MEDA PROJECT

Microfinance at the University
University of Torino

Case study

"Islamic microfinance and socially responsible investments"

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(273) لِلْفُقَرَاء الَّذِينَ أُحصِرُواْ فِي سَبِيلِ اللّهِ لاَ يَسْتَطِيعُونَ ضَرْبًا فِي الأَرْضِ يَحْسَبُهُمُ الْجَاهِلُ أَغْنِيَاء مِنَ التَّعَفُّفِ
تَعْرِفُهُم بِسِيمَاهُمْ لاَ يَسْأَلُونَ النَّاسَ إِلْحَافًا وَمَا تُنفِقُواْ مِنْ خَيْرٍ فَإِنَّ اللّهَ بِهِ عَلِيمٌ

273. " (Charity is) for the poor who are restrained in the way of Allah, and are unable to move about in the land. The unaware consider them wealthy because of their restraint (from begging). You shall recognize them by their countenance - they do not beg people importunately. And whatever of good things you give, then Allah is All-Knowing of it."

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1. Introduction

In his famous book *Wealth of Nations*, "Adam Smith argued that participation in religious sects could potentially convey two economic advantages to adherents (Anderson 1988, Noland).The first could be seen as a reputational signal: while the poor might look alike to potential employers, lenders, and customers, membership in a specific group could convey a reduction in risk associated with the particular individual and ultimately improve the efficient allocation of resources. Second, religious groups could also provide for extra-legal means of establishing trust and sanctioning miscreants in intragroup transactions, again reducing uncertainty and improving efficiency, especially where civil remedies for failure to uphold contracts were weak "[1].

This paper aims to focus on different issues: whether the economic behavior can be influenced by the predominant religious belief, the role of Islamic finance in Muslim societies nowadays but most of all its potential to fight poverty in those countries belonging to the so called developing world, when related with important economic development tools such as microfinance.

Both Islamic finance and microfinance seem to be concepts surrounded by a "fashionable aura" in Muslim developing countries: banks, financial institutions, MFIs, NGOs are very interested in the issues and most of all in the relation between the two, especially when it comes to fighting poverty. Strange enough, even if the interest is high[2], there are very few examples of actual MFIs operating in the field of Islamic finance and Islamic banks involved in microfinance.
Nevertheless, evidence proved that there is a need for and an interest on Islamic microfinance, for different reasons:

a. microfinance is a very flexible tool, whose models can be replicated but require to be tailored on the local socio-economic and cultural characteristics
b. the potential demand for tailored microfinance services is still largely unmet, also in countries where the majority of the population is constituted by Muslims

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[1] Noland M. "Religion, Culture and Economic Performance" Institute for International Economics

[2] For example, Sanable dedicated a workshop to Islamic finance during its first Annual Conference with the participation of: Mr. Bassem Khanfar, General Manager Microfund for Women, Jordan
Dr. Mohammed N. Alam**,** Islamic Microfinance Consultant, Canada, Mr. Kais Aliriani, Head of Unit, Small and Micro Enterprise Development Unit Social Fund for Development, Yemen, Mr. Magdy Moussa, Senior Manager and Finance Advisor Environmental Quality International (EQI), Egypt Ms. Eva Stenius, Associate JAK Members Bank, Sweden

c. some surveys proved that there is a high demand for Islamic banking especially in low and middle income predominantly Muslim societies[3]
d. commercial banks could be interested in this issue as a tool to reach interesting market niches, create loyalty in their clients and accomplish their client satisfaction strategies
e. Islamic finance, microfinance and socially responsible finance share most of their principles, such as:
    - Prohibition of all forms of economic activity which are morally or socially injurious
    - Egalitarian approach (no restriction to any category of clientele)
    - Focus on the well being of the community as a whole, concentrating on the poor, destitute or deprived sections of the society
    - Aim at social justice
    - Advocacy of entrepreneurship
    - Advocacy for financial inclusion through partnership finance[4]
    - Participatory approach
    - Risk sharing

   Moreover, they both constitute forms of finance that represent unconventional but effective solutions to financial needs, focusing on activities that lack capital but are promising and show a potential.

