ISLAMIC MICROFINANCE AS A POVERTY ALLEVIATION TOOL: 
EXPECTATIONS FROM OGUN, NIGERIAN
SUB - NATIONAL STATE

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ABSTRACT

This study attempts to understand how Islamic microfinance as a financial inclusion strategy can be applied in alleviating poverty and maintain sustainable development in Nigeria. It analyses the convergence of microfinance and Islamic finance in providing financial access to the poor in compliance with the Islamic social principle and tenets. This research employs the use of survey questionnaires and semi structured interviews. A descriptive analysis of data obtained from selected urban and rural areas was conducted using the deductive approach. The survey conducted in Ogun State, a sub national government of Nigeria reveal that notwithstanding the current upsurge in religious tension in Nigeria, religion is not a hindering factor to the implementation of Islamic microfinance. The religious affiliation is not considered critical to accessing microfinance products and services. The study recommends that microfinance of the Islamic genre, should together with other monetary and fiscal policies, will engender financial inclusiveness and be a veritable alternative of providing further inclusive financial access to the Muslims, the poor and other ethically minded investors in Nigeria. In order to achieve sustainable poverty alleviation, the ‘Tabarru’ principle which, focusses on helping the small-scale entrepreneurs and

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the poor vulnerables, meet their financial requirements, should be considered for adoption.

**Key words**: Financial Inclusion, Islamic banking, Microfinance, Islamic Microfinance, Poverty alleviation, Nigeria

1. **INTRODUCTION**

The stability of the financial environment plays an important role in the economic development of a country. Through its many agency and general utility functions conventional finance has over the years, recorded tremendous successes in the United Kingdom. Conventional banking practice is, predicated upon the intermediation model. The banks and other financial institutions earn profits from the intermediation spread between earned demand deposits and savings deposits (Ryu, Piao, & Nami, 2012). The development of a healthy national financial system is seen as a channel for the broader goal of national economic development. However, the coverage of financial services for most people are of limited success in developing countries (Adams Douglas, Graham & Von Pischke, 1984).

However, a section of the society have, been excluded from the financial system, with consequential, implication for sustainable development. Therefore, the provision of access to the formal financial system and services such as savings, payments, transfers, credit and insurance becomes critical in order to obviate the deleterious impact of development disparities. The financial inclusion framework which consists of the demand-side (consumers) and supply-side (financial sector providers) sides aims at ensuring that users and financial service providers are included in the formal sector and have incentives to actively do so. In this respect, and for inclusiveness, microfinance, which is a subdivision of the financial sector focused on fighting poverty, provides a medium for filling the credit gap created by the conventional banks. The advocacy for the emergence of an alternative form of finance based on the need to, effectively address the financial needs of the neglected low-income earners and poor begun to gain traction. Khan (2008) explains that microfinance refers to providing loans and other credit facilities to the poor with a focus on those not served by traditional institutions through programs designed specifically to meet their needs and circumstance.

Dahiru and Zubair (2008) considers financial exclusion as the major challenge confronting the microfinance scheme in Nigeria. This is corroborated by Aliyu and Zubair (2008) who contend
that the majority of the population of Nigeria live below the poverty line, despite various conventional microfinance institutions. Such programmes have largely failed to meet the goals of providing access to more poverty-stricken people. The federal government of Nigeria has also grasped the importance of microfinance as a vital medium to increase access to the formal financial system. The apex bank in Nigeria states that out of about 40 million people living in abject poverty, the current microfinance institutions has covered less than one (Central Bank of Nigeria - CBN, 2011).

The results obtained from several microfinance studies in Nigeria results have shown a positive influence on poverty (Irobi, 2008; Wright, 2000; McCulloch & Baulch, 2000). The microfinance in Nigeria is however faced with daunting challenges. These include: high repayment default rate inadequate awareness, communication gaps and insufficient support from government. In addition, they suffer from inadequate equity capital and lack of standardized reporting in addition to performance monitoring for the system (Irobi, 2008). Frasca (2008), given the reported constraints of the conventional microfinance, advocates for Islamic microfinance as a veritable alternative to conventional microfinance. Sanusi (2013) also advocate for the strategic introduction of Islamic and other Sharia compliant finances which he considered key in bringing in large part of population into an organized financial sector.

