Journal of Ecohumanism
2024
Volume: 3, No: 8, pp. 2839 – 2860
ISSN: 2752-6798 (Print) | ISSN 2752-6801 (Online)
https://ecohumanism.co.uk/joe/ecohumanism
DOI: https://doi.org/10.62754/joe.v3i8.4933

Islamic Economic Mechanisms to Achieve Inclusiveness and Islamic Finance for Sustainability

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Abstract

The present study explores avenues for Islamic economics to achieve financial inclusiveness and Islamic finance to achieve sustainability. The study focuses on the importance of providing financial services to the poor as a tool for development and poverty reduction. The study also reviews impediments to poor people's access to financial services, such as low income, high risks, high costs, and cultural and religious constraints. The present study emphasizes the importance of providing Shariah-compliant financial services to the poor in Islamic countries. The study also addresses the regulatory aspects of Islamic financial institutions and the role of zakat and waqf in achieving financial inclusion and sustainability.

Keywords: *Financial Inclusion, Islamic Finance, Islamic Economy, Sustainability, Sustainable Finance.*

Introduction

Delivering financial services to the poor is an important tool to achieve the first of the Millennium Development Goals, which is to halve absolute poverty, as the United Nations has made clear. The ADB emphasized that providing a variety of financial services to the poor is a critical component of an effective poverty reduction strategy. It is agreed that the provision of credit for use in productive activities over years can increase the income of the poor to levels where they exceed the poverty threshold. However, until recently, the majority of poor people in most countries were denied access to financial services, whether coercively due to economic and social factors or voluntarily for cultural and religious reasons [1].

The poor face many risks that make them vulnerable to returning to poverty. So, they need mechanisms to increase their income levels, help them cope with shocks, and reduce their vulnerability. The fragility of a family, community or state depends on the nature of the risks they face and their ability to cope with them. Amid the diversity of causes of poverty and the risks faced by the poor, a debate has emerged about the shift from microfinance to "inclusive finance," which includes the provision of a variety of financial services to the poor, including savings, credit, and insurance. These financial services enable the poor to have access to capital to participate in productive projects, manage risk, increase their income and savings, and get out of poverty [2].

Studies confirm that the influence of finance on poverty could be enhanced if the reach of financial service provision expands. But the poor are often excluded from formal financial services due to their low income, high risk, high cost and lack of information, as well as imbalanced information, and problems and costs related to the volume of financial services. The market has business issues or is disrupted by acute information issues and verification costs. In addition, given the small size of the current financial services market for the poor, the cost of financial services is relatively high [3].

Another important factor that can hinder poor people in Muslim countries' access to finance is cultural and religious norms, as people may choose not to avail themselves of financial services for religious reasons. Many poor people in Muslim countries prefer not to deal with traditional interest-based financial institutions due to Islam's prohibition of usury. A report shows that nearly 72% of the population of Muslim countries do not use formal financial services, and a large proportion of the population (ranging from 20 to more than 40%) do not use traditional microfinance to avoid interest [4].

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Therefore, providing finance to the poor in many Muslim countries requires the provision of sharia-compliant services. The present study focuses on the regulatory aspects of micro-level financial institutions and points out some of the regulatory issues affecting their operations. The literature on financial inclusion will be reviewed to identify the factors affecting the provision of financial services to the poor, focusing on four key elements of Islamic financial inclusion, including identifying different regulatory models for service provision to the poor, examining the provision of a variety of services by these institutions, assessing the sustainability and breadth of service providers, and finally assessing the role of zakat and waqf in the operations of financial institutions providing services to the poor. Because information and data are based on secondary sources, assessments of the breadth and prevalence of different organizations are based on anecdotal evidence.

Inclusive Finance: Scope and Limitations

Inclusive financing for the poor includes providing financing facilities to enhance productive income generation, savings opportunities to build assets, and insurance services to protect them from risks. This section reviews the key issues in the provision of these services at the enterprise level. Organizations face a delicate balance between scale-up and sustainability when delivering these services to the poor. The topic of the balance between sustainability and scale-up has been extensively discussed in the literature on inclusive finance.

While many research papers have provided conflicting evidence on the issue, a comprehensive study by Hermes, Linsk, and Masters (2011) [5] using data from 435 MFIs covering an 11-year period, clearly shows the delicate balance between the two. Issues related to the provision of various services to the poor and their implications for scale-up and sustainability will be addressed in the following discussion.

Microfinance

Although microfinance has existed in various forms for a long time, the initiation of microfinance programs as a tool for poverty reduction through formal institutions began in the 1970s. Microfinance programs provide loans to the poor and operate very differently from traditional commercial banks. To receive funding from these institutions, the client or beneficiary must be poor. Small amounts of credit are granted at reasonable interest rates and repaid in weekly or monthly installments. Sometimes, MFIs extend loans to individuals to build houses or for group projects.

