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ISLAMIC MICRO FINANCE BANK: AN ALTERNATIVE TOOL FOR POVERTY ALLEVIATION IN NORTHERN NIGERIA

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ABSTRACT

Despite the modest achievements recorded by Microfinance Banks in Nigeria, the poverty rate in the country remains daunting and that majority of the disadvantaged and economically active poor remain financially excluded. A huge part of the Islamic population particularly in northern part of the country are also reluctant to use conventional Microfinance products due to their incompatibility with Islamic principles, charging high fixed interest rates, credit diversion and the skewed nature of the distribution of Microfinance Banks which further limits financial inclusion in the region. These basic challenges can be resolved if an Islamic Micro-Finance Institution is designed in an integrated manner by incorporating the two basic and traditional institutions of Islam, Awqaf and Zakat with Islamic Micro-finance into a single framework in order to promote financial inclusion and reduce poverty among such population. The proposed model will be effective in poverty alleviation since the poor borrowers will have less debt burden as their capital investments will be partly met by funds from zakat that does not require any repayment and part of the Zakat funds will be used in disbursing funds to fulfil basic consumption needs to the hard-core poor target group. Thus, the paper recommends that a Non-Governmental Organization abiding by Islamic norms and ethics with the objective of poverty alleviation would be the ideal form of organization that will provide micro-finance facilities based on Islamic principles using Zakat and Awqaf funds as two major sources of finance.

***Keywords**: Islamic Microfinance, Zakat, Awqaf, Poverty*

İSLAMİ MİKROFİNANS BANKASI: KUZEY NİJERYADAKİ YOKSULLUĞUN AZALTIMASI İÇİN ALTERNATİF ARAÇ

ÖZ

Nijerya'da mikrofinans bankaları tarafından kaydedilen ılımlı başarılara rağmen, ülkedeki yoksulluk oranı göz korkutucu olmaya devam ediyor. Dezavantajlı ve ekonomik anlamda aktif fakirlerin çoğunluğu mali açıdan dışlanmış durumdadır. Özellikle ülkenin kuzey kesimindeki Müslüman nüfusun büyük bir kısmı, konvansiyonel Mikrofinans ürünlerini, İslami ilkeler ile olan uyuşmazlıkları, yüksek sabit faiz oranları, kredi çeşitlendirmesi ve Mikrofinans bankalarının dağıtımdaki çarpık niteliği nedeniyle isteksiz davranmakta ve bu da bölgedeki finansal erişimi daha da sınırlamaktadır. İslam'ın iki temel ve geleneksel kurumunu (evkaf ve zekat) bir araya getirerek bütünleşmiş bir tarzda tasarlanmış İslami bir Mikrofinans Kurumu, bu temel zorlukları çözebilir. Bu sayede finansal erişim teşvik edebilir ve nüfusun yoksulluğu azaltılabilir. Önerilen model, yoksulluğun azaltılmasında etkin olabilir zira sermaye yatırımları kısmen, herhangi bir geri ödeme gerektirmeyen zekattan elde edilen fonlardan ve kısmen de en fakir hedef grubunun temel tüketim ihtiyaçlarını karşılamak için kullanılan fonların yeniden dağıtımında kullanılacak olan zekat fonlarından sağlanacaktır. Bu nedenle, makale, yoksulluğun hafifletilmesi amacıyla İslami normlara ve ahlaka uyan bir Sivil Toplum Kuruluşunu, Zekât ve Evkaf fonlarını iki önemli finans kaynağı olarak kullanarak İslami ilkelere dayanan mikro finansman imkânı sağlayacak ideal bir organizasyon biçimi olarak önermektedir.

***Anahtar Kavramlar:** İslami Mikrofinans, Zekât, Evkaf, Yoksulluk*

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Poverty has become a major socio-economic problem in most countries of the world especially developing countries. Many national governments in Africa have tended to treat poverty as a purely economic problem that could be overcome by means of carefully planned and implemented economic development programs. But such approach has often led merely to increase in average incomes and gross national product (GNP) but has not led to visible improvements in the living standards of the masses of the people. The general observation indicated clearly that aggregate economic development efforts among developing countries of Africa such as Nigeria, Mali, Kenya etc, does not necessarily lead to poverty eradication and that a better way to fight the menace of poverty that will impact on the welfare of the people and raise their living standard particularly the socially vulnerable groups is to promote financial inclusion among such population in order to make capital available for micro businesses and prospective entrepreneurs.

