

CHALLENGES OF ISLAMIC MICROFINANCE IN SRI LANKA: WITH SPECIAL REFERENCE TO COMMERCIAL CREDIT-HEAD OFFICE COLOMBO

MRF Nashath ⁽¹⁾, **MHM Nairoos** ⁽²⁾

¹Assistant Lecturer in Islamic Banking & Finance, Department of Islamic Studies, FIA, SEUSL

²Senior Lecturer in Islamic Studies, Department of Islamic Studies, FIA, SEUSL

mrfnashath@gmail.com

Abstract

Islamic Microfinance has been identified as an important tool in increasing the productivity of poor and help to economic development. The main objective of this study is to empirically analyze the challenges of Islamic Microfinance in Sri Lanka. Thus Islamic Microfinance of Sri Lanka also faces remarkable challenges while growing fast in the nation. This is because of lack of financial techniques and human resources. This study examines the impact of selected challenges in Islamic Microfinance and it is practiced by Commercial Credit. A qualitative study is carried out which include personal interview, questionnaire and secondary data materials. Questionnaires are dealing with selected challenges in Islamic Microfinance. The target population for this study considers the staff of Commercial Credit Head office. A simple random sampling technique is used to select the respondents surveyed for this study. For data statistical analysis, the researcher applied statistical package for Social Science (SPSS) 16.0 computer software package under which person Coefficient, Coefficient of determination and Regression analysis were calculated to analyze data. This study is identified the challenges of Islamic Microfinance in Sri Lanka. Findings indicate that there is a significant positive relationship between selected challenges in Islamic Microfinance from the sample point of view. The study recommends for Islamic Microfinance staff working in market needs adequate training, motivate the staff, use the latest technological systems and government must invest in supportive financial infrastructure. This research reveals that staffs at Commercial Credit have perceptions that the selected challenges are impacted on practices of Commercial Credit.

Key words: Islamic Microfinance, Challenges of Islamic Microfinance, Microfinance, Sri Lanka

Introduction

The religious perception about the interest rate along with other qualification requirements represent the major obstacles that hinder poor Muslim people to approach Conventional Commercial banks and other financial institutions for credit. This clearly indicates the need to establish a suitable credit system capable of meeting the un-banked Muslim people's needs without breaking their religious rules. This Islamic finance gives an opportunity for needy Muslim poor people to apply for loans that might be used in creating new job opportunities which will eventually contribute in mitigating their poverty level.

Islamic finance has another branch of finance called Islamic Microfinance. Islamic Microfinance is specifically designed for underprivileged people who lack access to credit and who do not want to violate the Islamic laws of borrowing.

The basic principle of Microfinance as succinctly expounded by Dr. Muhammad Yunus, the Founder of Grameen Bank Bangladesh and the recipient of the Nobel Peace Prize in 2006, that Credit is a fundamental human right. The primary mission of Microfinance is, therefore to help poor people in assisting themselves to become economically independent. Credit or loan is given for self-employment and for financing additional income generating activities. The assumption of the Grameen model is the expertise of the poor are under-utilized.

Islamic Microfinance has become one of the new recent hottest topics that provide alternative way for funding poor Muslim people. This type of funding depends basically on following the Islam instructions of not to charge interest rate on loans disbursed. However, Islamic micro financial institutions can charge borrowers specific amount decided in advance to cover up the operating expenses incurred by the institutions when operating. The concept of Islamic Microfinance industry is relatively new and still faces a lot of difficulties and challenges.

During the long journey of Islamic Microfinance in Sri Lanka massive numbers of Islamic Microfinance programmes have been launched targeting the rural population. Government organization and non-government organization (NGOs) have contributed significantly to the development of Islamic microfinance activities in Sri Lanka.

Islamic Microfinance is most applicable on commercial credit in Sri Lanka They give some products for consumers but the face many challenges. So this study is going to find out the Challenges of Islamic Microfinance on commercial credit in Sri Lanka with special reference for Colombo head office.

Problem Statement

Islamic Microfinance applicable on commercial credit in and it is a first license commercial Bank in Islamic Microfinance applicable in Sri Lanka. Commercial credit produces their Microfinance for customers and towards that they have achieved profit. But, when they are exercising this programme, they certainly face many challenges as well. Through this study researcher attempts to explain the challenges faced by Islamic Microfinance and the solution can be taken it.