Although the microfinance approach has evolved over time, Grameen Bank's group-based model remains the predominant model for most microfinance institutions. Under group-based programs, a person must form a group of individuals who are similar in socioeconomic status to receive credit. A number of groups gather in a center, and members elect a center president and a vice president. Weekly meetings of the center shall be held in a suitable place within the local community. All members (clients) of the centre must attend these meetings (Morduch, 1994) [6]. An MFI staff member attends weekly meetings to conduct banking transactions and other business with the center members. Initially, most MFIs only offered credit facilities. Some MFIs offer (compulsory) savings programs and risk mitigation funds. However, Hulme (2000, 26) [7] notes that these funds are "not designed to meet the poor's need for savings mechanisms" but rather are a means of securing loans and providing low-cost capital.

While group-based microfinance is one of the predominant models, microfinance institutions have evolved to include different types that offer non-profit and for-profit organizations a variety of financial services to the poor. Many commercial banks, including major international banks such as Citigroup, Deutsche Bank and HSBC, have started offering microfinance. Most of the funding provided by commercial organizations is based on individual rather than group lending.

Many studies suggest that microfinance has a positive influence on income levels and reduces fragility. Although there is a lot of literature that shows the success of microfinance institutions, some studies indicate that these institutions fail to target the poor who are most in need. For example, (Hermes, Lensink,

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and Meesters 2011) [5] suggest that microfinance institutions do not serve the poorest, as they are not given loans or withdraw from credit programs.

A major problem for MFIs is the balance between sustainability and depth of scope. Due to the lack of funds mobilization and high management costs, the costs of providing funding to these institutions become very high. For example, Bennett states that management costs for five MFIs in South Asia range from 24% to more than 400% per lender dollar.

Accurate Insurance

The insurance sector is considered complementary to the banking and securities markets in promoting economic growth (Brainard, 2008) [8]. The insurance industry can play an important role in poverty alleviation if services are provided to the poor to reduce their risk and increase their level of safety. However, compared to microfinance, the field of microinsurance is relatively new, and its provision is very limited, covering only 0.5% of the poor in Africa and less than 3% in Asia in 2007 [9] (Bhatty, 2010).

The principles of microinsurance differ from traditional insurance in many respects. The International Association of Insurance Supervisors (IAIS 2007) [10], defines microinsurance as “insurance that is accessible to low-income earners, offered by a variety of different entities, but managed in accordance with generally accepted insurance practices.” Thus, this definition excludes some government welfare and emergency support programs because they are not funded by a risk premium fund.

McCord, Zenklusen, and Steinmann (2011) [11] point to some key characteristics of microinsurance compared to traditional insurance. Microinsurance customers are poor and face greater risks, which leads to fluctuations in their income, and they can pay only small premiums. To understand the problems of providing insurance services to the poor, it is important to know what risks they face and how to manage them. The risks faced by the poor are categorized in different ways. Holzmann and Jorgensen (2000) [3] maintain that risks may be normal or resulting from human activity. The World Bank (2001) identifies the sources of risk from shocks at the small, medium, and large levels.

Risks also vary in terms of frequency and severity, which are associated with expected welfare losses [12]. SwissRe (2010) outlines four main types of risks faced by low-income households: first, health risks, which may lead to direct costs due to sudden medical treatment or income losses for health-related reasons. Second, risks related to life events such as old age or the death of the breadwinner. Third, financial risks resulting from various causes such as property loss, falling product prices, or crop failure. Finally, risks of natural disasters that may result in loss of life and property.

Insurance is sold to customers through various distribution channels, which include agents and intermediaries of insurance companies. Providing insurance to the poor faces several challenges, including a lack of actuarial data on poor households and limited distribution options, making providing insurance more risky and costly. Thus, commercial insurers and their intermediaries are reluctant to offer insurance to the poor. Nonprofits may be needed to provide microinsurance Roth, McCord, and Liber (2007) [13].

Despite its relative novelty, microinsurance faces the same sustainability and scale-up problems as microfinance [14]. Mosley (2003) identifies key sustainability and scale-up issues in relation to microinsurance. Like microfinance, there are mutual information problems and ethical misuse in providing insurance to the poor. Ethical misuse suggests that more risky households may resort to insurance services, while misinformation shared may lead to more risky behavior after insurance is provided.

In addition to the problems of unbalanced information, the cost of providing insurance is high due to the small size of the insurance coverage. Costs also rise because transaction costs increase due to lack of economies of scale and contract enforcement mechanisms (Morduch, 2006) [15]. Along with high risk, high transaction costs associated with small transaction size and low demand can drive up the costs of providing microinsurance, making it difficult to sustain. This entails that the provision of microinsurance may require subsidies until a certain level of operations is reached in terms of the number of customers.

