverty is not being able to avail 2112 kilo calorie of nutrition per day per person.

On the contrary, Islamic approach to poverty line is Nisab i.e. people having less than Nisab (no zakat is due on wealth) amount of income is poor. This is a universal definition which is applicable in any time and any place of the world. The definition of poverty in conventional approach is not universal i.e. it needs to be revised in course of time and it is not applicable in developed countries.

4.3.2. Approaches to poverty alleviation

Anti-poverty programme can be broadly classified into two strategies:

(a) Indirect strategies that formulate a macro-economic policy framework to ensure sustainable growth, higher employment, higher per capita income, and eventually reduce poverty; and

(b) Direct strategies that target the underprivileged population and provide them necessary assistance to ensure credit access, improve health conditions, increase literacy rate and ultimately eradicate poverty.

Indonesia, Malaysia, and Thailand are good examples of countries that have alleviated poverty through indirect strategies. These countries pursued consistent macro-economic policies that ensured growth of six per cent or greater and increased public spending on education, health, family planning, etc. for decades. In contrast, Bangladesh is an example of direct policy application where government and non-governmental organisations (NGOs) provide a set of services for the targeted poor population like ensuring access to credit, health care and educational services to targeted underprivileged individuals.

4.3 THE ISLAMIC PERSPECTIVE OF POVERTY ALLEVIATION

Although poverty, and also poor, in Islam is not merely a matter of material concerns. Islamic definition of poverty entails more spiritual aspects than that of material. The existence of both is interrelated and thus undeniable. Therefore, deprivation of either one of these aspects may give rise to poverty.

The Prophet, as narrated by Abu Huarairah is reported to have said: "Indeed, the real richness is that of the heart (spiritual) itself". The mafhum mukhalafah (or inverse meaning) of the above statement is that the real poverty is the spiritual poverty. Though spiritual aspect of poverty is more important in Islam than that of material, the

The Prophet also says that either poverty or hunger may lead to infidelity. Thus, redefinition of these terms is merely reconsideration of the Islamic spiritual values.

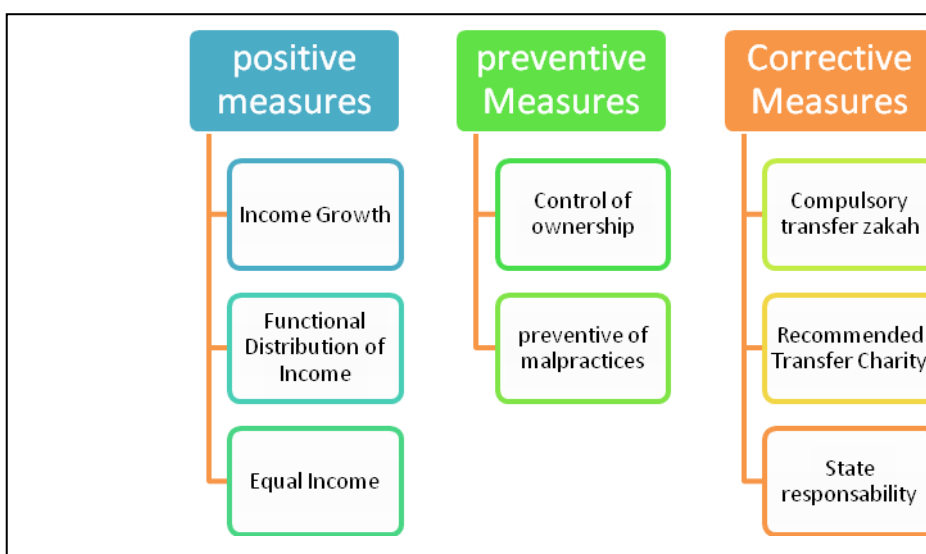
The Quran talks of two types among the poor, the needy and the beggar-miskin and fakir. The needy are generally not known to the others because they do not ask, but they may be in more straightened circumstances than the bigger.

According to Islamic faith, poverty alleviation is the responsibility of individuals and the state⁹, whether separately or jointly. Islamic law is clear about the responsibility and the role of both individuals and the state regarding poverty elimination. The shari'ah also provides guidance to how such role can be undertaken. According to Sirageldin (2000), Islamic ethical system supports poverty alleviation strategies that are based on the principle of promoting economic growth, productive equity, and individual commitment. The Islamic financial system should also reflect these objectives of Islam¹⁰.