At a very basic level, the disbursement of collateral free loans in some cases constitutes an example of how Islamic banking and microfinance share common aims. Thus Islamic banking and microcredit programs, may complement one another in both ideological and practical terms (Dhumale, Sapcanin, 1999).
Even if they both constitute fairly new trends in the financial environment, the inclusion of Islamic finance and microfinance in the activities of the traditional banking system evolved in a quite similar way, because they both started from a marginal position and managed to reach a growing popularity.

[3] Ibrahim M. 2004 in Range 2004
[4] Ferro N. "Value Through Diversity: Microfinance and Islamic finance and Global Banking", Fondazione ENI Enrico Mattei, June 2005

2. The basic principles of Islam and Islamic finance

Islam is the world's fastest growing religion, a process of growth that does not affect only the traditional Islamic countries, namely those located in Northern Africa and Middle East, but also other countries in every continent. Muslims cover approximately a quarter of the world's population, 1.2 billion people.
According to the tradition, the Prophet Muhammad was born in Makkah, a city in the present-day Saudi Arabia in 570 C.E. Muhammad received divine revelations (**The Holy Quran**) over a period of 23 years in the seventh century of the Christian Era.
For Muslims, the Holy Quran and the **Sunnah** constitute the primary sources of knowledge: the Holy Quran confirms what was revealed to earlier messengers of God and serves as the criterion of what is right and what is wrong while the Sunnah is collected in books which are separated from the Holy Quran and are known as Hadith[5] books. While the Holy Quran is considered totally as the "word of God revealed to the Prophet", not every hadith is considered authentic. Early Muslim scholars have classified **hadith** into various categories ranging from different levels of authenticity to false hadith.
In Islamic societies, the Sunnah constitutes the second most important source of jurisprudence after the Quran. "The most difficult part of Islamic Law for most westerners to grasp is that there is no separation of religion and state. The religion and the government are one. Islamic Law is controlled, ruled and regulated by the Islamic religion. The theocracy controls all public and private matters. Government, law and religion are one. There are varying degrees of this concept in many nations, but all law, government and civil authority rests upon it and it is a part of Islamic religion. There are civil laws in Muslim nations for Muslim and non-Muslim people. Shariah[6] is only applicable to Muslims and it governs every aspect of their lives."[7]

The foundation of Muslim life are the so called Five Pillars of Islam: faith or belief in God and the finality of the prophet hood of Muhammad, worship respecting the five daily prayers, almsgiving and concern for those who are in need, self-purification through fasting and the pilgrimage to Mecca for those who are able to do it.

[5] The Arabic word **hadith** is very similar to Sunnah, but not identical. A hadith is a *narration* about the life of the Prophet (saas) or what he approved - as opposed to his life itself, which is the Sunnah as already mentioned.
[6] Traditional Islamic law

[7] Shariah Islamic Law April 7th, 2005 by Denis J. Wiechman, Jerry D. Kendall, and Mohammad K. Azarian

Not unlike the non-Muslim developing countries, those counting a significant Muslim population have tested a huge variety of economic systems. For centuries Muslims have developed ways to integrate their religious beliefs with the external economic realities of the nations they lived in. This has shown varying degrees of compatibility with the empires and customs they encountered. Like most things in Islam, the economic and financial issues adapts to al-urf, "the custom"[8].