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Organizational Features, Sustainability, and Communication

The balance between scaling up financial services and sustainability is closely linked to the regulatory features used to deliver financial services to the poor. Roth,McCord, and Liber (2007) [13] refer to four main categories of organizations that provide financial services to the poor: the first are commercial companies that provide financial services with the aim of making a profit. The second is NGOs that provide financial services as non-profit organizations to achieve social goals. The third category includes cooperative societies owned by members and professionally managed. Finally, community-based organizations owned and managed by members.

The combination of cooperatives and community-based organizations differs in that the former are professionally organized and managed. Because of their social mission, NPOs are better suited to provide services to the poorest segments of the population.

The type of approach used to deliver financial services depends on the organizations' objectives. The first approach is the poverty approach, in which financial institutions act as non-profit organizations with the aim of providing financing to the poor and extremely poor (Schreiner, 2002) [16]. NGOs, government agencies, cooperatives, and development financial institutions provide financial services in this approach (Bennett, 1998) [17]. Due to the cost of financing the poor, the long-term sustainability of the operations of these organizations without subsidies becomes a problem.

The second approach focuses on self-sufficiency where financial institutions operate as for-profit organizations (Schreiner 2002) [16]. Financial institutions' operations are sustained by providing larger loans to the less poor at higher interest rates. Various methods are used, such as the linked approach offered by formal financial institutions through intermediaries or special programs (Bennett, 1998) [17]. The commercial approach to providing financial services may support the growth of small enterprises, but it may not work as a tool to eradicate extreme poverty (Weiss and Montgomery, 2005) [18].

Apart from the goals of the organizations, the type of organizational structure also depends on the nature of the services provided. For example, McCord, Zenklusen, and Steinmann (2011) [11] point out that the difference between microcredit and microinsurance is that in microcredit, it is the lenders' money that is at risk, while in microinsurance, it is the clients' money that is at risk. Therefore, micro-insurance providers need to earn the trust of customers more than micro-credit providers. To improve the problem of trust in microinsurance, which is challenged in dealing with riskier customers and poor infrastructure, cooperative and mutual organization structures can be used (Weidmaier-Pfister, and Klien 2010) [19].

Based on the abovementioned factors, it is possible to determine the relevant and necessary organizational features for the provision of inclusive finance:

Organizational Structure

The organizational structure is based on the legal status of the organization. This depends in part on the list of organizational structures available in different countries. The organizational structure falls into four categories as defined by Roth, McCord, and Liber [11] businesses, NGOs, cooperative societies or mutual organizations, and community-based organizations.

Regulatory Environment

The Regulatory system defines the range of Islamic financial products that different organizations can offer, as well as the conditions under which certain financial products are allowed to be offered. On the one hand, regulations provide opportunities for certain products such as demand deposits, and on the other, they can introduce restrictions on the offering of financial products.

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Sources of Funding

Depending on the organizational structure and type of business activity, sources of funding vary. In addition to seed capital, MFI funds come from two main source categories: liabilities such as deposits and loans, and donations that provide financing at discounted interest rates. In the case of microinsurance, contributions from participants are the main source of funds.

Products and Services Offered

As discussed earlier, products of interest in inclusive finance include savings, financing and insurance opportunities for the poor. Savings can be classified as limited investment, where opportunities are limited to specific or illiquid forms of deposits, or unlimited, which offers wider savings opportunities, including demand deposits.

Scope of Services

The scope of services is measured by the number of customers it serves. The depth of the scope of services is measured by the proportions of poor people served. The scope of services can be evaluated in relative terms and depends on the size of the organization's operations, while the depth of the scope of services can be measured by factors, such as the size of savings, financing and insurance contributions.

Sustainability

Sustainability refers to the ability of a financial institution to continue its activities without subsidies. Variables used to measure sustainability include operational sufficiency and return on assets(Cull, Demirgüç, and Morduch, 2007) (Hartarska and Nadolnyak, 2007) [20-21]. Other variables, such as the number of borrowers per branch and access to funds, can also be used to determine efficiency and sustainability.

Islamic and Inclusive Finance

The social role of the Islamic financial sector can be better illustrated by providing financial services to the poor with the aim of increasing their income and wealth. Islamic financial institutions specialized in focusing on poverty provide services to the poor using Shariah-compliant methods and mechanisms. Therefore, the assets and liabilities of Islamic financial institutions differ from their conventional counterparts.

An important aspect of Islamic finance methods is that financial capital cannot claim a return on itself, and the transaction must involve a genuine sale or exchange of goods or things. This includes financing models such as musharaka, mudaraba, murabaha sale and other instruments that enable the provision of finance to the poor in ways consistent with Islamic law.