4.4 POVERTY ERADICATION SCHEME OF ISLAM

IM gives the investor a chance to get involved in worthwhile projects which could essentially play a significant role in targeting poverty and alleviating it in many countries around the world. IM primarily relies upon the provision of financial services to the poor or developing regions which are subject to certain conditions laid down by Islamic jurisprudence. It represents the merging of two growing sectors: microfinance and the Islamic finance industry. It has the potential to not only be the solution for an increased demand to help the poor but also to combine the Islamic socially responsible principles of caring for the less fortunate.

Fig. 2: the poverty alleviation of Islam



4.5 INTERNATIONAL PARTICIPATION IN POVERTY ALLEVIATION

On the international level, the United Nations Development Program (UNDP) is committed to eradicating poverty worldwide. This program focuses on providing countries with what they most need and what the program is best at providing mainly: helping these countries improve their policy-making, and enhance their ability to build institutions as the principal means to eradicate poverty. The UNDP also provides countries with the technical advice resources needed to make their governance structures more participatory, more accountable, and more pro-poor.

On the top of the poverty international organizations, in addition to the United Nations we can find the International Monetary Fund, the World Bank, the Asian Development Bank, the African Development Bank, The International labor Office, The Islamic Development Bank (IBD), and the Food and Agriculture Organization.

4.6 IMF AROUND THE WORLD

⁹ Abdul Karim (2004) indicates that Islam, in contrast to the modern concept of the welfarestate, holds the individual as much as the stete responsible for the welfare of all members of society, particularly kinship and those who belong to the same community.

¹⁰ Many Islamic scholars pointed out the philosophical basis of the Islamic financial system lies in *adl* (social justice) and *ihsan* (benevolence)

Islamic Micro Finance (IMF) has been developed with the aims of providing loans to the poor as well as small and medium size enterprises that have little or no access to capital from the banking sector, which concentrates only on the bigger players in the economy. Recent publications (2010) on world's hungry people by Food and Agricultural Organization (FAO) reveal that some 925 million people are living in hunger, with Asia Pacific having the highest proportion of people living in poverty. The establishment of IMF in the Asia and Pacific region would have the prospect of bridging the gap between the rich and the poor; hence the demand for IMF.

Islamic microfinance is becoming an increasingly popular mechanism for alleviating poverty, especially in developing countries around the world. The Islamic microfinance industry as a whole is expected to reach over \$2.0 billion in 2012 and is a continually growing sector due to its ethical principles and prohibition of riba (interest). This amount of assets is, however, only 1.0 per cent of the total microfinance of the world.

Table 3: IM around the world

Region	Programme	Country	Investment modes
MENA countries	Mit Ghamr	Egypt	Musharaka, Murabaha
	Sanadiq at Jabal-AL-Hoss	Syria	Qard hassan
	Mu'assasat Bayt Al-Mal	Lebanon	PLS modes
	Hodcidah microfinance Programme	Yemen	Murabaha
South Asia	Rural development Scheme of IBBL, Al-Falah Rescue, Akhuwat	Bangladesh	Bai muajjal
	AICMEU and Bait-un-Nasr	Pakistan	
		India	Qard hasan
Southeast Asia	Tabung Haji	Malaysia, Indonesia	
	Baitul Maal wat Tamwil	Network of over two thousand institutions	Murabaha, Musharaka
	Baitul Maal wat Tamweels		ljara, Qard
	Azouad finances Plc		
Sub-saharan Africa	Azouad finances Plc	Northern Mali	
		Sudan	
Central Asia	FIANCA's Village Banking	afghanistan	Qard hasan

4.7 EVOLUTION OF POVERTY ALLEVIATION INITIATIVES

Poverty alleviation has many phases in modern time. One approach is trickle-down strategy through market mechanism or through growth promotion, benefits of which could hardly reach the poor. Cooperative movement also failed to benefit the small farmers and the landless as it is occupied by the well-to-do farmers. Target group approach through microfinance and credit entitlement is another method; but it could not bring the desired result because of its high interest rate and failure to reach the ultra poor. The introduction of IM changed the scenario with borrowed scheme replaced in it.

Key considerations of poverty alleviation scheme should be able to address the ultra poor. There should be social charter accepting that the poor are entitled to get initial capital along with their micro-finance entitlement to make them fit as market player. This should ultimately turn into a credit-plus integrated poverty alleviation scheme.