Islamic finance as defined by Jobst (2007) is a financial relationship involving entrepreneurial investment that, is subject to moral prohibitions. The principles Islamic finance forbid interest earning, risk taking, gambling, sinful activities, money lending to customers and speculative trade. It is predicated on real goods and services trading based and contract-sharing reward. It is about ethical dealings with wealth redistribution objective and reduction of poverty (Hayat, 2009).

Although Islamic microfinance is yet to be implemented in Nigeria, this study is set out to examine its possible impact on poverty alleviation in the country using Ogun State, one of the 36 sub-national governments as a case study. The research investigates the Islamic concept of microfinance as a financial inclusion strategy in alleviating poverty. The scope of the sample is purposively based on carefully selected key stakeholders comprising of regulatory body, financial institutions and general public.

The rest of the paper is organized as follows: the conceptual review that covers the concept of financial inclusion, Islamic finance, conventional and Islamic microfinance, comparison of both
financial systems, and poverty and poverty alleviation in Nigeria; the methodology of study; findings and analysis; conclusions and recommendations based on the findings of this study.

2. CONCEPTUAL AND LITERATURE REVIEW

2.1. Poverty

The World Bank (2004) defines poverty as a condition where the basic human needs such as healthcare, education, food, water, shelter are not available. It further states in its 2002 publication that a person is deemed poor if his/her consumption level is less than US$1 per day. Dogarawa (2007) reports that Nigeria is, rated among the world’s top 20 poorest nations. with high level of poverty, despite the amount of crude oil, natural gas and other natural resources the nation produces. As the decades have gone by, the number of people living in poverty continues to increase. However, the rate of poverty in Nigeria has dropped from 35.2% of population in 2010/2011 to 33.1% in 2012/2013, according to the World Bank country manager at the Nigeria Economic Report (2014).

The causes of poverty have been ascribed to several factors. For Nnadi (2008), it is the impact of globalization on the Nigerian economy through a foreign direct investment decline and unemployment. Unfortunately, sumarising the Development Indicators report of the World Bank for Africa, Teshome (2008) surmised that the hitherto veritable gateway to employment (education) is no longer certain. Corruption, defined by Transparency International as the abuse of power entrusted officially for private benefit has been fingered as yet another culprit (Ozoh, 2012). The lack of diversification of the economy resulting on over dependence on Oil, the lack of capital and the labour resources under-utilization of during the farming season are others (Igbuzor, 2004),. The combination of these various complex poverty contributing factors also include negative and / or low economic growth, deffective macroeconomic policies, lacuna in the labour market resulting in limited job growth, low productivity and low wages in the informal sector, and a lag in human resource development (Olowa, 2012).

2.2 Financial Inclusion

Financial inclusion also known as inclusive financing is the provision of financial services
at costs which are affordable to disadvantaged and low income segments of society. The main aim is the alleviation of poverty. It is envisioned that the economic empowerment of the poor will be made easier by easing access to financial capital, hitherto unavailable to this class of people. Microfinance involves the provision and making possible financial services hitherto inaccessible to the low income segment of society. Globally, the institution of microfinance is recognized as a veritable instrument for promoting financial inclusiveness and consequently, reduction of poverty.