The economic systems that were set in Muslim countries have generally followed the blueprints of the developing world and "reflect persistent tensions between equity and growth, import substitution and export-led industrialization, and agricultural and industrial investment. Due to the close ties between some Muslim countries and the global economic and financial system, however, these tensions have expressed themselves in particularly stark form in much of the Muslim world. For example, oil wealth and the resulting flow of labor remittances and bilateral aid has dramatically influenced the course of development in many Muslim countries, stretching from Tunisia to Malaysia. The extent to which religious doctrine has influenced economic policy and the normative choices that underpin such policies varies tremendously over time both within and among Muslim countries. Islam has no single, monolithic vision of economic justice; as a result, there is a void at the heart of Islamic doctrine which is filled by the complex interaction of political, social and economic forces. Thus the vexing question of why Islam is brought into debates on economic policy at some junctures and ignored at others becomes a task for historical and sociological inquiry"[9].

In Muslim countries, especially those located in the North Africa and Middle East region, the economic liberalization and increasing interdependence of the 1980s and 1990s highly influenced the political and economical choices of governments.

The banking system, in particular, strongly reacted to these changes: in the 1980s and 1990s Muslim bankers and religious leaders developed ways to integrate Islamic law on usage of money with modern concepts of ethical investing. Consequently, a sophisticated economic discipline has emerged with its own concepts, analytical tools and institutions. Some of these revived traditional micro venture capital and ethical investing frameworks that thrived in medieval times. However, they incorporated many modern techniques and technologies. A number of researchers suggest that the underlying causes of the genesis of modern Islamic economics was based more on the desire to reflect beliefs about Islamic identity than to establish a more ethical or religiously sound banking system

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[8] term referring to the custom, or 'knowledge', of a given society, leading to change in the fiqh (Islamic jurisprudence).

[9] University of Berkley, California , Institute of International Studies "The Moral Economy of Islam"

2.1 The principles of Islamic banking

Islamic banking, based on the Quranic prohibition of charging interest, has moved from being a theoretical concept to embrace more than 100 banks operating in 40 countries with multi-billion dollar deposits world-wide. Islamic banking is widely regarded as the fastest growing sector in the Middle Eastern financial services market.
It is important then to understand the principles of Islam that underpin Islamic finance. The Shariah consists of the Quranic commands as laid down in the Holy Quran and the words and deeds of the Prophet Muhammad. The Shariah disallows Riba and there is now a general consensus among Muslim economists that Riba is not restricted to usury but encompasses interest as well. The Quran is clear about the prohibition of Riba, which is sometimes defined as excessive interest. "O You who believe! Fear Allah and give up that remains of your demand for usury, if you are indeed believers." Muslim scholars have accepted the word Riba to mean any fixed or guaranteed interest payment on cash advances or on deposits. Several Qur'anic passages expressly admonish the faithful to shun interest.
In general, the principles of Islamic banking are:

a. Al Zakat (the 4th pillar of Islam). One of the most important principles of Islam is that all things belong to God, and that wealth is therefore held by human beings in trust. The word *zakat* means both 'purification' and 'growth'. Our possessions are purified by setting aside a proportion for those in need.
b. The prohibition of taking interest rates (Al Riba)[10]. Within the Islamic scholars, there are two interpretations on what Riba means:

- A modernist view, according which reasonable interest rates are allowed
- A conservative view, which states that any kind of fixed interest is wrong

[10] Critics of Islamic economics anyway argue that the fundamental characteristic of charging interest (i.e. charging a premium, on the principal amount of a loan, for the time value of the loaned money) is not truly eliminated in Islamic banking, but rather the interest is merely hidden and relabeled.
The Quran anyway, clearly states that interest rate is forbidden, especially because related with usury:

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 Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord desist shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the fire: they will abide therein (for ever) 2: 275
ye who believe! fear Allah and give up what remains of your demand for usury if ye are indeed believers. 2: 278
ye who believe! devour not usury doubled and multiplied; but fear Allah; that ye may prosper. 3:130

c. the prohibition of unproductive speculation or unearned income (Al Maysir[11]) as well as gambling (Al Quimar)
d. freedom from excessive uncertainty
e. the prohibition of debt arrangements - most Islamic economic institutions advise participatory arrangements between capital and labor. The latter rule reflects the Islamic norm that the borrower must not bear all the cost of a failure, as "it is Allah who determines that failure, and intends that it fall on all those involved."