The government in Nigeria therefore came up with micro finance banks in order to provide collateral free credit access to the poor as it is assumed that lack of collateral is the most important obstacle in availing formal credit which hinders the overall investment and profitability of the micro-entrepreneurs. Thus, micro-finance aims at providing collateral free financial services to the poor to assist them develop micro-businesses, increase their income level and eventually get out of the poverty trap (Dichter, 2007). The microfinance and supervisory framework issued by the CBN in 2005 sought to encourage the development of SMEs and empower low income groups in Nigeria. According to the CBN (2005), the policy provides for the setting up of private sector driven MFBs to provide services for poor and low income groups; cover the majority of the poor but economically active population, promote the participation of at least two-thirds of states and local governments in micro credit financing and improve women's access to financial services.

Notwithstanding the modest achievement recorded by MFBs in Nigeria, the poverty rate in the country remains daunting such that majority of the disadvantaged and economically active poor remain financially excluded. For instance many of the micro entrepreneurs still lack access to credit thereby impeding economic growth and development. Indeed, as noted in the Revised Microfinance Policy; a large percentage of Nigerians are still excluded from financial services. A study by Enhancing Financial Innovation and Access (EFIA) in August, 2010 revealed that 39.2 million people representing 46.3 percent of the Nigerian adult were excluded from financial services. The survey also revealed that Nigeria is lagging behind South Africa, Botswana and Kenya with 26 percent, 33 percent and 32.7 percent financial exclusion rate respectively (EFIA, 2010).

In Northern Nigeria however, high level of unemployment, poverty and low level of financial access continue to create high demand for microfinance. But the skewed nature of the distribution of MFBs in Nigeria had limited the access of a vast majority of the economically active poor to credit in Northern Nigeria because of the uneven distribution of the MFBs in the country. Even in those parts of the country with sizable number of MFBs, most of the institutions are located in urban places to the neglect of the rural areas because of pure profit making considerations (Thom-Otuya and Chukuigwe, 2014).

Evidences has also suggests that many potential clients of microfinance in the North categorically reject the products of conventional micro finances due to non-compliance to Islamic principles, charging high fixed interest rates, credit diversion, credit rationing and non-conformity with the Islamic faith of the majority population. Thus, these obstacles hindered the effectiveness of the conventional Microfinance in reducing extreme poverty in northern Nigeria.

It is against this background that this paper tries to conceptualize and propose the creation of an Islamic microfinance in the Northern Muslim dominated states as a means of fighting the high prevalence of poverty in the region. There is an opportunity for Islamic micro-finance to grow and be effective as it is in conformity with popular beliefs of the people and will take care of the needs of the under-privileged Muslim population. The paper adopted a model which was proposed by (Hassan, 2010) as a model for poverty alleviation in Bangladesh with some modifications to suit the peculiarities of our society. The model combined Islamic micro-finance with two traditional Islamic tools of poverty alleviation such as Zakat and Awqaf in an institutional set-up.

Islamic Micro-Finance

Islamic banking has grown significantly over the past three decades at an annual rate of over 17% with an overall capitalization of US$1.7 trillion at present (WIBC Report, 2014). Islamic micro-credit an evolving concept with outreach in mostly the Arab world has grown considerably to more than 1.6 million borrowers in 2014. Islamic microfinance refers to the system of finance that is based on Islamic law, also known as

"Sharia." It combines the elements of "Islamic finance" and "microfinance." The main feature of Islamic finance that differentiates it from conventional finance is the non-existence of a fixed, pre-determined interest in any financial transaction. Islamic microfinance has a major role in poverty alleviation in under-developed nations across the world. A huge part of the Islamic population is reluctant to use conventional financial products due to their incompatibility with Islamic principles. Islamic microfinance is a way to promote financial inclusion among such population. Islamic microfinance is the need of the time, and can be used as a weapon for poverty alleviation as poverty can be alleviated through "qard-e-hasna" (a goodwill loan) particularly in an Islamic dominated society like northern Nigeria.