These models contribute to enhancing financial inclusion by providing opportunities for the poorest to access finance and investment, thereby supporting economic and social development.

Islamic MFIs

Since interest (a form of riba) is forbidden in Islam, the asset and liability components of Islamic microfinance institutions consist of various types of interest-free financial instruments. The collective approach used by MFIs offers social guarantees, reducing credit risk and ensuring higher recovery rates. Since most microfinance programs include social development programs, adopting a microfinance approach can mean a much broader program to create wealth for the poor and bring more broad development.

The methods of Islamic finance are many and varied. The type of funding instrument depends on the type of activity for which funding is granted. In addition to interest-free good loans (Qard al-Hasan), Islamic

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finance principles can generally be categorized into partnerships (companies) and exchange contracts (offsets).

The partnership can be on a profit or output sharing basis. Profit sharing can take two forms: participation and speculation. In participation, more than one party can provide funding, participate in the project and distribute the profit at an agreed rate. In Mudaraba, one party provides financing while the other party manages the project, and the profit is shared at an agreed rate.

In addition to the different types of exchange contracts, the principle of deferred trade is the most important. A deferred trade contract can be either a deferred sale of the price or a deferred sale of the commodity. What matters in microfinance is the deferred sale of the price (forward sale), where the commodity is delivered at the time of the contract, but the price is paid later. The price can also be paid in future in installments.

Another type of financial transaction in this context is a Murabaha sale, where an Islamic finance institution buys a commodity or asset and sells it to the customer with an increase in price. The customer pays for the commodity or asset at a future date or in installments. A lease (ijara) is a contract that allows the customer to use an asset against payment of a lease.

Different types of funding arrangements can be used to fund diverse activities. The principle of participation in production (agricultural and non-agricultural) can be adopted. The Islamic Finance Corporation can provide a portion of the financial capital to produce the output and in return receive a share of the profit.

In commerce, an Islamic finance institution and a customer can jointly finance the purchase and sale of a particular commodity and distribute the profit. Mudaraba production means that the Islamic Finance Corporation finances the project while the client manages it.

In agricultural production, the sharing of output can take the form of sharecropping. The Islamic Finance Corporation may finance the purchase of irrigation equipment, fertilizers, etc., which the landowner uses on his land to grow a particular crop. The harvested crop is then divided between the landowner and the Islamic Finance Corporation in an agreed proportion.

In addition to the profit-sharing principle discussed above, forms of Murabaha and Ijara financing can also be used in production. For example, if a customer needs initial capital (such as equipment or appliances), an Islamic Finance Institution can buy items and sell them to the customer at an increase in price.

In agriculture, the item can be a cow or poultry sold by the Islamic Finance Corporation with an increase in price. The customer pays the price of these items in the form of agreed installments in the future. Similar transactions can take place under a lease (ijara).

In trade, profit-sharing plans and deferred trade contracts can be used. Under the profit sharing scheme, the Islamic Finance Corporation becomes a partner in the trading business and receives a share of the profit. The Murabaha principle can also be applied where the Islamic Finance Institution buys the items to be traded and then sells them to customers with an increase in price. Customers pay the Islamic financial institution after selling the goods.

In transportation services, the principle of increase in price and the principle of rental can be applied. For example, if a customer wants to buy a rickshaw, an Islamic finance institution can buy it and sell it to the customer at an increase in price. The customer then pays the price according to an agreed payment plan. Alternatively, a lease can be arranged that includes the payment of rent as well as a portion of the capital in the customer's installments. Once all installments have been paid in full, the client becomes the owner of the jolt.

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Micro Takaful

Micro Takaful is a type of Islamic insurance that targets low-income individuals. It seeks to provide them with financial protection against the risks they may face. This type of solidarity aims to promote financial and social stability for the most vulnerable groups, such as the poor and low-income people.

Micro Takaful Characteristics

Islamic Sharia

Micro Takaful follows the principles of Islamic Sharia, which means that it is free from interest (riba) and any Islamic prohibited financial practices.

Participation

Micro Takaful is based on the principle of collective risk sharing, where premiums are pooled from subscribers and channelled to a mutual fund used to compensate subscribers when covered events occur.

Social Solidarity

Micro Takaful aims to support the most vulnerable by providing them with financial protection.

Diversity of Coverage

Micro Takaful provides a variety of insurance products that suit the needs of the poor, including health insurance, life insurance, property insurance, and others.

Low Costs

Micro Takaful provides insurance services at a low cost to suit the capabilities of the target groups.

Accessibility

Micro Takaful seeks to facilitate access to insurance services through local distribution networks and to provide services of a simple nature that is easy to understand by beneficiaries.

Importance of Micro Takaful

Enhancing financial inclusion

By providing insurance services to groups that do not benefit from traditional services, Micro Takaful contributes to enhancing financial inclusion.