The estimate of global working-age adults with no access to any type of formal financial services to be about 2.5 billion. In addition, only 24% of adults in Sub-Saharan Africa have a bank accounts (Muzigiti & Schmidt, 2013). The figures for Nigeria as of 2010 are no less favourable: About 79 percent of the population do not have access to formal financial services, The women folks and the rural population constitute about 85% and 86% of the unbanked population respectively. Illiteracy is another factor which forces them to deal with cash. Research shows that 55% and 19% use bank for savings purposes, and prevent theft respectively. In all, only 3% use Microfinance banks (Credit Awareness, 2010). The task of admitting these 'exiles orphans' into the formal financial family is an arduous one. One of the veritable avenue for achieving this is through microfinance.

2.3 Conventional Microfinance

Microfinance, a way of providing access to financial services for small and micro businesses, hitherto difficult because of qualifying parameters high transaction costs. The cooperative societies were known by different names in Nigeria: Esusu in the Southwest, Adashi in the North and Etodo in the Eastern part of Nigeria. The country has about 870 conventional microfinance banks licensed by the Central Bank of Nigeria (CBN, 2013).

Several microfinance researches in Nigeria have results showing a positive influence on beneficiaries (Irobi, 2008; Wright, 2000; McCulloch & Baulch, 2000). All the authors consider microfinance as a powerful and effective and poverty alleviation contrivance. The microfinance in Nigeria is however faced with daunting challenges. These include: inadequate awareness, high repayment default rate, insufficient support from government and communication gaps. In addition, they suffer from inadequate equity capital and lack of standardized reporting in addition to performance monitoring for the system (Irobi, 2008).
All the various governments in Nigeria have at one time or the other recognised the debilitating impact of poverty on the citizenry and the economy. These programmes are directed towards the poor especially amongst rural dwellers and women. Some of the finance based anti-poverty programmes put in place by the government of Nigeria in the past were the Peoples Bank, which sought to provide loans to prospective entrepreneurs on soft terms and without stringent requirements of collaterals. The Peoples Bank were to serve as sources of cheap funds for communities. Others efforts include the Community Banks and rural banking regulations of the CBN which forced banks to open branches in the rural area hitherto considered unprofitable. The essence of these inclusive financing programmes which have recorded varying levels of success is poverty alleviation.

The next discussion will be on the Islamic microfinance which provides another vista of opportunity for financial inclusiveness to millions of Muslims and other ethically minded investors who currently rebuff microfinance products that do not comply with Islamic law (Haram) and other morals.

2.4 Islamic Microfinance (IsMFI)

The distinguishing features of key Shari'a principles from the conventional genre has necessitated the emergence and development of a separate finance industry. Specifically, Islam prohibits speculative investments (Mayseer), interest (Riba), usury, and Gharar which is commercial uncertainty. In addition, all activity must be for permitted purposes (Halal), (Figure. 1).
Islamic microfinance represents the convergence of two sectors: microfinance and Islamic finance. It has addresses unmet demands in microcredit facilities in addition to meeting the key Islamic injunctions of providing support to the less fortunate (Karim, Tarazi & Reille, 2008). The objective is to enhance the living standard of the poor because it discourages exploitation and social injustice. The philosophical basis of the Islamic financial system according to Dogarawa (2008) is in the Adl (social justice) and Ishan (benevolence). In view of these principles the positive influence of Islamic microfinance, on reduction in the level of poverty is manifested in the inclusion of those that have hitherto been excluded from financial services. The Islamic microfinance is more inclusive than the conventional one in addressing poverty alleviation. It blends the creation of wealth with understanding for the poor. The transparency in accounting and the meticulous documentation in the Islamic framework, is a central requirement of financial transactions.
A composite model of Islamic microfinance which combines the profit with the not-for-profit modes of Islamic microfinance has been provided by Obaidullah (2008). The model starts when a Zakah Fund is established with contribution from donors and/or by an Islamic Microfinance Institution (IsMFI) or programme. This fund is applied in acquiring monetary and physical assets. The physical assets are used to expedite skills and training education while in the view of (Hassan, 2010), the monetary assets is kept in the form of a cash Waqf, or Sadaqat. The IsMFI identifies the needy and economically inactive destitute persons to whom part of Zakah funds is given towards meeting their basic necessities in terms of grants and safety net expense. In addition, the IsMFI arranges for skills training to these economically inactive persons.