Modes for Islamic financing: Conventional micro-finance institutes (MFI) asset portfolio is of fixed interest nature while Islamic micro-finance institutes' (IMFI) asset portfolios should feature diversity in terms of mode of financing and areas of financing. Figure 2 describes the basic categories of diversified financial products the Islamic financing system offers.

5 THE POVERTY IN BANGLADESH

Over 1100 millions of the Muslim population is living below poverty line (less than \$2 per day)¹¹. Thus in this scenario, it is extremely important to note that Islamic microfinance has tremendous potential in a country like Bangladesh where, according to official estimates, 125 million people are Muslim, or 89.7% of the national population and could be used as a powerful weapon to fight against poverty. It can develop a valuable human capital base by satisfying the financial needs of the society and positively contribute towards their economic growth.

Therefore, combining the Islamic social principles of caring for the less fortunate with microfinance's power to provide financial access to the poor has the potential to reach out to millions more people, many of whom say they would prefer Islamic products over the Haram conventional microfinance products.

Bangladesh is still in the category of least developed over populated poor country. All out efforts are being made through different strategies and approaches by Government and Non Government Organizations to move out of poverty and reduce poverty by 50 per cent by 2015.

6 THE IM IN BANGLADESH: AN OVERVIEW

6.1 THE ISLAMIC MICROFINANCE INSTITUTIONS IN BANGLADESH

Utilising Islamic financial instruments such as Murabahah and Musharaka to help in facilitating IM cannot only spur the IM sector but can also increase the options of Islamic finance and make it more accessible to poverty stricken countries.

Hundreds of IM institutes have been developed across the world. Like many countries of the world a number of banks in Bangladesh have incepted IM scheme to cater for dealing with poverty. In this paper we will see how it works and if this can contribute to alleviate poverty.

Among South Asian countries Bangladesh leads the group with organizations like Islami Bank Bangladesh, Social and Investment Bank Bangladesh, Al-Fallah and Rescue. The Islamic microfinance institutions in Bangladesh have been primarily using deferred-payment sales (bay mu'ajjal) mode of financing. They have been facing tough competition from conventional giants like Grameen Bank and BRAC.

Though according to some studies, Islamic microfinance institutions have displayed better financial performance than their conventional counterparts, the latter have a far greater outreach. Indeed, institutions like Grameen and BRAC have pioneered models of microfinance that are replicated across the globe.

6.2 REPLICATING THE GRAMEEN MODEL IN MUSLIM SOCIETIES

The pioneering contribution of Grameen and its founder Professor Muhammad Yunus towards poverty alleviation can hardly be overemphasized. Recipients of Nobel Peace Prize for the year 2006, Grameen and Prof Yunus have provided a model of microfinance that is being replicated through one of the largest international networks of microcredit organizations for the poor in the world. There are currently eighty-six Grameen type credit and savings programs in twenty-eight countries. The key features of Grameen model, such as, entrepreneurship development among the poor, lending to groups based on mutual guarantee, small sized recurring loans, have all now become features of the text-book model of microfinance.

With widespread poverty in the Islamic world, the Grameen methodology has naturally attracted proponents of Islamic finance who share a common goal. However, the major discomfort in replication of the Grameen model in Muslim societies is its interestbearing product portfolio. Though Grameen is part of the conventional interest-based system, it is very different from the conventional banking system. In the words of its founder, Grameen model "is almost the reverse of the conventional banking methodology." Some major points of departure are as follows:

- There is no legal instrument between the lender and the borrower in the Grameen methodology;
- There is no stipulation that a client will be taken to the court of law to recover the loan, unlike in the conventional system;
- There is no provision in the methodology to enforce a contract by any external intervention¹².

¹¹ Estimates in the report of the 2011 International Conference on Islamic microfinance held in Islamabad.

¹² When a client gets into difficulty, conventional banks get worried about their money, and make all efforts to recover the money, including taking over the collateral.

Grameen system helps the borrowers to build their own pension funds, and other types of savings. In case of death of a borrower, Grameen system does not require the family of the deceased to pay back the loan. There is a built-in insurance program which pays off the entire outstanding amount with interest. No liability is transferred to the family.” The points of departure perhaps push Grameen very close to Islamic ideals. It appears that with some modification, especially with a financial engineering approach to development of Shariah-compliant products, the Grameen model has all the potential for eradication of poverty from Muslim societies in a manner that is compatible with Islamic Shariah – both in letter and spirit.