Risk Protection

Micro Takaful helps provide financial protection to individuals against risks such as illness, accidents or natural disasters.

Promoting Social Sustainability

Micro Takaful contributes to enhancing social sustainability by providing financial security for vulnerable groups.

In general, micro-takaful is an important tool for achieving financial stability for the poor and promoting financial inclusion in low-income communities.

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Many Islamic scholars point out that a traditional insurance contract that includes periodic payments of premiums against future compensation is not Sharia-compliant due to the presence of excessive uncertainty (gharar). While the Islamic Fiqh Academy announced that traditional insurance is prohibited - in Resolution No. 9 (9/2) - the Academy proposed the use of cooperative insurance based on charitable donations (donations) and cooperation or mutual assistance (cooperation).

As a result, various models of Takaful insurance (Mutual Guarantee) have been developed to offer Shari 'a compliant insurance plans. The main organizational feature of Takaful insurance is mutual insurance, where the policyholder takes on the role of owner and risk holder, and the Takaful insurance operator (TO) performs the managerial role.

Mudaraba Model

In this model, the operator (TO) and the participants have a partnership relationship. Participants contribute donations to the Participants' Takaful Insurance Fund, which is managed by the Operator. The operator invests money in income-generating activities and gets a share of the profits. After the participants' claims are covered, the surplus is distributed among the participants.

Agency Model

This model is similar to the Mudaraba model, but the operator acts as an agent rather than a partner. Thus, the operator receives an administration fee as compensation in lieu of profits. Takaful insurance can include the features of both Mudaraba and agency contracts.

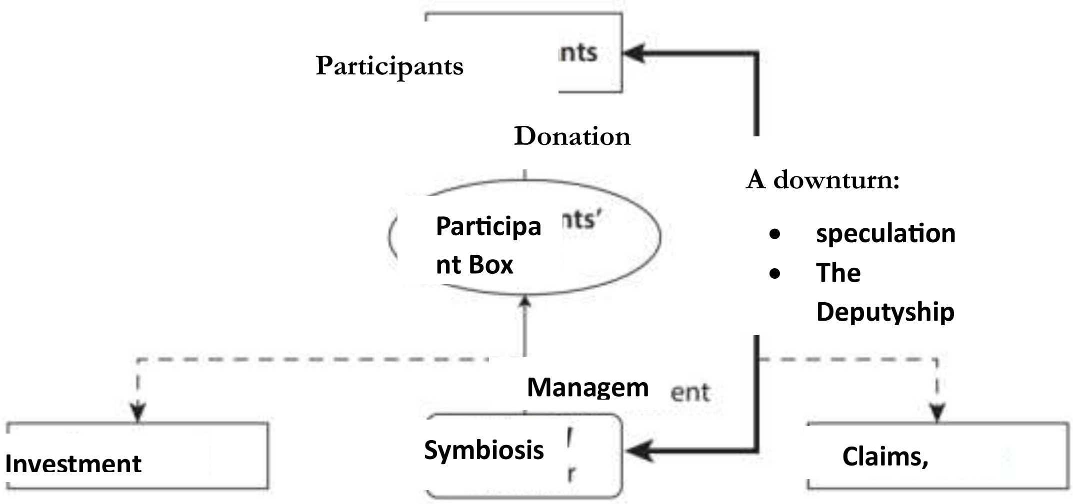
Endowment Model

The Takaful Insurance Fund takes the form of an endowment fund. The endowment is initially established by the operator, and the participants' contributions are added to this fund. The relationship between the participants and the operator in the waqf model can be either speculative or agency.

- *Legal Questions*

Hussain (2009) [22] points out that the operating model of Takaful insurance raises a fundamental legal question about whether Takaful insurance is a mutual insurance or a proprietary company. This question is related to asset ownership and how to manage Takaful insurance in general.

In general, Takaful insurance seeks to strike a balance between mutual risk coverage between participants and ensuring that operations are Sharia compliant by leveraging Mudaraba, Wakala or Waqf models.



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Picture (1) Basic Structure of Takaful Models

In the context of Takaful, participants are the owners, and they have the right to appoint managers or operators of Takaful insurance (TOs). However, it doesn't always have to be that way. On the one hand, participants own the Takaful Fund along with its associated assets and liabilities. On the other hand, the institution or Takaful insurance operator manages the fund with complete freedom of action (Hussein, 2009).

Although this legal predicament is difficult to resolve, the separation between profit or non-profit takaful insurance is on the basis of its legal status. If the Takaful Insurance Operator is granted a license as a business entity operating through shareholders providing capital, it will be considered a for-profit organization. If Takaful is registered as a cooperative or association, it will be considered a non-profit entity.

Based on these differences, Takaful insurance operators can be distinguished based on their objectives and legal status. This difference can be reflected in how takaful insurance operators manage the fund, how profits or surplus are distributed among participants, as well as the ownership structure.