Research Question

The dissertation is based on following research question:

1. What are the challenges they face in the practices of Islamic Microfinance in Sri Lanka?

Follow up Question

This problem is analyze through these follow up Questions

- ✓ What are the Internal challenges faced by Islamic Microfinance in Sri Lanka?
- ✓ What are the External challenges faced by Islamic Microfinance in Sri Lanka?

Objective of study

Major Objective

Main purpose of this study is, to find out the challenges faced by Islamic Microfinance in Sri Lanka.

Secondary Objective

- ✓ To find out the internal challenges faced by Islamic Microfinance in Sri Lanka
- ✓ To identify the external challenges faced by Islamic Microfinance in Sri Lanka

Research Methodology

Type of study

Commercial credit is taken for the research. This study has been carried out with their major challenges for Islamic Microfinance and identifies the accurate challenges of Islamic Microfinance in Sri Lanka; researcher has carried out a pilot survey. Therefore, this research is an exploratory research design to explore to the selected challenges of Islamic Microfinance providing better understanding.

Data and method of Data collection

While deciding about the method of data collection to be used for the researcher should keep in mind two types of data

Primary Data

Primary data is collected by Dream Fulfiller (Microfinance) of commercial credit and staff were interviewed and discussed with and had recorded their collective information. In addition, needed information was collected through a self-designed structured questionnaire. Questionnaires were distributed directly to the Dream Fulfiller and Islamic Bank unit Staff. The questionnaires contain questions that are related to selected factors of Islamic Microfinance.

Secondary Data

Secondary data mean which have already have been collected by someone else and which have already been through the statistical processes. Other relevant secondary sources and analyzed to archive the research objectives. Such as, Magazine, Books, Journals, Research Article and Newspapers, Annual report of commercial credit, Websites, audios, video and broadcasts.

Method of Measurement

For data analysis, descriptive analytical techniques such as column charts, line charts, pie charts, graphical illustration etc. were used. For the statistical analysis, the researcher applied statistical package for Social Sciences (SPSS) 16.0.

Population and Sample

The target population for this study comprised Dream Fulfiller (Microfinance) and staff of commercial credit head office Colombo. The samples of 30 them are randomly selected and were collected.

Category	No. of population	Sample Selected	Percentage (%)
Staff	30	30	100%

Table: 1.1 Population and Sample of commercial credit

Hypothesis

Some selected serious challenges are taken for the hypothesis testing. Islamic Microfinance sector in Sri Lanka commercial credit is affected by these challenges. Therefore the challenges have been considered as independent variables. Islamic Microfinance has been considered as dependent variable.

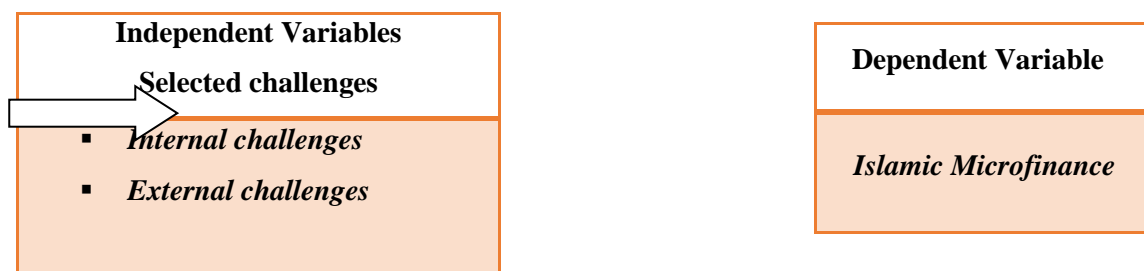


Figure 1.1 Variable Models

Significant of Study

The main aim of Islamic finance and banking is to provide the Muslim society with an Islamic alternative to the conventional banking system that was based on prohibited items in Shariah. The theory of Islamic finance gives view to the development of Islamic banking where the functions of a bank do

not vary between conventional and Islamic banks. However the operations, philosophy and objectives differ significantly between the conventional and Islamic banks.