7 THE IM IN BANGLADESH: AN OVERVIEW

7.1 ISLAMIC BANKING IN BANGLADESH

Alongside the conventional interest based banking system, Bangladesh entered into an Islamic banking in 1983. At present, out of 48 banks in Bangladesh, 7 PCBs (Private Commercial Bank) are operating as full-fledged Islamic banks and 20 branches of 9 conventional banks are partially involved in Islamic banking. The Islamic banking industry continued to show strong growth since its inception in 1983 to June 2009.

Table 4: Islamic banking in Bangladesh

	Islamic Banks	Islamic Banking Branches	Islamic Banking Sector	Private Commercial Banks	All Banks
Particulars	2	3	5	5	6
Number of banks	7	9	16	30	48
Number of accounts	429	20	449	2185	6936
Number of accounts (in thousands)	5048	n.a	5048	11961	37573
Number of employees	15627	403	16030	n.a	n.a
Deposits	428.0	36.4	464.4	1783.3	2603.1
Investments (credits)	411.5	22.8	434.4	1483.3	1939.9
Investments deposits	0.96	0.92	0.94	0.83	0.75

Source: Annual Report 2008-2009, Bangladesh Bank

Islamic banking has great prospects and potentials in Bangladesh for rapid expansion to cater to the ever increasing demand from all segment of community of people of the country including Non-Muslims. Islamic banking has an inbuilt shariah principles and mechanism to ensure the equitable fair and welfare oriented development.

Islamic banks through profit and loss sharing mode of investment including charitable activities can be an alternative pathway to reduce poverty in Bangladesh which has been indicated clearly from analysis of continuous and comparative success of IBBL in the banking sector of Bangladesh.

7.2 A COMPREHENSIVE STUDY OF ISLAMIC BANKING PRACTICES IN BANGLADESH

While Islamic banking may not be a totally new concept, the widespread expansion of this form of banking is certainly a fairly recent phenomenon. There are more than 150 Islamic banking institutions and these institutions not only operate in Muslim countries, but have also gained footing in non-Muslim countries.

Since Islamic banks are founded on the same Islamic business principles and are governed by the same law i.e. Sharia laws, there should be no differences in terms of operations and practices amongst them. In reality however, many differences in practices do occur among the Islamic banks.

6.2.1. Islamic Bank Bangladesh Limited (IBBL)

➤ *IBBL at a glance*

Islami Bank Bangladesh Limited is a Joint Venture Public Limited Company engaged in commercial banking business based on Islamic Shari'ah with 63.09% foreign shareholding having largest branch network (246 Branches & 30 SME/Krishi Branches i.e. total 276 Branches) among the private sector Banks in Bangladesh. It was established on the 13th March 1983 as the first Islamic Bank in the South East Asia.

It is listed with Dhaka Stock Exchange Ltd. and Chittagong Stock Exchange Ltd. Authorized Capital of the Bank is Tk. 20,000.00 Million (\$ 250.47 Million) and Paid-up Capital is Tk. 12,509.64 Million (\$ 156.66 Million) having 60,302 shareholders as on 31st December 2012.

The mission of the IBBL is to establish Islamic Banking through the introduction of a welfare oriented banking system and also ensure equity and justice in the field of all economic activities, achieve balanced growth and equitable development in through diversified investment operations particularly in the priority sectors and less developed areas of the country. Also, the IBBL try to encourage socio-economic upliftment and financial services to the loss-income community particularly in the rural areas.

IBBL's vision is to always strive to achieve superior financial performance, be considered a leading Islamic Bank by reputation and performance; The key goal is to establish and maintain the modern banking techniques, to ensure soundness and development of the financial system based on Islamic principles and to become the strong and efficient organization with highly motivated professional, working for the benefit of people, based upon accountability, transparency and integrity in order to ensure stability of financial systems; It tries to encourage savings in the form of direct investment; It also tries to encourage investment particularly in projects which are more likely to lead to higher employment.

➤ *Investment Sheme*

■ Household Durables Scheme (HDS)

The objective is to increase standard of living and quality of life of the fixed income group by extending them investment facilities to purchase household articles.

■ Small Business Investment Scheme (SBIS)

This schele is designed to:

- Helping the educated unemployed youths of rural and urban areas for self-employment.
- Providing investment to small businessmen and entrepreneurs.