Use of Zakat and Waqf in Inclusive Finance

The concept of waqf can be integrated into the takaful insurance model. The literature on Islamic microfinance highlights additional religious tools such as zakat (imposed charity) to promote financing for the poor. Zakat is one of the basic pillars of Islam that directly affects others economically. It obliges Muslims to distribute part of their wealth to the deserving groups to achieve the economic emancipation of the poor. Similarly, waqf is a voluntary charity with broad economic implications. These institutions were able to solve the problems of poverty and expand social services in ancient times.

Sadaqah (charity) and Qard al-Hasan (interest-free loans) are tools to support the poor and redistribute income to their benefit. Zakat and waqf-generated income can be incorporated into Islamic microfinance, which may prevent the transfer of funds and benefit the poorest beneficiaries (Ahmed 2002) [23]. Zakat provided to the poor for consumption, asset building and production purposes can be used to boost the funds of Islamic microfinance institutions. These support funds can be provided either as grants or interest-free loans (Qard Al Hassan) according to the needs of the beneficiary. These backstopping funds reduce the need to transfer funds for depreciation and/or asset purchase, and funds taken for productive purposes are expected to be appropriately invested.

As a result, the overall return on invested funds is expected to be higher and the likelihood of default relatively lower. Thus, merging Zakat, Sadaqah, and Waqf institutions with microfinance increases the likelihood of repayment of funds to small Islamic finance institutions. In addition, Zakat provided to the poor can be used for consumption purposes to avoid diversion of funds from productive activities.

Çizakça (2004) [24] proposes a model in which the concept of cash endowment can be used to serve social goals in society. One use of the cash endowment would be to provide microfinance to the poor. Similarly, El-Gari (2004) [25] proposes the creation of a non-profit financial institution, the Qard al-Hasan Bank, which grants interest-free loans (Qard al-Hasan) to finance the poor. The bank's capital comes from the cash endowment donated by wealthy Muslims.

Kahf (2004) [26] and Ahmed (2004) propose the creation of microfinance institutions based on zakat and waqf. They point out that the proceeds of the endowment can be used to finance small productive projects at subsidized prices. Ahmed (2011) proposes a model for an Islamic waqf-based microfinance institution that can offer microfinance and facilitate wealth creation for the poor. The cash endowment shall constitute the capital of the Corporation. Capital can be used alongside deposits to finance the poor.

Given the charitable nature of zakat and endowments, these tools can be used to solve the balance between scale-up and sustainability to some extent. For poverty-focused nonprofits, philanthropic funds from these

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sources can provide the support needed to sustain their activities. For for-profit commercial organizations, Zakat and Awqaf can offer subsidized funding sources that can be used to scale up towards the poor.

Inclusive Islamic Finance: An Overview and Comparison

This section reviews different models of organizations that provide a variety of Islamic financial services to the poor. Because the information gathered about different features comes from secondary sources, certain information about some variables may not be available. In some cases, conclusions regarding some variables may be based on anecdotal evidence.

The variables used to assess the organizational features of various organizations that provide financial services to the poor include organizational structure, regulatory environment, sources of funding, products and services provided, scope of coverage, and sustainability. The features of these variables are presented to a range of organizations that provide Islamic microfinance services to the poor using both poverty and commercial approaches. The review below shows the main features of these variables for these organizations and highlights the different patterns they adopt to provide Islamic financial services to the poor. These models are based on the specific goals pursued by organizations, whether they focus on the social aspect and the fight against poverty or seek to achieve profitability, while adhering to the principles of Islamic Sharia.

Rescue, Bangladesh (NGOs)

In Bangladesh, NGOs can be registered under different formats, but most MFIs choose to register as Voluntary Social Welfare Organizations under the Voluntary Social Welfare Agencies (Registration and Control) Ordinance 1961. Organizations working on public donations or government aid are considered voluntary social welfare agencies and are registered with the Ministry of Social Welfare. Registered organizations obtain legal status and become eligible for grants from the government and other sources, including foreign sources. As an NGO, registered organizations are not subject to any regulatory body.

Among the registered organizations offering Islamic microfinance in the country's Rangpur region, Rescue adopts a group-based lending model from traditional financing institutions and adapts Islamic principles and values. Began operating in 2008 Rescue's main donors, who founded the MFI, became members of the board of directors that makes up the institution's policymaking body. The CEO manages the organization and is responsible for implementing the decisions made by the Board of Directors.

