Islamic Microfinance Symposium
Harvard Law School - April 14, 2007

Financing the Poor Towards an Islamic Microfinance: A Short Report

This April, the Islamic Finance Project (IFP) of the Islamic Legal Studies Program (ILSP) at Harvard Law School hosted a symposium on "Financing the Poor: Towards an Islamic Microfinance." The symposium brought together a diverse, international group of speakers from the microfinance and Islamic finance sectors who shared their experiences and offered their opinions on potential collaboration between the two sectors.

Nazim Ali, the Director of IFP, opened the symposium and noted the inspiration behind this conference: that microfinance has repeatedly arisen as a topic of interest for Islamic finance as a means to reach the average person and help alleviate poverty. Baber Johansen, Acting Director of ILSP and Affiliated Professor at Harvard Law School, commented upon the burgeoning interest in financing the poor, and Islamic finance's longstanding interest in promoting equitable economic development, as reflected in the ample attendance at this symposium. The keynote speakers then opened the symposium with discussions on the synthesis of Islamic finance and microfinance.

The first keynote speaker was Robert A. Annibale, Global Director of Microfinance at Citigroup, who shared his insights about Islamic finance and microfinance, especially since the two have not been integrated in many discussions. In his experience, microfinance institutions, "bankers to the poor," originally took root in domestic, local markets, but now have expanded to larger markets with a broader range of services. He noted that these microfinance institutions tend to have high operating costs that are offset by charging high interest rates, which are hard for the poor to afford. Therefore, Annibale urged institutions to make their methods more efficient, because the customer pays for the inefficiencies.

It is here that Annibale sees potential for Islamic finance to make a difference. Under conventional microfinance, risk is borne by the borrowers, and rarely by the institutions. NGOs and other institutions offer efficient services to supplement their lending—but these services add to the cost base. Islamic finance stresses interest-free methods of providing capital, including joint venture methods where risk and reward are shared by the institution and the borrower. In terms of the overall market picture, Annibale discussed the Microfinance Information Exchange and its transparent analysis of microfinance groups. He has found that there are only small-scale offerings across the North African region and Pakistan, areas where more competition would be beneficial. Indonesia and Bangladesh have developed microfinance markets, on the other hand. In Bangladesh, microfinance institutions have penetrated the population more than traditional banks. According to Annibale, microfinance is also growing in India, especially South India, although restrictions have been placed in some areas because people had to pay very high interest rates, and religious leaders spoke out against this usury and exploitation by telling people they did not have to pay these rates. Annibale stressed that microfinance is most successful when there is competition and, therefore, innovation, as consumers benefit the most from such circumstances.

Aamir Rehman, former Global Head of Strategy at HSBC Amanah, presented the second keynote on behalf of Iqbal Khan, HSBC Amanah's founding CEO. Rehman discussed how the ethos of Islamic finance is highly compatible with the spirit of microfinance. Islamic finance is *shari'a* based, focusing on ethics and values that are, at root, universal. It also offers a community-based, alternative program to promote genuine economic activity. It has many challenges, as it is a young industry that still has to work to establish credibility. Rehman argued that the industry has not focused on poverty alleviation because it needed to meet both world-class banking standards and *shari'a* requirements to serve its customers, in addition to providing profits to investors. While the social goals of the *shari'a* are noble, Islamic finance has been working to meet commercial standards first as a sign of the sector's viability before trying to meet its social responsibilities, according to Rehman.

Rehman noted that microfinance aligns well with Islamic finance because both share the same social goals and finance-related goals, such as fair access to capital and reaching an under-served population. He said that Islamic finance must work to move from a consumer-debt industry to a savings industry, which dovetails with microfinance because it assists in business development and savings. If integrated, Islamic finance and microfinance could reach a three-billion-person market. Rehman reminded the audience that in the past, trade played an integral role in the spread of Islam, so Islam has a history of valuing trade and entrepreneurship.

According to Rehman, traditional banks often seek growth through increasing the debts of consumers, but Islamic banking seeks to depart from this debt-based approach. The instruments for this shift from a "*shari'a*-compliant" to a "*shari'a*-based" mindset exist, but they must be enhanced and used appropriately for success. There must also be a change in measurements of success. To do this, Rehman thinks that Islamic finance must partner with microfinance as a philanthropic endeavor. Microfinance institutions have access to rural and poor communities, and Islamic finance offers *shari'a*-based commercial services to create a strong partnership.