■ Agricultural Implement Investment Scheme (AIIS)

- To provide power tillers, power pumps, shallow tube wells, thresher machines etc. on easy terms to unemployed rural youths for self-employment.
- To the farmers to help augment production in agriculture sector.

■ Women Entrepreneurs Investment Scheme (WEIS)

- To extend the investment facilities to Women Entrepreneurs of different tires of the society.
- To assist the potential unemployed women to involve them in production process.
- Uplift of socio-economic condition of women by diversifying investment portfolio.

■ Rural development scheme

Bangladesh with its 38% people living below poverty line and 18% living in absolute poverty is suffering from acute rural-urban economic disparity coupled with illiteracy, lack of proper health and sanitation facilities. The country's economy is basically an agrarian one with vast majority living in rural areas. The agriculture sector is unable to provide any further scope for employment resulting in influx of rural population towards urban areas. Rural areas are characterized by stagnant agriculture and scanty industries. Underemployment and unemployment is a regular phenomenon particularly in rural areas. The vast human resources have remained unutilized due to lack of education, proper training and concerted efforts to help grow the rural economy. It results in uneven distribution of income which causes serious set back in balanced geographical growth as well as growth of GDP.

Islami Bank Bangladesh Limited was founded with the major objective of establishing Islamic economy for balanced economic growth by ensuring reduction of rural-urban disparity and equitable distribution of income.

In view of the above, Branches of the Bank have been encouraged to invest their deposits in their respective areas and in particular for the economic uplift of the rural people.

Accordingly, a Scheme in the name and style of 'Rural Development Scheme' has been introduced in 1995 to cater to the investment needs of the agriculture and rural sector to create opportunity for generation of employment and raising income of the rural people with a view to alleviate poverty. It is treated as first Islamic Microfinance Model in the Country & abroad.

The main objectives of the Scheme are:

- To extend investment facilities to agricultural, other farming and off-farming activities in the rural areas.
- To finance self-employment and income generating activities of the rural people, particularly the rural unemployed youths and the rural poor.
- To alleviate rural poverty through integrated rural development approach.
- To extend investment facilities for hand tube-wells and rural housing, keeping in view the needs of safe drinking water and housing facilities of the rural dwellers.
- To provide education and Medicare facilities to the down-trodden people.

■ **Integrated development approach**

The purpose of the Scheme is not only providing Micro Investment facilities to the stake- holder but also ensure various types of facilities & services to the downtrodden people as a part of Integrated Development Approach as well as Corporate Social Responsibility. The following areas have been covered under the Scheme:

- Humanitarian Assistance Program
- Education Program
- Capacity building or Training Program
- Health & Medicare Program
- Environment protection Program

■ **Performance of rural development scheme up to 31 March, 2013**

Islamic Bank Bangladesh Limited launched its Rural Development Scheme (RDS) in 1995. In the mean time, 207 Branches of the Bank have been operating the activities of the Scheme in their respective areas. These Branches are working among the poor in 15,748 villages of 61 districts of the country. Present number of members is 765,011 since beginning the scheme. The members are provided investment facilities an amount of BDT 62,063.64 million against which the outstanding was 11,263.75 million. Rate of recovery of the Scheme is more than 99.59%.

Table 5: The performance of rural development scheme in Bangladesh

		<i>in million Taka (\$)</i>
<i>Sl.</i>	<i>Areas of performance</i>	<i>No.&Volume/Amnt.</i>

Area Coverage		
1	<i>No. of Branches handling the Scheme</i>	207
2	<i>No. of Villages (no. of total village in the country is about 87,000)</i>	15,748
3	<i>No. of Districts (no. of total district in the country is 64)</i>	61
4	<i>No. of Centers</i>	24,976
5	<i>No. of Groups</i>	156,001
6	<i>No. of Members (existing)</i>	765,011
7	<i>% of Women members in the Scheme</i>	84%
8	<i>Average no. of members per Centre (expected no. 40)</i>	31
9	<i>No. of Clients (Who availed investment)</i>	491,032
Financial Statement (RDS & MEIS)		
10	<i>Cumulative disbursement (since inception)</i>	62,063.64
11	<i>Present outstanding</i>	11,263.75
12	<i>Overdue</i>	45.35
13	<i>Percentage of Recovery</i>	99.59%
14	<i>Balance of Members' Savings (including Centre Fund)</i>	3,538.31
Financial Statement (MEIS)		
15	<i>Number of clients under MEIS</i>	57,184
16	<i>Cumulative disbursement (since 2005)</i>	14,840.12
17	<i>Present outstanding</i>	4,849.78
Manpower Position		
18	<i>No. of Field Officers</i>	2,150