As an effective alternative to conventional micro-financing, Islamic micro-financing institutions (mentioned hereafter: IMFIs) are evolving in different countries as well. Some of the elementary differences between IMFIs and conventional MFIs as pointed out by Ahmed (2012) are discussed below:

1. **Sources of Funds:** Unlike the conventional Microfinance that depend on interest free or low interest foreign aid, Islamic Microfinance Institutions may collect funds from religious contributions through the institutions of Awqaf, Zakat, and other charities.

2. **Modes of Financing:** Islamic Microfinance has a divers mode of financing and areas of financing. Apart from interest-free loans (Qard-Hasan), the principles of Islamic financing can be broadly classified as partnerships (Shirakat) and exchange contracts (Mu'awadat).

a) Non-Profit-and-Loss Sharing Modes: Non-profit-and-loss sharing modes can include different transaction modes such as:

i. Bay'-mu'ajjal: is a mode of deferred sale in which the object of the sale is delivered at the time of the contract but the price is paid later. The price can also be paid in future instalments.

ii. Murabaha: is a special type of financial transaction, in which the Islamic Microfinance buys a good or asset and sells it to the client at a mark-up. The client pays for the good or asset at a future date or in instalments.

iii. Ijarah: is similar to a conventional leasing contract in which the client uses an asset by paying rent.

iv. Ijarah wa iqtina': is similar to a hire-purchase scheme or a lease purchase scheme in which the instalment includes rent as part of the price. When the instalments are fully paid, the ownership of the asset is transferred to the client.

b) Profit and loss sharing Modes: Among different profit and loss sharing modes, the following are most commonly practiced:

i. Musharaka: is an equity participation mode of contract where the financer provides both equity and entrepreneurial skills on a project and thus shares profit or loss on a fixed proportion. The Musharakah principle can be used in production (agricultural and non-agricultural). Islamic Microfinance can provide part of the financial capital to produce an output and in return receive a share of the profit.

ii. Mudarabah: Production undertaken under the Mudarabah principle implies that the Islamic Microfinance provides financing and the client manages the project.

iii. Muzara'ah: is an output-sharing contract specifically for agricultural production where the bank may provide funding for the purchase of irrigation equipment, fertilizers, which the landowner uses on his land to cultivate a certain crop.

A Model of Islamic Micro-Finance

The basic challenges of conventional micro-finance in reducing extreme poverty as identified above can be resolved if an Islamic Micro-Finance Institution is designed in an integrated manner by incorporating the two basic and traditional institution of Islam, the Awqaf and the Zakah with Islamic Micro-finance into a single framework.

Considering the extreme nature of the poverty level in northern Nigeria, the said institution should use the Zakah fund in disbursing funds to fulfil basic consumption needs for the hard-core poor target group in the first place, as on principle no return can be realized from Zakah fund and Zakah fund should be disbursed within one financial year this may reduce the chances of loan default because the tendency of the poor to use the loan fund for consumption purpose will be met. As their basic consumption needs are covered, the poor micro-entrepreneurs may be in better position to focus on their business alone. Zakah fund may also be used in providing the capital investment of or providing the business initiation fund and for that no return should be charged. While, the Awqaf funds may be used as investable fund in providing capital investment and working capital financing for the micro-businesses.

Moreover, since Islamic financing modes are based on principle of social justice and equity and Riba is prohibited, Islamic MFIs are likely to yield better result in terms of poverty reduction if they are properly designed as it will result in less financial burden on the poor. Such visible benefits of such a financing organization in contrast to conventional micro-credit organization will be greater.

Benefits of Islamic Microfinance

If implemented, the proposed model will contribute to poverty alleviation by combining all three approaches: positive measures (like increasing income growth through development of micro-business for the poor), preventive measures (through ensuring functional re-distribution among factors of productions) and corrective measures (engaging Zakat and Awqaf).

Unlike conventional MFIs, under the proposed model, the poor borrowers will have less debt burden as their capital investments will be partly met by funds from zakah that does not require any repayment. Since Islamic financing modes are based on profit-and-loss sharing principle, so there will not be any fixed interest payment burden for the borrowers. All these factors will lead to lower default rates and graduation from poverty will be higher.