It was in the context of these two keynote speeches that proposals for and case studies of Islamic microfinance were presented in the symposium's first panel, which was moderated by Asim I. Khwaja, Associate Professor of Public Policy at the John F. Kennedy School of Government, Harvard University.

Opening with an alternative view of microfinance, Samer Badawi of the Consultative Group to Assist the Poor, Washington, D.C., opined that although there is evidence supporting the value of microfinance, there is also enough evidence to the contrary to cause alarm. Microfinance is not reaching the poorest of the poor, even though this was its purpose, and loans are going to activities unrelated to entrepreneurship. Islamic finance can in principle and practice correct these defects.

Hans Dieter Seibel, Professor at the University of Cologne, Germany, discussed the case study of Indonesia, the largest Muslim country in the world with a mixed history of Islamic microfinance. Seibel noted that Islamic microfinance banks statistically have not done well compared to their conventional counterparts. Part of the reason for the decline is absentee ownership and little competence in Islamic finance, but Mudarabah savings and fixed deposits have proved to be successful. Seibel emphasized that a proper legal framework and regulation of interest rates are important for the success of Islamic microfinance, which faces many challenges as a developing industry.

Contrasting Afghanistan with Indonesia, Siraj Sait, a Senior Lecturer in Law at the University of East London, UK, introduced the Global Land Tool Network, which uses Islamic land instruments as a priority to empower the poor. Sait argued that the poor do not consist of the "end line," but are part of the entire process. The challenges of Islamic microfinance include an end-user skepticism about Islamic compatibility and a lack of state regulation. The goals are to create pro-poor, scalable, and replicable tools; cross-fertilize between generic and Islamic tools; and define stakeholders.

Then, Taha Abdul Basser, a Ph.D candidate at Harvard University, presented a paper by Dr. Muhammad Anas Zarqa, advisor to The International Investor, suggesting that a monetary waqf (cash trust) be used as an Islamic vehicle to help the productive poor. He explained that the Islamic finance industry has not focused as much on these tools for social justice because the industry was new. In order for Islamic finance to succeed in the social justice aspect of its mission, it must convince its clients and develop managerial talent.

Saif I. Shah Mohammed, a J.D. candidate at the Columbia University School of Law, NY agreed with Badawi that microfinance has been over-hyped and that a partnership between Islamic finance and microfinance may be the best approach, focusing on Bangladesh in particular. However, Islamic microfinance institutions must overcome distrust from the microfinance sector of the Islamic finance industry, especially since there is a confusion of terms. To heal some of these wounds, Mohammed thinks that the *ulema* need to explain terms, and provide practical solutions to the problem.

The speakers also contended, however, that these issues can be resolved if people from the Islamic finance and microfinance sectors work together. Aamir Rehman and Robert Annibale reiterated that a hybrid model integrating philanthropic and commercial goals or a nonprofit model using charitable sources such as *zakat* offer a relationship between the Islamic finance and microfinance industries.

Michael Ainley of the UK Financial Services Authority connected the current development of microfinance to Europe's past transition from credit unions and community banks to its contemporary economic system. Ainley also noted the importance of effective government regulation and supervision of the industries. Aqil Abdus Sabur, interim President of the Philadelphia Commercial Development Corporation, linked the discussion to microfinance as practiced by the Prophet Muhammad's (PBUH) companions over a thousand years ago.

The panelists offered closing remarks, reminding the audience of Islam's history in finance and the great potential future of Islamic microfinance. This is a project that is growing in the United States, the United Kingdom, continental Europe, the Middle East, and Asia. However, it is important to keep the purpose in mind, as Shyakh Nizam Yaquby insisted during his conclusion: the goal is to eliminate poverty, not to cloak goals to exploit people.

The symposium, attended by over 120 scholars, professionals, and students, was praised by many attendees as a landmark event. The session was characterized by a genuine exchange of ideas between two sectors—Islamic finance and microfinance—that share core ideals but have not cooperated deeply before.