While the banning of interest is rooted in Muslim theology, proponents of Islamic finance provide strong motivations to support the ban of interest rate. First of all, in an Islamic profit sharing contract the return on capital will depend on productivity and the allocation of funds will be primarily based on the soundness of the project, improving the capital allocation efficiency. Second, the Islamic profit sharing system will ensure more equitable distribution of wealth and the creation of additional wealth to its owners. Third, the profit sharing regime may increase the volume of investments and hence create more jobs. The interest regime accepts only those projects whose expected returns are higher than the cost of debt, and therefore filter out projects which could be acceptable under the Islamic profit sharing system (Zahier, Hassan).

According to the Indian researcher Dr. F.R. Faridi, “Islamic Economics comprises Justice, Equality and Fair Play. In fact, it is the best form of bringing about equality among the masses. Islamic Economics defines certain rules that regulate company structure, effectively preventing abuse and corruption. For instance, Islam forbids monopolies by outlawing the hoarding of wealth and eliminates copyright or potency laws that would open the avenue for potential monopolies to develop. Also, Islam protects the ownership of businesses and companies by restricting ownership of companies only to those who contribute both capital and effort to the company or business, thus effectively putting the seal on such concepts as “corporate takeover” from ever becoming a reality.”

Islamic banking presents a holistic approach, based on Islamic principles on behalf of the individual and at the same time of the society he/she belongs to giving serious consideration to the global development constraints of the society.

[11] Maisir refers to gambling and to any form of business activity where monetary gains are derived from mere chance, speculation and conjecture. For example uncertainty of the timing of benefits in a pure life insurance contract creates an element of maisir. The basis of compensation must be clearly pre-defined. In its absence, the proceeds of a life insurance policy may not relate to premiums paid up to the date of death.

2.2 The Islamic financing contracts

Since Islamic Banking can be rather complex, Sharia principles are governed by Islamic experts or 'Ulama'. It is always essential to obtain the approval of the Sharia advisor of the bank on the forms of the financing contracts, in order to ensure their compliance with the principles of Islamic Sharia. These contracts in fact are exposed to high risks and arise a problem of moral hazard. In fact, they require substantial trust between the banks and their customers in terms of honesty, integrity, management and business skills. Equally problematic is the aspect of monitoring and supervision. Given the fact that both mudharabah and musharakah are equity financing in character, collateral is not a prerequisite[12].

Tarek S. Zaher and M. Kabir Hassan (2001) define five basic Islamic financing contracts:

- Murabaha (Financing Resale of Goods)
- Ijara and Ijara wa-Iqtina (Lease financing)
- Istinsa
- Mudaraba (or Modaraba – participation financing)
- Musharaka

a Murabaha

This constitutes one of the most well known Islamic products, consisting in "a cost-plus profit financing transaction in which a tangible asset is purchased by an Islamic institution at the request of its customer from a supplier. The Islamic institution then sells the asset to its customer on a deferred sale basis with a mark up reflecting the institution's profit"[13].

b Ijara and Ijara wa-Iqtina

These concepts are very close to the Western idea of *leasing*. In the first case the financial institution leases an asset to its customer agreeing on lease payments for a certain period of time but excluding the option of ownership for the client.
In the second case, the client has the option ownership by buying the asset from the financial institution.
"The conditions governing both types of leasing are that assets must have a long/secure productive life, and must not be handled in an un-Islamic way, meaning that the lease payments must be agreed on in advance to avoid any speculation"[14]

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[12] Iqtisad Al Isalmy "Contracts in Islamic Commercial and their Application in modern Islamic Financial System" Ramadhan 1424 H/2003 @Islamic-World.Net
[13] Tarek S. Zaher and M. Kabir Hassan, ibid.
[14] Tarek S. Zaher and M. Kabir Hassan, ibid.

