

Microfinance in the Arab World: Shaping the Industry's Future

First Annual Conference of SANABEL, Microfinance Network of Arab Countries

Islam and Microfinance

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Islam and Microfinance



- Why Islamic Microfinance
- Risk Sharing and Sales vs. Profits from Lending Money (the fundamentals)
- Musharaka - Mudaraba - Murabaha (the application)
- Islamic Microfinance Experience
- Comparison with Traditional Lending
- Challenges and Opportunities

Why Islamic Microfinance




- Microfinance is targeting the poor, and in some programs *"the economically active"* poor
- A significant percentage of targeted groups in specific geographic areas of the Arab world are strictly abiding by Islamic business rules

Why Islamic Microfinance



It is therefore, the responsibility of development practitioners to devise “access to capital” mechanisms that cater to the belief of men and women who are not accessing conventional microfinance services for religious reasons

Risk Sharing and Sales vs. Profits from Lending Money: the fundamentals



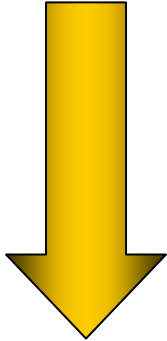
“Those who devour usury Will not stand except as stands one whom the Evil one by his touch Hath driven to madness. That is because they say: Trade is like usury But God hath permitted trade and forbidden usury”

Qura'an (El Bakara - 275)

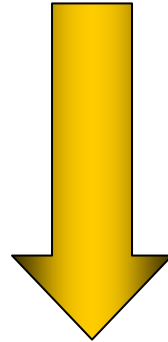
Risk Sharing and Sales vs. Profits from Lending Money: the fundamentals

- Islam views that money is not an asset that should earn a surplus *in, and of* itself
- Profit is allowed, because it entails sharing risks and rewards. In that, it complies with Islamic ideals of social equity since both the lender and the entrepreneur share the "*investment or business*" risk. The basic premise is that profits or returns are related to the transaction and not to the time of repayment

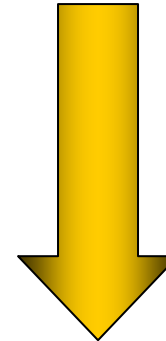
Musharaka – Mudaraba – Murabaha the application



An Equity Participation where both parties invest money. Profits and Losses are shared according to the amount invested, or according to the parties' agreement.



A trustee financing where the financier invests only money and the entrepreneur invests labor. This agreement could be coupled with a "buy back" option if agreed to by both parties.



A cost plus mark-up where the seller "*financier*" and the buyer both know the acquisition price of a good. A profit margin is negotiated between the two parties. Payments are normally made on installments.

Islamic Microfinance Experience

UNCDF/SUM MicroStart/Al-Eslah Society

Bahrain

Applied Murabaha. However, the program faced expansion problems and high administrative costs, mainly due to additional efforts required from loan officers to physically buy the goods and re-sell them to the clients.

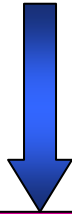
Utilized the services of volunteer youth to escort the clients, buy the goods in the association's name and re-sell them to the client, on the spot. In some cases, where the society knows the client and/or the vendor, it could empower the client to buy the goods in the society's name and re-sell them to him/herself.

Added an option for good clients to have a "Qard Hassan" or benevolent loan (*not to exceed 50% of the total transaction amount*) in addition to the Murabaha transaction. In that case, the society requires a larger mark-up on the Murabaha portion to compensate the required returns on its total money engaged.

Comparison with Traditional Lending

	Islamic Microfinance	Traditional Lending
Business Risk	Shared in Musharaka and Mudaraba, and not shared in Murabaha	Assumed by the borrower, the loan transaction is not linked to any other factor
Repayments	Peer pressure and moral obligation to pay are present, besides collateral	In many programs, post-dated checks and promissory notes are the only collaterals
Administrative Costs	High, due to more time spent in the field by officers to execute the transactions	Fast loan disbursement is essential to the clients and should be continuously sought by lenders
Growth	Institutions do not access commercial lines of credit, but could enter into Mudaraba agreements with institutional investors	Financially sustainable Microfinance Institutions could access lines of credit and leverage its financial resources

Challenges and Opportunities



Need to devise more efficient outreach mechanisms

Has to include Business Development Services (BDS), especially for enterprises entering into Musharaka and Mudaraba to monitor the investments

made

Should always strive to portray the institution in a non-charitable manner. Contrary to the classical view of an Islamic-oriented institution



Musharaka, and Mudaraba are more attractive to small and medium enterprises

Could be beneficial in group projects and village/group lending programs

Could access institutional capital in non-traditional forms "Mudaraba, zakat, donations, and "trustee" Wakf Bonds