The beneficiaries are constituted into groups when graduate with requisite skills. These teams mutually guarantee the provided facilities (Kafala) with combination of for-profit debt-based modes (Ijara, Salam, Bai-muajjal, Isijrar or Istisna) and/or equity-based modes (Musharaka or Mudaraba). The group members are provided with higher levels of financing when they pay back their current debt. In case of actual defaults, the liabilities accounts are paid off from the Zakah funds. In order to ensure the sustainability of the programme, the team members are to form a micro-insurance (Takaful) fund from their savings. This composite model of Islamic microfinance is represented in Figure 2.

Figure 2: Composite Model of Islamic Microfinance
Source: Adapted from Obaidullah (2008).
Awojobi and Bein (2011) attest to the efficacy of the microfinance schemes in all Middle East nations. The schemes have successfully enhanced employment opportunities, improved social and economic condition of the target, and raised real wages. This finding is also supported by Siddiqi (2002) who reports the comparative advantage of Islamic finance over the conventional alternative.

Islamic financial products and services are available to all regardless of religious belief. Islamic microfinance products include Salam for financing agriculture and Bay al-Muajjal-Murabahah of providing working capital (Hassan, Kayed, & Oseni, 2013). There are many models in operation. Dhumale and Sapcanin (1999) identified three main instruments Islamic Micro Finance (IMF) models. In the profit and loss model (Mudaraba), entrepreneur manages the project using the funds provided by the financial institution who bears the possible loss. In the Musharka model, a joint venture arrangement exists wherein both the entrepreneur and financial institution contribute to the capital and sharing of any profit or loss. In the Murabaha scheme, the bank procures the products and sells them to micro entrepreneur and with a markup.

The model propounded by Hassan and Ashraf (2010) provide for the creation of a Zakah fund (one of the Islamic five pillars) is designed to address the poorest of the poor with which to cover the losses arising from the default by very small microenterprises. The fund also covers part of the project evaluation costs of the commercial banks. Qardhasan loans are also provided for funding micro insurance to reduce vulnerability of the non-poor from becoming poor due to external shocks. This is in addition to the creation of mutual guarantee funds to pay for accidents, losses of property. In addition, loans are also provided to build the productive capacity of the households as part of inclusive growth programmes.

Dasuki (2006) recommends the group-based lending scheme and Ibn Khaldun’s concept of Asabiyah which as a unifying force is analogous to the modern concept of social capital. In the Qardhasan savings/lending model, the loan depositor receives saving points instead of interest for the size and duration of the funds provided. After achieving a sufficient number of those points, the group member should be eligible for taking out a loan himself. The model which is a form of cooperative finance practice has been professionally applied by non-Muslim banks JAK Medlem, Nordspar (Sweden and Denmark) and by Strohalm Foundation (The Netherlands).

The Islamic microfinance banks need to institute measures that guarantee loan repayment. In the event of default by a group member, De Aghion and Morduch (2005) recommend that in
line with the practice of the Grameen bank, such defaulter and the other group members will have to quit their membership of the bank. The other group members are likely to repay the loan on behalf of the defaulter since they would want to retain their beneficial membership of the bank. In effect, they are would, in the face of possible collateral liability be careful in admitting a group member. This is useful to micro-lenders in overcoming “adverse selection” problem.

If the Islamic microfinance banks considers the business project too risky despite the various risk mitigation techniques available, Wilson (2007) recommends that it should adopt or adapt the Wakalah model which is acting only as an agent for the disbursement of funds provided from Zakat fund or Non-Governmental Organisation (NGO) and other donor agency. This may become necessary since Islamic microfinance institutions do not intend to go into bankruptcy occasioned by massive repayment defaults. Islamic finance by nature which is asset-backed provides opportunity for more realistic funding of production and real investment activities. This in the opinion of Umar (2014), facilitates the development of critical infrastructure which should contribute positively to the development of the real sector of the economy. The next area will discuss the methods and approaches through which facts will be gathered in this study.