c Istinsa

"Istinsa is a pre-delivery financing and leasing structured mode that is used mostly to finance long term large scale facilities involving, for example, the construction of a power plant".[15]

d Mudaraba

"Mudaraba is a trust based financing agreement whereby an investor (Islamic bank) entrusts capital to an agent (Mudarib) for a project. Profits are based on a pre-arranged and agreed on a ratio. This agreement is akin to the Western style limited partnership, with one party contributing capital while the other runs the business and profit is distributed based on a negotiated percentage of ownership. In case of a loss, the bank earns no return or negative return on its investment and the agent receives no compensation for his (her) effort"[16]

In this kind of contract, all the financial responsibilities rely on the business itself: the financial institution invests on an idea, a project and shares its fate.

From the perspective of financial services, Modaraba falls under three categories:

1. Demand Deposits: These deposits are not restricted, payable on demand and do not share in any profits.
2. Mutual Investment Deposits: An Islamic Bank will combine these deposits with the Bank's money in order to participate in mutual investment transactions conducted by the bank. Under these deposits, the percentage of profit is fixed at the end of the bank's financial year.
3. Special Investment Deposits: An Islamic Bank will invest these deposits in a specific project or investment upon the request or the approval of the depositor. The depositor in this case will be entitled to receive profit and is liable for the losses, provided that the bank is not negligent or in default. At the end of the deposit period, the bank receives its share of profit against its contribution of experience and management, while the depositor receives his share of profit as a capital share contributor[17].

All these deposit transactions are based an Islamic Sharia concept called 'Modaraba' (Participation Financing), where one party (the depositor) provides the cash and the other party (the Bank) provides the experience and management.

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[15] Tarek S. Zaher and M. Kabir Hassan, ibid.

[16] Tarek S. Zaher and M. Kabir Hassan, ibid

[17] http://executivecaliber.ws/sys-tmpl/islamicfinancing/

e Musharaka

This contract is very similar to a joint venture with participation financing. "Two parties provide capital for a project which both may manage. Profits are shared in pre-agreed ratios but losses are borne in proportion to equity participation"[18]. The peculiar aspect of this contract is not the sharing the profit and losses, but sharing the management and the decision taking process.

3. The basic principles of microfinance

Microfinance is constituted by a range of financial services for people who are traditionally considered non bankable, mainly because they lack the guarantees that can protect a financial institution against a loss risk.

The true revolution of microfinance is that this tool gives a chance to people who were denied the access to the financial market, opens new perspectives and empowers people who can finally carry out their own projects and ideas with their own resources, and escape assistance, subsidies and dependence. Microfinance experiences all around the world have now definitely proved that the poor demand a wide range of financial services, are willing to bear the expenses related to them and are absolutely bankable.

The target group of microfinance[19] is not constituted by vthe poorest of the poor, who need other interventions such as food and health security, but those poor who live at the border of the so called poverty line. Those who could reach more easily a decent quality of life and who have entrepreneurial ideas but lack access to formal finance.[20]

[18] Tarek S. Zaher and M. Kabir Hassan, ibid

[19] According to the CGAP, the clients of microfinance—female heads of households, pensioners, displaced persons, retrenched workers, small farmers, and micro-entrepreneurs—fall into four poverty levels: destitute, extreme poor, moderate poor, and vulnerable non-poor. While repayment capacity, collateral availability, and data availability vary across these categories, methodologies and operational structures have been developed that meet the financial needs of these client groups in a sustainable manner. More formal and mainstream financial services including collateral-based credit, payment services, and credit card accounts may suit the moderate poor. Financial services and delivery mechanisms for the extreme and moderate poor may utilize group structures or more flexible forms of collateral and loan analysis.The client group for a given financial service provider is primarily determined by its mission, institutional form, and methodology. Banks that scale down to serve the poor tend to reach only the moderate poor. Credit union clients range from the moderate poor to the vulnerable non-poor, although this varies by region and type of credit union. NGOs, informal savings and loan groups, and community savings and credit associations have a wide range of client profiles.