In addition to the initial capital provided by a few donors, most MFI funds come from external sources and are mandatory customer savings. In 2001, Rescue's total assets were Tk 3.91 million (approximately USD 70,045), and the liability side was funded as follows: 2.2% through a total capital fund, 4.4% through customer savings, 92.4% from borrowing from government agencies, and the 0.9% from other liabilities. In the same year, Rescue had 2,515 customers, averaging a distribution of Tk 2,148 per member, with a return rate of 16%. A large percentage of the beneficiaries (97.5%) were women, and the dropout rate was 3.8%. The average savings per customer was Tk. 352.7, and the risk fund per customer was Tk. 62.3. Rescue's rate of return on assets (ROA) was 3.6%, lower than Grameen Bank's.

Bangladesh's Islamic microfinance institutions, including Rescue, have some problems obtaining funds from external sources, according to Ahmed (2002). Although some funds are available from government agencies, they impose certain conditions. Some of these conditions conflict with Islamic principles and limit the flexibility of the operations of Islamic microfinance institutions. For example, funds are awarded with interest and MFIs are required to recover a fixed rate of return on their investments. As a result, funds from these sources cannot be used for microfinance using some Islamic financing methods such as Mudaraba and Musharaka.

Lack of finance is one of the major constraints to the growth and effective operations of Islamic microfinance institutions in Bangladesh. The shortage of funds shortens the expansion of MFIs' operations, and has other negative impacts. Microfinance institutions cannot hire enough workers at competitive wages.

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ISSN: 2752-6798 (Print) | ISSN 2752-6801 (Online)
https://ecohumanism.co.uk/joe/ecohumanism
DOI: https://doi.org/10.62754/joe.v3i8.4933

The lack of funds leads to fewer field workers, which reduces the ratio of employees to beneficiaries and negatively affects supervision and monitoring. Paying lower wages affects the ability to attract higher-productivity workers, resulting in experienced workers moving to other organizations that offer better wages and benefit packages. This increases the likelihood of default and decreases the expected income of Islamic microfinance institutions.

Takaful T&T Friendly Association, Trinidad and Tobago (Friendly/Cooperative Association)

Takaful T&T Friendly Society (TTTFS) is a multi-purpose cooperative established in 1999 under the Friendly Associations Act (18 of 1950) of Trinidad and Tobago for Muslims in the country. The friendly association option was chosen by law because it does not impose restrictions on the use of sharia-compliant alternatives. Moreover, there was no requirement for large paid-in capital, and the option allowed for a small start with gradual growth potential.

- TTTFS Services and Activities

Microinsurance Scheme

TTTFS provides a microinsurance scheme under the Funeral Benefits Scheme (FBS), where members contribute to the scheme an annual amount to cover three family members and pay an additional amount per family member in excess of three.

Investment Funds

TTTFS has several investment funds, including an investment fund, a pilgrimage fund, and an endowment fund for charitable purposes.

Membership Subscription

Members can benefit from the various services provided by the association by paying an annual membership fee of TT $20.

- *Funeral Benefits Plan (FBS) Details*

Takaful Scheme Structure

FBS is characterized by the structure of the agency-based Takaful model. Members contribute Trinidadian $120 per year to cover three family members, and pay an additional amount for each additional family member.

Management Fee

As agent (s), TTTFS charges a 15% contribution fee to manage funds and pay claims. This fee goes to the General Fund.

Investment of Funds

The proceeds of the Takaful Fund are invested with other investment funds of the association on a 70:30 speculative basis in the distribution of profits.

Funeral Grants

TTTFS shall pay a funeral grant of 2,500 Trinidadian Dollars upon the death of a Member or any Dependent. A portion of the surplus generated after claims are paid is allocated to the reserve, and the remainder is distributed to the members.

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Takaful Supplements

In 2008, an additional amount of T $2,000 was added as payments for the claims of the families of the deceased. This additional amount includes a grant of $1,000 from the Surplus Endowment Fund and another $1,000 from the General Fund.

- *Sustainability and Growth of the Plan*

The Funeral Benefits Scheme (FBS) has managed to sustain over the years, resulting in an annual surplus and an increase in reserves. At the end of 2011, the accumulated reserve stood at TT $16,523.

Overall, TTTFS offers diverse services to the Muslim community in Trinidad and Tobago, with a focus on delivering Shariah-compliant financial solutions that meet their needs.

Bramo Foundation, Indonesia (non-profit organization)

The Pyramo Foundation (Yayasan Pengembangan MasyarakatMustadh 'afiin) is a non-profit foundation based in Bogor, Indonesia, founded in 1993 as a multi-purpose social development foundation. The Foundation provides various services to the poor and is managed by three councils or committees. The founders who pledged an initial capital of IDR 250 million to the Foundation are also members of the Board of Trustees.

- *Financing Programs*

Pyramo Foundation runs three different microfinance programs:

Bank of Pericreditan Rakyat Sharia (BPRS)

Baitul Mal Finance (BMT)

Kobaratsi Bait Elective (BAIK)

These Islamic financial institutions provide financing to different types of clients.

