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e-MFP
European Microfinance Platform

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Strengthening MFIs in Developing Countries
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Workshop on :
Islamic Microfinance: institutional diversity
Organized by Hans Dieter Seibel (seibel@uni-koeln.de)

– Summary –

Dialogue

Islamic finance, which is built on profit-sharing and objections against the payment of interest (*riba*) on savings and credit, evolved only within the last four decades. Depending on whether these objections are institutionalised by the government, voiced by the people from below or propagated by religious organizations in a secular state, Islamic finance may be mandatory as in Iran, informal as in Syria or in competition with conventional finance as in Indonesia. The coordinator of this session, Prof. Hans Dieter Seibel of the University of Cologne, Germany, pointed out that Islamic microfinance is just emerging and that this might be the first workshop on Islamic microfinance to take place. He stated that the common denominator of the contributions to this workshop was the diversity of institutions on a continuum from informal to formal. The issues that the session would explore would be institutional options, financial products and the regulatory framework.

Mr Bahman Mansuri presented the microfinance activities of Bank Keshavarzi (BK), the agricultural bank of Iran, through a linkage banking project in cooperation with DRMFS. BK provides loans from its own resources and deposit facilities as well as crop and livestock insurance; technical assistance is supported by Italy through IFAD. In a first phase, local NGOs help organizing solidarity groups which guarantee their members' loans from BK. In a second phase, the groups are offered the opportunity of evolving into self-help groups of a larger size, which mobilize their own capital and function as informal financial intermediaries, with access to refinancing from BK. The core target group are the rural poor, rural women and young adults. Surprisingly, 95% of the groups are mixed groups; 57% of the members are women; and 40% of the groups are headed by women. Repayment performance has been excellent.

Ms Nashwa Abdulkarim of the Rural Community Development Project(RCDP) in Syria, was unable to attend due to visa difficulties; so Prof. Seibel spoke on her behalf. Until recently, banking was state-owned and secular, and microfinance non-existent. In 1998, UNDP, in cooperation with the Ministry of Agriculture, made preparations for the establishment of *sanadiq* (pl.), member-owned village funds in Jabal al-Hoss, one of the poorest areas in Syria. The start-up is self-financed through member share capital for small initial loans for 1-3 months. When financial intermediation is found satisfactory, UNDP provides a capital injection. Each *sandug* (sg.) is self-managed and autonomous. This has included the adoption of Islamic banking, with murabaha (buying-and-selling) as their main financial product. Women opted for inclusive membership, rather than establishing their own fund. As of June 2006 there were 32 sanadiq with 7360 shareholders, close to 50% of them women. The repayment rate is 95%. While capital injections by donors have greatly increased loan sizes, loan periods and dividends in the 32 sanadiq, they have at the same time held back expansion to other villages, which are hesitant to start on their own resources without a commitment of external capital injections. For better or worse, which only the future will tell, through decree n° 125 of 16.05.2006 a microfinance section is now incorporated in the Ministry, providing a framework for the sanadiq as semi-formal financial institutions.

Mr. Iman Budi Utama of GTZ in tsunami-stricken Aceh in Indonesia presented a new approach to cooperative reform through Islamic cooperatives. Of 1,052 government-directed financial cooperatives in the province, registered but not effectively regulated nor supervised, only 3% were found to be performing reasonably well, while 64% were non-performing. In this situation, instead of attempting to reform an ailing conventional cooperative sector, it was decided to establish new savings and credit cooperatives and to be strict on the legally required minimum share capital as proof of effective ownership. To prevent the failures of the past, GTZ, together with local authorities, adopted a two-pronged approach: (a) in an Islamic province given autonomy in choosing its own legal framework (*Qanun*) and in direct response to popular demand, it was decided to set up *Baitul Qirad* (BQ), a uniquely Acehnes term for Islamic financial cooperatives; (b) simultaneously, a support structure of secondary cooperatives (*BQ Centers*) for effective regulation and supervision of the adherence of the primary cooperatives to cooperative law, Islamic principles and internal by-laws is being established. Islamic cooperative banking software and packages of staff training are provided by PNM (see below). GTZ's support is focused on 15 BQs and two BQ Center at the east coast, serving as a model for expansion over a province with four million inhabitants.

The role played by PNM in microfinance in Indonesia was presented by Mr. Dali Sadli Mulia, with particular emphasis on Islamic microbanking regulated by both financial and Islamic authorities. PNM is a government organization carved out of the central bank after the financial crisis of 1997/98 with the objective of strengthening two sectors with technical and financial assistance: rural microbanks (BPR), which are regulated and effectively supervised by the central bank, and financial cooperatives registered but not supervised by the Ministry of Cooperatives. While PNM is responsible for all institutions in the two sectors, it puts particular emphasis on Islamic BPR-Syariah (86 out of some 2,200) and Islamic cooperatives (3,000 out of some 36,000). The main inputs provided by PNM are equity participation and term loans for restructuring and expansion, computerized standard operational procedures in Islamic banking, and management and staff capacity building. PNM is now facing the challenge of fully commercializing its services with national outreach, after the government withdrew its regular budgetary allocations and turned PNM into profit-making company relying on its own resources.

Action

The situation today in Islamic microfinance is one of institutional diversity and, at the same time, of lack of global communication and transparency. The diverse forms of providers

of microfinance services include self-help groups, member-owned local financial institutions, cooperatives, regulated microbanks, commercial banks and agricultural development banks as well as insurance companies. Theoretically, this may allow Islamic microfinance to expand the frontier of inclusive finance to a much wider clientele. The ability to reach such a diverse clientele means that Islamic microfinance needs to adapt its products to local demand and to make the procedures of Islamic microfinance, including standardized IT, more user-friendly.

However, Islamic finance still occupies but a small, though rapidly expanding, niche in global banking; and of that niche microfinance accounts, in statistical terms, for a very small quantity. Most of the emerging Islamic microfinance sector is unregulated and without effective (self-) supervision. In virtually every country there is an urgent need for self-regulation and effective self-supervision to be organized in many cases, not by the central bank, but by self-organized associations of the various types of Islamic MFIs. There is a rich experience in continental Europe in self-organizations of (former) MFIs which emerged from informal local financial intermediaries during the 18th and 19th century and evolved into today's cooperative banking and savings banking networks.

It was agreed that the future actions required were:

- To develop a dialogue between those interested in Islamic microfinance,
- To disseminate information about Islamic financial principles and products,
- To survey different countries' experiences with Islamic financial institutions and projects and to use this to develop a data base,
- To link Islamic MFIs and policymakers to European actors, including those with historical experience in microsavings and microcredit.
- To establish a working group on Islamic microfinance and eventually perhaps a research and advisory center.

For further information see www.microfinance-platform.eu .