19	No. of Project Officers	176
20	No. of Zone Officers	20

■ ***The urban poor development scheme***

As Islami Bank Bangladesh Limited established with a view to develop welfare oriented banking system and to ensure equity and justice in the field of all economic activities, the Board of Directors in its emergent meeting held on 19.02.2012 approved a new Scheme under the name & style of “Urban Poor Development Scheme (UPDS)”. The Scheme activities started formally from 14.05.2012 through Gandaria Branch, Dhaka.

Objectives of UPDS

- To alleviate urban poverty through Investment in income generating activities
- To improve the livelihood of urban poor specially the slum dwellers
- To improve the Health, sanitation & education status of urban poor specially the children & women
- Help to improve the environment of the poor
- Reduce the level of crime & violence through the development of ethical and religious values.

6.2.1. Al-Arafah Islami Bank Limited (AIBL)

➤ ***AIBL at a glance***

Islam provides us a complete lifestyle. Main objective of Islamic lifestyle is to be successful both in our mortal and immortal life. Therefore in every aspect of our life we should follow the doctrine of Al-Qur'an and lifestyle of Hazrat Muhammad (Sm.) for our supreme success. Al-Arafah Islami Bank started its journey in 1995 with the said principles in mind and to introduce a modern banking system based on Al-Qur'an and Sunnah.

A group of established, dedicated and pious personalities of Bangladesh are the architects and directors of the Bank. Among them a noted Islamic scholar, economist, writer and ex-bureaucrat of Bangladesh government Mr. A.Z.M Shamsul Alam is the founder chairman of the bank. His progressive leadership and continuous inspiration provided a boost for the bank in getting a foothold in the financial market of Bangladesh.

A group of 20 dedicated and noted Islamic personalities of Bangladesh are the member of Board of Directors of the bank. They are also noted for their business acumen. Al-Arafah Islami Bank Ltd. has 78 branches and a total of 1711 employees (upto December 2010). Its authorized capital is Taka 5000 millions and the paid-up capital is Taka 4677.28 millions.

Wisdom of the directors, Islamic bankers and the wish of Almighty Allah make Al-Arafah Islami Bank Ltd. most modern and a leading bank in Bangladesh.

➤ ***Some data on the Bank***

Table 6: AIBL : some data

Particulars	2004	2005	2006	2007	2008
Authorized Capital	1000.00	1000.00	2500.00	2500.00	2500.00
Paid up Capital	586.99	677.94	854.20	1153.18	1383.81
Reserve Fund	488.00	542.22	835.98	1091.95	905.33
Shareholders Equity	957.26	1220.16	1690.18	2037.50	2705.74
Deposit	10108.28	11643.66	16775.34	23009.13	29690.12

Investment	8150.16	11474.41	17423.19	22906.37	29723.79
Import	9337.49	12631.60	1882.14	27042.72	32685.13
Export	3639.34	4932.90	914.27	12714.91	20176.64
Total Income	1120.85	1452.68	2172.48	2955.61	4387.26
Total Expenditure	771.96	904.48	1202.71	2199.43	2859.16
Profit before Tax	348.89	548.20	855.47	756.18	1528.09
Profit after Tax	158.76	262.90	470.02	347.31	668.24
Income Tax	157.00	215.10	385.45	235.53	590.66
Total Assets	12874.61	15336.89	21368.17	30182.32	39158.44
Fixed Assets	195.17	208.00	215.11	334.48	396.76
Earning per share (Taka)	263.68	387.80	550.24	30.12	48.29
Profit Earning Ratio			4.89		
Dividend per share	15.5%	26.00%	35%	20%	30%
Bonus					
No. of Shareholders	5379	5402	4487	12013	10664
Number of Employees	803	771	912	1033	1080
Number of Branches	40	41	46	46	50
Manpower per Branch	20	19	20	23	-

*all statistics are in million taka

➤ **Special features of the Bank**

As an Islami bank, we are singular in every positive aspect. We provide a bunch of state-of-art banking services within the wide bracket of shariah. We are unique with our products, strict with our principle and uncompromising with our honesty. Some of our special features that make us notable in Islami banking sector are as follows:

- All activities of AIBL are conducted under an profit/loss based system according to Islamic Shariah to get the nation rid of Usury.
- Its investment policies under different modes are fully Shariah compliant and well monitored by the board of Shariah Council.