3. RESEARCH METHODOLOGY

In this study, as advocated by Saunders, Lewis, and Thornhill, (2009), triangulation which, within one study deploys more than one data collection method to achieve a more accurate research has been used. In order to vitiate the impact of perception bias, the use survey questionnaires have been coupled with semi structured interviews. The choice of multiple methods as advocated in business and management research by Saunders et al. (2009) has been adopted.

The descriptive analysis including ratio analysis and percentage analysis were used to describe the socio-economic and demographic characteristics of respondents in the study area. Specifically, the size and composition, the sex and educational attainment of the respondents were analysed in the study. The use survey questionnaires and semi structured interviews was employed. The structure of the questionnaires provides for both open and close-ended questions. The respondents are to pick their choice in the structured questionnaire section. Steps have been taken to eliminate as much as possible bias and ambiguity. The respondents were also given the opportunity to freely comment on the ability of the Islam in providing entrée avenues for the “unbanked” into the formal financial system.
Four hundred copies of the questionnaire were administered in ten clusters towns drawn purposively and divided equally between rural and urban areas spread throughout the State. These are Abeokuta, Ijebu-Ode, Sagamu, Ota, Ilaro, Ago-Iwoye, Ijebu Ife, Kobape, Imeko and Imo Lisa. The target respondents include agriculture, retail marketing, civil service commission, beneficiaries of OSAMCA loans and general public which consist of civil servants bankers and all other occupations. A stratified random sampling technique has been adopted for this research to reflect the population size of each town. Next, we present the data analysis and interpretation of results.

4. FINDINGS, DATA ANALYSIS AND DISCUSSIONS

The number of responses received was 344 (86%) The response rate is considered adequate for drawing empirical inferences. Ten semi structured interview sessions were held with enlightened professionals in sociology, banking and finance management on the subject matter. The result of the findings show that all the people in and above the age bracket of 18 and 60 years will benefit from Islamic microfinance which coincides with the constructive and productive work force.

From the above analysis, a good majority of Christian respondents (68%) agrees to patronize Islamic products when provided which attest to the fact that religion is not a constraining factor to access Islamic microfinance. This is not surprising in view of the fact that religious this society do not really discriminate along religious lines. Different religious persuasions can be found within even nuclear families.

The research has revealed that about 38% of the respondents have been refused loan requests in the past due to inadequate funds which corroborates
the fact that existing micro finance institutions are not capable of meeting the demand of the potential market. Indeed, CBN, (2005) states that existing micro finance in Nigeria serves less than one million out of the potential 40 million people living in abject poverty.

From the findings, 68% of the sample population are interested in sharing their business with an Islamic micro finance bank (Table 1).

Table 1: Readiness of Respondents to Share Profit with Islamic Microfinance

<table>
<thead>
<tr>
<th>Response</th>
<th>Number of Respondents</th>
<th>% Distribution</th>
</tr>
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<tbody>
<tr>
<td>Yes</td>
<td>234</td>
<td>16</td>
</tr>
<tr>
<td>No</td>
<td>110</td>
<td>84</td>
</tr>
<tr>
<td>Total</td>
<td>344</td>
<td>100</td>
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Source: Field Survey 2014

This indicates the perception of respondent with respect to the significance of the Islamic genre of finance to the expansion of their business operations due to the principle of profit and loss sharing

Of the respondent, 84% objected to punishment for loan default which has been a major challenge for Islamic finance. However, Eighty nine percent (89%) of respondents wholly support the notion that Islamic microfinance can alleviate poverty, which supports the findings of majority of the literature. On the questions designed to find out what the respondents feel about the impact of Islamic microfinance on the real sector of the Nigerian economy and if a positive sustainable development is attainable. Seventy Eight percent (78%) of respondents are positively in line with the position of Siddiqi (2002) that Islamic finance creates better value for financial activities through to the close link between real economic activities and Islamic finance.

