Discuss the Challenges & Initiatives in

ISLAMIC MICROFINANCE DEVELOPMENT

Framework & Strategies

IFSD FORUM 2007

Islamic Financial Sector Development Forum
On the side line of the Annual Meeting of IDB Group
Dakar, Senegal - 5th of May 2007
IFSD FORUM 2007

Building on the success of the Islamic Financial Sector Development Forum (IFSD Forum) which was held in Kuwait on May 28, 2006, and in order to further streamline the future path of the industry, and enhance the role of Islamic finance in promoting inclusive financial sectors, CIBAFI and the Islamic Research and Training Institute IRTI, have felt the importance of organizing similar events to discuss topics that are of vital strategic and policy interest to the Islamic financial industry and to facilitate enhancing the role of the industry in promoting sustainable economic development and just social progress.

The IFSD Forums aim at providing a platform for strategic policy dialogue for sharing country and institutional experiences with regard to developing the various segments of the Islamic financial services industry; identifying key challenges of the industry's different segments in an integrated manner and promoting cooperation, knowledge sharing and partnership in alleviating the challenges thus facilitating the industry's orderly development, competitiveness and stability.

With a view to make financial services accessible and affordable to the masses, the IFSD Forum 2007, takes a holistic stock of the various challenges facing the development of Islamic microfinance services with a view to promote dialogue among the stakeholders to integrate Islamic microfinance services in national financial sector development policies; discusses the prospects of integrating Zakah, Awqaf and Islamic financial contracts in the financial sector development strategies; facilitate policy, financial infrastructure and financial institution development and promotes cooperation and knowledge sharing in the development of Islamic microfinance services.

Why Microfinance

Poverty alleviation and development of Islamic Financial Services Industry (IFSI) are two key strategic objectives of the Islamic Development Bank (IDB) Group in addition to enhancing economic cooperation among the member countries. These are also enshrined in the IDB Vision 1440H and the OIC 10-Year Work Plan. In implementing the IFSI development objective, during 2005-2006, the Islamic Research and Training Institute (IRTI), a member of the IDB Group, anchored the preparation of “Ten-Year Framework and Strategies (TYFS) for Development of the Islamic Financial Services Industry”, a joint initiative of the IDB Group and Islamic Financial Services Board (IFSB). The TYFS document was approved by the IFSB Council in its meeting held in Kuala Lumpur on March 26, 2007.

Enhancing access to financial services is a powerful tool in combating poverty in a sustainable way. Islamic finance makes financial services relevant for a large segment of world population. However, during the consultation process on the TYFS document and at the IFSI Development Forum held in Kuwait as side activity of the 2006 IDB BoG meetings, and organized jointly by IDB/IRTI, and CIBAFI (General Council of Islamic Banks and Financial Institutions), it was widely felt that there is a need to focus on Islamic Microfinance Development as top priority initiative in order to align IFSI development with poverty alleviation. Therefore, the IFSD 2007 concentrates on promoting dialogue among stakeholders to develop holistic strategies and policies that can facilitate the development of Islamic Microfinance Services.

Executive Summary

Microfinance (MF) is a powerful poverty alleviation tool. It implies provision of financial services to the poor and low-income people whose low economic standing excludes them from formal financial systems. Access to services such as, credit, venture capital, savings, insurance, remittance is provided on a micro-scale enabling participation of those with severely limited financial means.

The provision of financial services to the poor helps to increase household income and economic security, build assets and reduce vulnerability; creates demand for other goods and services (especially nutrition, education, and health care); and stimulates local economies. A large number of studies on poverty however, indicate that exclusion of the poor from the
The financial system is a major factor contributing to their inability to participate in the development process.

In a typical developing economy, the formal financial system serves no more than twenty to thirty percent of the population. The vast majority of those who are excluded are poor. With no access to financial services, these households find it extremely difficult to take advantage of economic opportunities, build assets, finance their children’s education, and protect themselves against financial shocks. Financial exclusion, thus, binds them into a vicious circle of poverty.

Microfinance and Islamic finance have much in common. Islam emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole. Principles encouraging risk sharing, individual rights and duties, property rights, and the sanctity of contracts are all part of the Islamic code underlying the financial system.