- During the year 2007, 70% of the investment income has been distributed among the Mudaraba depositors.
- AIBL believe in providing dedicated services to the clients imbued with Islamic spirit of brotherhood, peace and fraternity.
- The bank is committed towards establishing a welfare-oriented banking system to meet the needs of low income and underprivileged class of people.
- The Bank upholds the Islamic values of establishment of a justified economic system through social emancipation and equitable distribution of wealth.
- Following the Islamic traditions, it is assisting in the economic progress of the socially deprived people; in the creation of employment opportunities and in promotion of rural areas to ensure a balance development of the country.

➤ **Micro finance**

The economy of Bangladesh mostly depends on rural development. Poverty stands in the way of the growth of this economy. Although a number of NGOs and financial organizations work in the sub-urban and villages with a view to alleviating poverty, a very few are found working with the compliance of Islamic Shariah. It is a national responsibility to alleviate abject poverty from the rural area. To help change the socio-economic condition of the impoverished people of the villages, Al-Arafah Islami Bank Limited has initiated a project entitled "Krishi O Grameen Khudra Biniog Prokolpa (Microfinance). With this project, Bank is working for reduction of poverty, development in agricultural sectors, creation of job opportunities etc. We hope this will develop the socio-economic condition of a large segment of the rural folk.

■ **The main characteristics**

It is a group based work. The main characteristics are:

- This is a supervised investment programme
- A group consists of 5 (five) members
- Eight groups make a Samitee. It means that a Samitee contains 40 members
- Every group has a Group Leader and a Deputy Group Leader
- Every Samitee has a Samitee Leader and a Deputy Samitee Leader
- All members must attend the weekly meeting
- Ceiling of Microfinance Investment is from Tk. 3,000 to Tk. 50,000

■ **Purpose**

- To facilitate rural entrepreneurs
- To develop socio-economic condition of rural people
- To save rural people from usury
- To facilitate the growth of agro-industries
- To create employment scope
- To broaden the base of Islamic Banking in the rural society
- To encourage women entrepreneurs

6.3. Scope of the prospects and challenges of IM in Bangladesh

In Bangladesh, Islamic microfinance faced many challenges such as:

- Low institutional technical capacity, established policies and procedures and guidance
- Requires high level of transparency - the difficulty associated with calculating profits and losses
- High transactions costs

Also, challenges associated with a demographic reality include poor infrastructure, including a dearth of formal financial services, widespread illiteracy, and a lack of consensus among the country's Islamic scholars about what makes a financial product Sharia-compliant.

In Bangladesh, Islamic microfinance had a positive impact on poverty reduction as shown by empirical studies, especially in rural areas. The study concluded that the various loans program have a significant role in alleviate poverty, unless they were in an environment with material and social capital sufficient to achieve the goals of said programs. Islamic micro finance has won recognitions as an important strategy against poverty it is an institution that is ready and prepared to serve larger population of the target poor individuals.

The study was expected to improve the practice of Islamic Microfinance because it highlights and provide a better understanding to IMF programs and how IFIs can contribute to the alleviation of poverty. The social role of Islamic financial sectors can be best exemplified by providing finance to the poor so as to increase their income and wealth. One of the main approaches to benefit the poor is to facilitate their accessibility to appropriate financial services and products. Islamic financial institutions need to consider some measures such us the establishment of new branches in area lacking financial services. Also, hiring and training local male as well as female staff in order to better reach and serve poor clients in their communities has a capital role in term of poverty alleviation. Applying group guarantees or group lending should be an effective method in reaching the poor, reducing the risk of default, and lowering transactions costs. Furthermore, designing special lending program based on repeated loans of increasing size and duration is important is a key task. Such program be supposed to encourages business expansion, provides an incentive for timely and complete repayment and, develops continuing relation with the financial institution; Providing complete financial services including savings or deposit mobilization not just lending, reducing transactions costs in terms of money and time through simplifying credit application and approval procedures, and increasing the decision authority of field offices and finally providing standardized financial services and products which meet the various needs of borrowers with fees and no riba or interest, should be taken in account.

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