Such an integrated model may effectively resolve fund inadequacy by using funds from the Zakah and the Awqaf. The IMFIs may use the Zakah fund in disbursing funds to fulfil basic consumption needs for the hard-core poor target group in the first place, as on principle no return can be realized from Zakah fund and Zakah fund should be disbursed within one financial year. Zakah fund may also be used in providing the business initiation fund and for that no return should be charged. However, the Awqaf funds may be used as investable fund in providing capital investment and working capital financing for the micro-businesses.

The proposed model may also reduce the chances of loan default because the basic inherent tendency of the poor to use the loan fund for consumption purpose will be met. As their basic consumption needs are covered, the poor micro-entrepreneurs may be in better position to focus on their business alone.

Moreover, since Islamic financing modes are based on principle of social justice and equity and Riba is prohibited, Islamic MFIs are likely to yield better benefit if they are properly designed. In addition, borrowers will have lower refundable loan, as a result of utilization of Zakah funds, it will result in less financial burden on the poor. Thus, the visible benefits of such a financing organization in contrast to conventional micro-credit organization will be greater.

To sum up, the proposed Islamic micro-financing model will yield more benefit towards the overall social welfare. If such an IMFI is undertaken on a pilot project basis, and further operational adjustments are made accordingly, there may be a visible impact on poverty reduction among the targeted poor population and if a number of NGOs apply this model, the aggregate benefit will be greater.

Organizational Frameworks and Operational Procedures

Development initiatives have identified private and non-governmental organisations as more effective and more efficient in terms of poverty alleviation because of the inefficiencies and corruption that are associated with government involvement. Donor agencies are increasingly focusing on more private participation and NGOs (non-government organizations) particularly when it comes to issues of programs that are targeted at the poor and the less privileged populations. Considering these factors, we therefore propose that a Non-Governmental Organization abiding by Islamic ethics and norms with the objective of poverty alleviation would be the ideal form of organization.

I. **Mission and Vision:** The vision of the Organization should be to create a poverty free society based on the Islamic principles of equality, social justice, and balanced growth. The mission of the Organization should be collecting Zakat and Awqaf contributions from a specified locality and providing a credit facility to the poorest segment of society.

II. **Objective:** The main objective of the Organization should be to reduce poverty through the balanced growth and development of different segments of society, develop micro-business among the poor to enable them to attain a sustainable income growth and eventually get out of the poverty trap and also provide financing for other items such as education, health services, and house building.

III. **Key Functions:** Using an integrated approach, a single concern would be responsible for the management of Zakat, Awqaf and Islamic financing. This organization would perform three key responsibilities:

a) Collecting and managing Zakat funds from prospective Zakat donors as well as from other Zakat fund management institutions.
b) Collecting and managing Awqaf funds from prospective Awqaf donors, and from other Awqaf fund management institutions.
c) Providing micro-credit to the poor on the basis of Islamic Sharia.

IV. Credit Delivery Model: The proposed model may provide micro-finance facilities based on the adaptation of Islamic principles, group recovery, and a credit disbursement model by undertaking a few pilot projects to analyze the response of customers in different localities.

Financial Management Framework

Principles of Fund Management: In the proposed model, the NGO will use Zakat and Awqaf funds as the two major sources of financing. On principle, Zakat funds do not need any return or repayment. Zakat funds would be used for two purposes: to fulfil basic needs and to provide capital investment so that a member could start a micro-business. Awqaf funds could be used as source of funding as well. From Awqaf funds, both capital investment and working capital investments could be made. In case of capital investment with Awqaf funds, the NGO would engage Mudaraba mode. However, in the initial phases, the NGO may engage Awqaf funding only for working capital investment. For operational simplicity, the NGO would prefer the Murabaha mode of financing for working capital as that will also ensure that short-term credit is utilized in a proper way. Moreover, as the fee is fixed, it will ensure the NGO with stable and predictable revenue during the initial years. As Zakat fund's investment in capital investment will not generate any revenue, the NGO will be better off investing in Murabaha mode for working capital financing.

In addition to these two major sources, the NGO would also collect funds from borrowings from Islamic banks and financial institutions, deposits from members, deposits from its employees, and deposit schemes for non-members. If needed, the NGO can also go to the capital market and raise funds through issues of share capital. In its overall financial operations, the NGO will comply with Islamic banking principles and Islamic Sharia'h benchmarks.