[20] These people usually do not lack finance in a broad sense: they can borrow money from friends, relatives or local money lenders, but of course they cannot access a wider and safer range of services. They need a formal financial institution to rely on, to ask not only for credit but also saving or insurance

Beginning in the 1950s, development projects began to introduce subsidized credit programs targeted at specific communities. These subsidized schemes were rarely successful. Rural development banks suffered massive erosion of their capital base due to subsidized lending rates and poor repayment discipline and the funds did not always reach the poor, often ending up concentrated in the hands of better-off farmers. In the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended tiny loans to groups of poor women to investment in micro-businesses. This type of microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. Through the 1980s and 1990s, microcredit programs throughout the world improved upon the original methodologies and bucked conventional wisdom about financing the poor. First, it showed that poor people, especially women, had excellent repayment rates among the better programs, rates that were better than the formal financial sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed microfinance institutions (MFIs) to cover their costs.

These two features—high repayment and cost-recovery interest rates—permitted some MFIs to achieve long-term sustainability and reach large numbers of clients. In fact, the promise of microfinance as a strategy that combines massive outreach, far-reaching impact, and financial sustainability makes it unique among development interventions[21].

Microfinance is considered a very effective development tool: for this reason, year 2005 has been declared by the General Secretary of the United Nations "International Year of Microcredit". Microfinance is also a very flexible tool, that can be adapted in every environment, based on the local needs and economic and financial situation. For example, in Asia group microlending proved to be very effective, while in Egypt or in Brazil beneficiaries prefer individual lending. One more example: MFIs (Microfinance Institutions) and NGOs (Non Governmental Organizations) in India mostly rely on savings collection to support their institution and become sustainable while in Egypt they are forbidden by law to collect savings. Microfinance can be effective both in the South of the world and in Western countries, equally characterized by financial and social exclusion[22].
Following this logic, microfinance can easily be adapted to certain cultural environments, such as countries characterized by a majority of Muslims that follow the Islamic law. Moreover, the similarities in the principles of the two make microfinance

services, to deal with on a transparent basis (usury is usually a high risk for these people). Microfinance is filling this vacuum, the gap that until a few decades ago kept these people away from the realization of their own projects.

[21] Source: www.cgap.org

[22] Viganò L. a cura di "La microfinanza in Europa", Giuffrè ed., Milano, 2004

easier to expand in those countries, giving life to the new hybrid reality of Islamic microfinance.
A few studies have been carried out on the subject and experience on the field is still relatively small, but it proves to have huge potentialities both to fight against poverty financial and social exclusion and to enlarge and enrich the basin of clients of financial institutions in developing countries with an Islamic cultural substratum.

4. Islamic microfinance

Islamic convictions on the responsibility go well beyond mere profitability goals and coincide with the renewed perception on business recently at stake within the most advanced sectors of western business and civil societies. Far from the limits imposed by neo-classical thought, this new wave implies new sorts of responsibilities on behalf of the company falling under the rubric of **corporate social responsibility** (Ferro, 2005).
As its ultimate goal is the maximization of social benefits as opposed to profit maximization, through the creation of healthier financial institutions that can provide effective financial services also as grass roots levels, some authors (Al Harran, 1996) argue that Islamic finance, if inserted in a new paradigm, could be a viable alternative to the socio – economic crisis lived by the Western paradigm.
As stated before, a relatively few studies and a few experiences on the field are concentrated on Islamic microfinance.
Between the most complete researches on the topic, Dhumale and Sapcanin (1999) drafted a technical note in which they tried to analyze how to combine Islamic banking with microfinance. They took into consideration the three main instruments of Islamic finance (mudaraba, musharaka and murabaha) trying to use them as tools to design a successful microfinance program.