Toward that commercial credit also provide Islamic Microfinance facilitates for the poor persons in Sri Lanka But when they provide their performance they face many challenges. So in this challenges will impact the growth of Islamic microfinance sector. Same time finds and presents their challenges will very helpful to Islamic microfinance operators in commercial credit. So finding those challenges and suggests some alternatives and recommendations for those challenges that may create the positive challenges in Islamic microfinance sector in future. This will also affect the country's economic growth. According to commercial credit potential, the challenges were not researched in details. Hence, this study is very significant.

Scope of the Study

This study is based on faced challenges of Islamic Microfinance in Sri Lanka and it's carried out especially about commercial credit in Sri Lanka. Therefore it describes how the commercial credit exercising the microfinance and what is the output and challenges towards on it. (With special reference to commercial credit- Colombo head office)

Limitation of the Study

- ✓ The limitation of the study concerns the instruments Dream Fulfiller and staff the research. This study was limited to an interview and questionnaire administration methods with the hope of clarifying or explaining issues that cropped up during administration questionnaires.
- ✓ The sample size will also make it extremely difficult to generalize of the study to cover commercial credit.
- ✓ Due to workload and long hours of bank work, the researcher could not have all respondents responding to the questions asked especially staff.

Literature Review

There is a research paper on “**Challenges and solutions in Islamic Microfinance**” (Rashidah Abdul Rahman and Faisal Dean, 2013). There are many issues that relate to the sustainability of the current practice of Islamic Microfinance. That exclusion from financial services can be caused by high costs and prices, poor marketing, financial literacy of products or self-exclusion in response to negative experiences or perceptions. Furthermore, geographical constraints such as poor access to rural areas, weak law and order enforcement and records of the area are the major factors. In addition, banking behavior and practices, lack of suitable products and exclusion because of regulation, such as proof of identification are identified to exclude the poor. The challenges are many, which can be summed up into four main categories: market penetration, sustainability of Islamic MFIs, high transaction costs, and the effectiveness of Islamic MFIs in alleviating poverty.

In the article on “**Experiments in Islamic Microfinance**” (Mohamed El-Komi, Rachel Croson, 2010), the author describe for the main challenge to microfinance is the risk of default. The incentives for default in microfinance are greater than that in conventional credit. Microfinance loans typically do not involve collateral, increasing the incentive to default. Furthermore, relatively higher interest rates in microfinance have been an issue for debate among policy makers and academics alike. And also Moral Hazard is a main concern in credit markets, in general. It arises because of information asymmetries between the lender and the borrower. However, this problem is more severe in microfinance because of the lack of collateral and the relative high cost of monitoring with respect to the loan size.

The research on “**Islamic Microfinance Development: Challenges and Initiatives**” (Mohammed Obaidullah and Tariqullah Khan – Jeddah, 2008). The author argued that IMFI industry faced many challenges and he describe Diverse Organizational Structures, Shariah Compliance, (its include in Shariah boards, and Fiqh issues, divergent perceptions), Lack of Product Diversification, Linkages with Banks and Capital Market, Payment Systems, Transparency and Information Infrastructure, Education and Training, and Networking.

Another article on “**Islamic Microfinance Challenge: A Summary**” (Mohammed Khaled, 2011). As the blog series on Islamic Microfinance Challenge is wrapping up and they are, Market segmentation from day one, Takaful/Micro insurance , MFI/Bank should think as an investor and not only as a creditor and Savings.

The journal on “**Challenges Facing Islamic Financial Industry**”(Zamir Iqbal, 2012). For Islamic financial institutions, a financial engineering challenge is to introduce new Shariah compatible products that enhance liquidity, risk management, and portfolio diversification. Generally, attempts to apply financial engineering techniques to Islamic banking will require committing a great deal of resources to understanding the risk-return characteristics of each building block of the system and offering new products with different risk-return profiles that meet the demand of investors, financial intermediaries, and entrepreneurs for liquidity and safety. Securitization is a prime candidate for financial engineering. And the other hand Related to the challenge of financial engineering is another operational challenge for Islamic banks: the need to standardize the process for introducing new products in the market. And the other hand Risk Management and Diversification is one another challenge. Risk management is practiced widely in conventional financial markets; it is underdeveloped in Islamic financial markets.