Sources of Capital: As previously mentioned the NGO will raise funds from different sources with different contractual modes. In principle, the NGO will not engage in raising funds that does not conform to the Islamic norms of banking. The NGO will collect funds from the following sources.

1. Zakat contributions will be collected from prospective members, Zakat donors, or other Zakat fund management organizations. In the initial phase, the NGO might focus on its core function of micro-finance instead of collecting and managing Zakat funds. In countries where the government, by law, does not enforce Zakat, collecting sizeable amounts of Zakat at the initial stage might be a challenge. However, considering the way Zakat funds are collected, for any investment made on Zakat funds, no repayment or return can be charged.
2. In the initial phase, the NGO might opt for a similar strategy in collecting Awqaf contributions. However, on investments made from Awqaf contributions, return and repayment can be charged on Mudaraba mode. All of them should, however, be used for benevolent purposes.
3. Donations from other institutional and non-institutional sources might require repayment of principle, and in some cases profits, in addition on Mudaraba mode.
4. Borrowings from Islamic Banks and non-banking financial institutes will be collected based on Sharia'h principles, especially through Mudaraba mode.
5. The NGO can also generate funds from equity shares or from capital market participation.

Funds Utilization: The basic activity of the NGO is to provide credit for micro-businesses. As micro-business requires credit for both capital investment and the fulfilment of working capital needs, the NGO can arrange for both in a balanced way. Its capital investments can create the base upon which to provide working capital credit or short-term credit. As mentioned earlier, the NGO would involve Zakat contributions for non-redeemable capital investment with no return only. However, the working capital credit will be delivered based on the Murabaha model.

Apart from these two basic investments, the NGO will also engage in Mudaraba investment modes after it can build its own capacity and its clients are well versed in accounting principles. Moreover, investment in micro-credit, the NGO will undertake diversified investment activities such as investing in Islamic bonds. Earnings from such non-operational activities will provide a cushion during profit fluctuations resulting from uncertainties.

CONCLUSION AND RECOMMENDATIONS

Micro-finance involves providing credit without collateral to the marginally poor. The traditional micro-finance in Nigeria suffers from high default risk, skewed distribution, and non conformity with the popular beliefs of the majority. Successful NGOs from some countries alike such as the Amanah Ikhtiar Malaysia (AIM) have shown that Islamic micro-finance can be used as an alternative tool for providing interest free credits to create and sustain successful businesses. The paper therefore concludes that an Islamic micro finance will be effective in reducing the extreme nature of poverty in northern Nigeria by providing interest free credits to the disadvantaged and economically active population. The proposed model will be financially viable and sustainable in the long run, resulting from lower default rates and its diverse source of funds.

Considering the challenges faced by the conventional microfinance institutions particularly operating in a Muslim dominated society like northern Nigeria and the prospect of Islamic microfinance and its number of benefits, the paper suggests that:

1. A Non-Governmental Organization abiding by Islamic norms and ethics with the objective of poverty alleviation should be formed or adopt the model by the existing organisations such as the MSS, JIBWIS, JNI and etc, to provide micro-finance facilities based on Islamic principles using Zakat and Awqaf funds as the two major sources of finance.
2. At the initial stage, various state governments may provide certain percentage of the start up capital in order to support the organisation either as a grant or inform of an interest free credit to be repaid at later date.
3. Zakat Donors should also recognise and cooperate with such an organization to pay at least 50% of their annual Zakat donations to the organization and also the organization should design appropriate Awqaf certificates of different amount and distribute to Awqaf donors throughout the society.
4. The NGO may take its initial initiatives as pilot projects. Such pilot projects can be described as "units". A unit manager will lead the overall functioning of a particular locality and manage a number of credit officers who will disburse and collect the micro-credit loans to and from the borrowers. Credit officers will be responsible for the overall credit appraisals, credit delivery, monitoring, and recovery process. One credit officer will be in charge of a number of group operations. In addition to regular credit officers, a team of two or

three credit officers will be in charge of credit monitoring to determine whether or not credits are used properly. Such a team will also provide additional information, which will be used by unit managers and general management to analyze the model performance.

5. The paper also recommends for further researches in the area in order to come up with the appropriate model of Islamic microfinance that will suite the peculiarities of our society and the necessary framework for its efficient operations.

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