1. **a mudaraba model**: the microfinance program and the microenterprise are partners, with the program investing money and the microenterpreneur investing in labor. The microenterpreneur is rewarded for his/her work and shares the profit while the program only shares the profit. Of course the model presents a series of difficulties, given most of all by the fact that microentrepreneurs usually do not keep accurate accountability which makes it more difficult to establish the exact share of profit. As stated before the, these models are complicated to understand, manage and handle which implies that those who are involved need specific training on the issues. For this reason, and for an easier management of the profit sharing scheme, the mudaraba model might be more straightforward for businesses with a longer profit cycle.
2. **a murabaha model**: under such contract, the microfinance program buys goods and resells them to the microenterprises for the cost of the goods plus a markup

for administrative costs. The borrower often pays for the goods in equal installments, and the microfinance program owns the goods until the last installment is paid.

A murabaha model example: Hodeidah Microfinance Programme, Yemen

Although traditional banking products have been available in Yemen for many years (and are still the predominant type of finance), many people, especially the poor, have been reluctant to take credit, in part due to religious beliefs. This is one of the main reasons why the Hodeidah Microfinance Programme (HMFP) was implemented in 1997, in Hodeidah, a port city with a population of nearly half a million. It is characterized by an active economy based on trading, fishing, food production, small industries, handicrafts and transportation. In the early 1990s, during and after the Gulf War, many families returned to this city from Saudi Arabia and other Gulf States. Now, roughly 30 percent of the total population in Hodeidah are returnees, a key market segment for HMFP. Much of the population has conservative Islamic beliefs. The population studied showed a clear preference for the methodologies of Islamic banking in terms of receiving credit.

HMFP is the first microfinance project of its kind in Yemen and consequently has had to develop its human resources itself. It had 1770 active clients as of June 2000, 23 percent of whom were women and $350,000 in outstanding loans. The average loan size is 38,000 Yemeni Rial (YR) ($240 US dollars). There is a cycle of loans the clients go through but each level has a wide scope. The first loan can be up to 50000 YR ($300 US). The maximum loan for the final level is 250,000 YR ($1500 US).HMFP uses a group-based methodology. Group members are not confined to the same loan amounts or the same activities, although loan amounts need to be within the range of the cycle set by HMFP. There is also a small percentage of individual loans (10 percent).

The procedure is as follows: upon receipt of the loan application, the credit officer investigates the group and does a feasibility study for their activities. From this study, the officer can estimate the precise loan amount. If the feasibility study is positive, the client should identify items (commodities/equipment) needed from the wholesaler and negotiate a price. The credit officer then purchases items from that source and resells them immediately at that price to the client. HMFP has two elements of accounting/finance, which differ from most microfinance organizations. Both have implications for content of financial statements. The first is capitalization of the service charge expected upon disbursement, which affects the balance sheet. The second is the absence of the "principle of interest" on outstanding loan balances affecting yield on the portfolio and thus income earned.

Source (for detailed information also): UNCDF web site

Range, in his paper (2004), underlines how the prohibition of Riba in Islamic finance does not constitute an obstacle in building sound microfinance products; on the contrary, the side effects of an Islamic foundation could probably enhance it. These effects are: the high rate of return (compared to a fixed interest rate), the holistic approach in supporting businesses and productive activities, a more effective mobilization of excess resources, a fairer society.

An interesting case: the Mali-North Program of the German cooperation

GTZ (German Technical Cooperation) and KfW (German Financial Cooperation) worked on a development project in the former civil war areas of Timbuctu', Mali, constituted by three main components: rural development, promotion of municipal structures and microfinance.
The microfinance project was supposed to start through the creation of a financial institution managed and refinanced by the *Banque Nationale de Développement Agricole (BNDA)*, set in Bamako. But the potential customers of the bank preferred discuss the proposal in order to find a more suitable solution. The aim of the project was quite ambitious: the financial services were supposed to reach all the tribes of the area, the Moors, the Tuareg and various black African groups. The only common denominator on which the previous civil war opponents could agree was Islam: a bank that respected the religious rules for financial services would have been accepted by anyone. The selected bank was Azaouad Finances plc: the bank disburses loans and also promotes the collection of savings, not charging interest but participating in the profits and losses of the borrowers.
With the loan from Azaouad Finances, the market in the area blossomed: the business relationships of local merchants now reach Abidjan and the Arabian peninsula. The bank also has a small program intended to support women entrepreneurs. The bank also entered into cooperation with the BNDA in order to thereby link up with the SWIFT international payments system. Now the herdsmen can deposit the earnings from their business dealings in Abidjian or Dubai into their account in the town of Lere using a SWIFT transfer.