In this light, many elements of microfinance are consistent with the broader goals of Islamic finance.

Both advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. Both focus on developmental and social goals.

Both advocate financial inclusion, entrepreneurship and risk-sharing through partnership finance. Both involve participation by the poor.

**Key Principles of Micro Finance**

Consultative Group to Assist the Poor (CGAP) has come up with eleven key principles of Micro Finance on decade-long consultations with its members and stakeholders. These are as follows:

1. Poor people need a variety of financial services, not just loans. In addition to credit, they want savings, insurance, and money transfer services.
2. Microfinance is a powerful tool to fight poverty. Poor households use financial services to raise income, build their assets, and cushion themselves against external shocks.
3. Microfinance means building financial systems that serve the poor. Microfinance will reach its full potential only if it is integrated into a country’s mainstream financial system.
4. Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people. Unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from governments and donors.
5. Microfinance is about building permanent local financial institutions that can attract domestic deposits, recycle them into loans, and provide other financial services.
6. Microcredit is not always the answer. Other kinds of support may work better for people who are so destitute that they are without income or means of repayment.
7. Interest rate ceilings hurt poor people by making it harder for them to get credit. Making many small loans costs more than making a few large ones. Interest rate ceilings prevent microfinance institutions from covering their costs, and thereby choke off the supply of credit for poor people.
8. The job of government is to enable financial services, not to provide them directly. Governments can almost never do a good job of lending, but they can set a supporting policy environment.
9. Donor funds should complement private capital, not compete with it. Donor subsidies should be temporary start-up support designed to get an institution to the point where it can tap private funding sources, such as deposits.
10. The key bottleneck is the shortage of strong institutions and managers. Donors should focus their support on building capacity.
11. Microfinance works best when it measures—and discloses—its performance. Reporting not only helps stakeholders judge costs and benefits, but it also improves performance. MFIs need to produce accurate and comparable reporting on financial performance (e.g., loan repayment and cost recovery) as well as social performance (e.g., number and poverty level of clients being served).
Organizers

ABOUT IRTI

The Islamic Research and Training Institute (IRTI) was established in 1401 H (1981 G) to undertake research and provide training and information services in the member countries of the Islamic Development Bank and Muslim communities in non-member countries to help bring their economic, financial and banking activities into conformity with Shari'ah and to further economic development and cooperation amongst them.

Current Structure

IRTI is presently composed of four Divisions and three support units. These are: Islamic Economics, Cooperation and Development Division (IECD), Islamic Banking and Finance Division (IBFD), Training Division (TD) and Information Centre (IRTIC). The two Research Divisions conduct in-house research and manage external Research in their respective areas. The Training Division manages training programs for the personnel engaged in development activities in member countries as well as for those working in the Islamic banking and financial institutions. The Information Centre is responsible for developing information systems in the areas assigned to IRTI. The two supportive units are: Special Assignments Unit (SAU) and the Administrative Services Unit. The Special Assignments Unit implements a number of professional programs run by the Institute, while Administrative Services Unit looks after the administrative requirements of various technical divisions. The Publications Unit is responsible for the publication and dissemination of its research output.

ABOUT CIBAFI

Mission

The mission of CIBAFI is to be the organizational umbrella representing Islamic Financial Institutions and acting towards the advancement of the Islamic Financial Services Industry by serving and protecting it in different spheres and activities; Namely: Information, Media and Awareness, Research and Product Development, and Human Resources Development.

Objective

1. Promotion of Islamic financial institutions, dissemination of concepts, rules and provisions related to them and development and promotion of Islamic financial industry, and to enhance its existence regionally and globally.
2. Consolidation of co-operation among members of the Council and similar institutions in areas which serve the common objectives by using available means.
3. Providing information related to Islamic banks and financial institutions and related Islamic organizations.
4. Promotion of the interests of members, and to protect the industry and its safe march and confronting the common difficulties and challenges and promotion of co-operation among members themselves on the other hand and between members and other parties, particularly regulatory authorities.
5. To participate in the development of the Islamic financial services by encouraging research, development, product registration, and to track the development of its laws and the procedures of its registration.
6. To participate in the development of human resources so as to be in a position to tackle international challenges and development opportunities.
7. To perform any duties that further the attainment of CIBAFI goals.