Finding

Variables	Hypothesis	Correlation	Results
Internal challenges and Islamic Microfinance	H1 – negative relationship H ₀ – no negative relationship	0.358	H1 is rejected H ₀ is accepted

External challenges and Islamic Microfinance	H2 – negative relationship H ₀ – no negative relationship	0.310	H2 is rejected H ₀ is accepted
---	---	-------	--

(Source: field research)

Table 1.2 Results of Correlation Analysis

Correlation of selected Reasons and Islamic Microfinance is shown in the above table. It is positively correlated. The significant value (PValue) is higher than the tested alpha value (α) 0.01. Hence, the correlation is significant. Therefore, H₁, H₂ are rejected and H₀ hypothesis are accepted. This analysis has been made on overall selected Reasons and Islamic Microfinance. In that analysis also the relationship of the variables are positive.

Conclusion and Recommendation

Successful Microfinance increase access to financial services for a growing number of low income clients, offering them quick and simple savings and loan services. Islamic Microfinance still acting in Sri Lanka in various places now, such as NGOs, BOC and etc. But they were also facing many challenges. Because, Sri Lanka became one of the few countries which have specific legislation for Shariah compliant financial operations. That's for the reason banks are bear to provide Islamic Microfinance product and services to customers. Many challenges are result of the inappropriate environment in which Islamic Microfinance in working in Sri Lanka.

Based on the analyses the researcher has recommended for, Islamic Microfinance staff working in market needs adequate training. Ultimately, their training will draw some positive impacts on MFI sector in specific and may benefit the economy of the country at large, Islamic MFIs need dedicated and competent managers supported by well-trained and motivated staff and it is essential that the latest technological developments are incorporated into Islamic Microfinance.

Governments must invest in supportive financial infrastructure, which would lower the costs and risks faced by the microfinance industry. Government should provide for policy environment that allows diverse and competitive Islamic Microfinance.

References

Abd Elrahman ElzahiSaaid Ali, 2015, The Regulatory and Supervision Framework of Microfinance in Kinya: *International Journal of Social Science Studies*, Redfame Publishing, Vol.3.

Abdul Rahim Abdul Rahman, 2007, *Islamic Microfinance: A Missing Component in Islamic Banking*:EyotoBullertonof Islamic Area Studies, p 3853.

Ajaz Ahamed Khan and Isabel Philips, 2010, *The influence of faith on Islamic Microfinance Programmes*: published by Islamic relief Worldwide.

Ajaz Ahamed Khan, 2008, *Islamic microfinance Theory, Policy and Practice*: Islamic relief Worldwide.

Al haji AlhasanAbdulai& Muhammad Zubair Mughal, 2015, *Challenges for Islamic Microfinance: Business & Finance*.

Alexandra Frasca, 2008, *Islamic Microfinance in the Middle East and North Africa*:University of Texas.

Inun Jariya A.M, 2013, True Economy Prosperity through Poverty Alleviation- Islamic Microfinance as Commercial Venture: *International Journal of Business, Economic and Law*, Vol 2, Issue 2.

Jaenal Effendi, 2013, *The Role of Islamic Microfinance in Poverty Alleviation and Environmental Awareness in Pasuruan, East Java, Indonesia*: Universitatsverlag Gottingen

Microfinance Industry Report 2009

Mohammed Khaled, 2011, *Building a Successful Business Model for Islamic Microfinance: MENA Regional Representative*.

Mohammed Obaidullah and Tariqullah Khan, 2008, *Islamic Microfinance Development – Challenges and Initiatives Jeddah, Kingdom of Saudi Arabia*: Islamic Research and Training Institute, Islamic Development Bank, Dialogue Paper No. 2, 81p. Vol.17 No.2

Rashidah Abdul Rahman and Faisal Dean, 2013, *Challenges and solutions in Islamic Microfinance*: Accounting Research Institute, University Technology MARA, Selangor, Malaysia, Emerald Group Publishing Limited, Vol. 29, No. 4.

Zamir Iqbal, 2007, Challenges facing Islamic Financial Industry: *journal of Islamic Economics, Banking and Finance*.