Source: "Small Loans according to the Koran", Kohler W. Microfinance Akzente special GTZ

3. Future perspectives

Social welfare, unemployment, public debt and globalization have been re-examined from the perspective of Islamic norms and values. Islamic banks have grown recently in the Muslim world but still constitute a very small share of the global economy compared to the Western debt banking paradigm. It remains to be seen if they will find niches, although hybrid approaches, such as microfinance, which apply classical Islamic values using at the same time conventional lending practices, as lauded by some proponents of modern human development theory.
Islamic law allows room for financial innovation, and several Islamic contractual arrangements can be combined to design a new hybrid[23].

In the globalization era, banks and financial institutions in general cannot afford to face financial exclusion. The segment of the population that has been excluded from financial services so far, has to be seen as an opportunity, a profitable market niche. As a result of a major interest towards these people, positive social externalities will show.
The "financially excluded" group is heterogeneous and includes not only poor people in developing countries, but also migrants who need money transfer to manage their remittances in their home countries, young people with the enthusiasm of staring some new income generation activity but lack capital,
Exclusion can come about as a result of problems with access, prices, marketing, financial literacy or self-exclusion in response to negative experiences or perceptions.
Barriers to inclusion include:
• Difficulty in accessing financial services, whether that be geographically or culturally (for instance, language barriers)
• Inappropriate and not tailored products
• Excessive cost of some products such as home contents insurance
• Scarce knowledge of financial products caused by a lack of marketing in certain areas considered less profitable by financial institutions or difficulty in understanding financial products, for example low levels of financial literacy, which may lead to debt problems or wasting money on inappropriate products
• Government regulations or the interpretation of these (for instance, in the case of identification documents required for bank account opening)
• Psychological barriers such as negative perceptions of financial institutions or previous bad experience

Other issues include:
• Lack of free debt advice

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[23] Khan , Mansoor H "Designing an Islamic Model for Project Finance" *International Finance and Law Review* 6: 13 -16 in Dhumale and Sapcanin, ibid

• Lack of generic (non-brand specific) financial advice
• Lack of confidence in the banking industry
Groups particularly affected by financial exclusion tend to be those on low incomes. However, financial exclusion is dynamic as people move in and out of work and may have more or less need of financial services[24].

Ina future perspective, the key words will be:

- **Inclusion**
- **Tailoring** of financial products on needs and religious belief
- **Diversification** of the financial services offered
- Attention to the **social outcomes** of the financial activity both in developed countries (meeting the sensibility of some clients who are very attentive towards specific issues such as respect of human rights and environment, socially responsible criteria in the choice of investments and so on) and in developing countries (including the "non bankable" in the financial system will improve the general conditions of the whole society while socially responsible criteria will educate in being more respectful towards human and workers rights, gender and environmental issues and so on)
- Separation of competencies and **specialization** – in the whole range of financial institutions, the diversification and tailoring of products could also mean specialization of different institutions. MFIs that are close to or deriving from NGOs could specialize in financial services at the grass root level, commercial banks could specialize in micro and small entrepreneurs, Islamic banks to those clients with specific religious beliefs which do not fit with the western financial model.
- **Effectiveness** – both socially responsible investments in Western societies and Islamic branches/products in Muslim societies often proved to be merely a marketing operation used to attract new clients belonging to small niches. Given their high values, they should be taken into more serious consideration, and not only used as an easy way to attract new clients.

[24] SAFE: Services Against Financial Exclusion

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