The summary of the findings of semi structured interview the open-ended questions are that the conventional poverty alleviation schemes in the past years have not been successful in the last two decades. Their comments included ‘poor’, ‘it has not worked’, ‘they have not performed’, ‘poor outlay,’ ‘it has failed’, ‘no improvement’, ‘those schemes more often suffer implementation problems’, and ‘they are inefficient’. They also agree that Islamic microfinance in concert with the right fiscal and monetary policies framework, will contribute positively to poverty alleviation in Nigeria.
All the respondents to this question are not aware of any structure put in place to promote Islamic microfinance. The respondents also freely comment on the ability of the Islam in providing entrée avenues for the “unbanked” into the formal financial system. Majority (91%) believe in the ability of Islamic microfinance to generate financial inclusiveness through the provision of Halal (Shariah sanctioned) products including Mudaraba (profit and loss sharing by borrower/manager and the financier), Musharka (Joint venture wherein both the bank and entrepreneur participate in capital and share profit and loss) and the Murabaha (cost plus markup sale). Finally, majority of the respondents responded in positive light toward the introduction of Islamic microfinance in to the country.

The findings of this study are consistent with the theoretical underpinning of Islamic finance which is the sharing of profit and loss (PLS). To some extent, economic principles and analyses are based on the Qur’an and the Sunnah which are the sayings and doings of prophet Muhammad (SWT). As reported by Chapra (2008), it is the collective obligation (Fard Kifayah) of a Muslim society to take care of the basic needs of the poor. This is considered as the raison d’etre of society itself. In addressing poverty alleviation in an Islamic society, charity (the broad term being Sadaqat) takes a central position. Indeed, when compulsorily mandated on an eligible Muslim, Sadaqat is called Zakah which is the third among five pillars of Islam. Beyond these personal efforts at reducing poverty, institutional arrangements are also in place.

The operational scope of Islamic microfinance (IsMFI) is wider than its conventional counterpart. The intendment of microfinance is meant to get the poor out of poverty. However, the poorest population are still left out by conventional MFIs (Choudhary, 2002). The IsMFI is required to cater to this category by integrating the poverty eradication programmes, including Zakat, Qard-Alhasan and other voluntary charities (Sadaqatt) into their mandate.

5. CONCLUSION

The various financial inclusion strategies and programmes have met with varying degrees of success. The ideology of an Islamic microfinance institution appears to be potentially of a comparative advantage because Muslims want to carry out economic activities according to their religious injunctions. A population of about 80 million Nigerians Muslims constituting about half of its total population (Pew Research Centre, 2009) creates a potential market for this financial services genre. Coupled with about 70% of Nigerians living below poverty, the Islamic
microfinance can be a veritable alternative of providing further inclusive financial access to the Muslims.

The findings of this study are that religious affiliation is not a critical hindrance to access Islamic microfinance products and services. With the perception that the existing conventional microfinance institutions do not cater enough for those who really needs their services, Islamic microfinance when established promises to widen the breath of provision of financial services to the poor, other ethically minded investors and indeed many other Nigerians of all faiths.

Furthermore, it was noted in this study, that the adoption Islamic microfinance as a financial inclusion strategy for poverty alleviation needs to be accompanied with other enabling fiscal and monetary policies for it to be effective. Islamic microfinance concepts should be adopted by the government in concert with the structural transformation of the economy in order to achieve a sustainable, balanced and broad-based economic growth and development which will be inclusive of the poor and the disadvantaged.

In conclusion, as recommended by (Wilson 2007), sustainable poverty alleviation can only be achieved by teaching poor how to fish. For this objective to be achieved, the ‘Tabarru’ principle which focusses on helping the microentrepreneurs and the vulnerables poor meet their financial requirements should be considered for adoption.
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