- *Micro Takaful*

Pyramo's Takaful Micro Indonesia Working Group (Takmin) acts as a takaful intermediary for poor clients through a network of Islamic finance institutions in the country. Founded in 2006 as a pilot project, Takmin is the latest working group. It adopts the partnership-agent model with the aim of providing access to takaful services to clients and members of microfinance institutions within the Biramo Foundation and others.

- *Takmin Services*

Seed Funding

Seed funding to start Takmin came from an international NGO,Oxfam-Novibin the Netherlands in 2006.

Partnership with Takaful Indonesia

Takmin collaborates with the prestigious Takaful Indonesia to provide Takaful services as an agent to clients in the West Java, Central Java and Lampung districts.

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Takaful Services

Takmin offers various Takaful services such as Credit Life Takaful for MFI clients. This service covers debt repayment in case of death, excluding suicides, participation in crime, political risks, wars, riots, terrorism, sabotage, and drug and alcohol related events.

Premium Collection

The rates and collection of premiums shall be sent monthly to the insurance company at a rate of 0.05% per month on the outstanding amount of the loan. Coverage remains in effect until the loan is repaid. Takmin receives 25% of the monthly amount transferred.

- *Last Takaful Plan*

Takmin introduced a new takaful scheme called Takaful Ukhuwah Mikro for both MFI and non-MFI clients. Under the scheme, a MFI client can obtain insurance of IDR 1 million (~ USD 109.1) on death from any cause, and IDR 5 million (~ USD 545.50) on accidental death for a contribution of IDR 20,000 (~ USD 2.18) per year per person.

MFIs retain 25% of the contribution as an administrative fee, Takmin receives 25% of the remaining percentage (IDR 3,750) as a commission, and the remaining amounts go to Takaful Indonesia.

- *Business Performance & Growth*

Takmin served around 15,000 clients from 47 MFIs in 2011. The plan recorded 11 deaths in 2008 and 20 in 2009.

In general, the plan operates in surplus, and the main challenge to its expansion lies in convincing MFIs to enroll their clients in micro-takaful plans.

Takmin is promoting access to micro-takaful services to help the needy and provide financial protection to the poor in Indonesia.

IBBL Rural Development Scheme, Bangladesh (Commercial Bank)

Islamic Bank Bangladesh Limited (IBBL) is an Islamic commercial bank regulated by the Central Bank, Bank of Bangladesh. Although most of the Bank's products consist of traditional banking services, it also offers microfinance through its Rural Development Programme (RDS). RDS was launched in 1995 and started operations in 1996 to meet the investment needs of poor rural entrepreneurs.

- *RDS Program Details*

Funding and Monitoring

RDS is funded by IBBL's General Investment Fund, and overseen by the bank's management and board of directors. It is managed by a manager with extensive experience in microfinance prior to joining IBBL.

Program Objectives

RDS aims to eradicate rural poverty through a community development approach, targeting the rural poor.

Funding Mechanisms

WFP uses cluster-based funding, as this model suits the poor. It does not require material guarantees to obtain financing, but rather relies on social guarantees through the formation of groups and centers.

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Financing Methods

The RDS mainly uses the Murabaha or Deferred Price Sale method, where individuals are given small amounts ranging from Tk 3,000 to Tk 25,000 and paid in small weekly installments.

- *Programme Performance*

Scope and Results

As of June 2010, RDS provided microfinance services in 12,857 villages across 177 IBBL branches. A total of Tk. 42.28 billion was disbursed to 382,319 customers, with a recovery rate of 98.8%.

Funding Terms

RDS provides 12.5% yield funding, with a 2.5% on-time repayment discount, which is lower than traditional MFI rates.

Zakat Management System

IBBL also manages the Islamic Bank Foundation (IBF) which is created from Zakat, charitable donations and the bank's income that cannot be included in the bank's profits. IBF offers various social services.

- *Efficiency and Costs*

Efficiency

Ahmed (2004) suggests that Islamic banks can deliver microfinance more efficiently and effectively to the poor. Operating costs are expected to be lower as Islamic banks offer microfinance from their existing branches, reducing fixed costs.

Labor Costs

Wages paid to field workers and supervisors in Islamic banks may be higher than their counterparts in microfinance institutions, attracting more productive field staff.

Cost Savings

The overall operating costs of providing a certain amount of microfinance to a certain number of beneficiaries are expected to be lower in the case of Islamic banks compared to traditional microfinance institutions. The RDS program demonstrates how Islamic banks can efficiently and effectively provide microfinance services to contribute to the economic and social development of disadvantaged groups in rural communities.

Percritan Rakit Automobile Bank (BPRS), Indonesia (Rural Bank)

Indonesia is one of the most diversified financial sectors in the world, catering to different segments of the population. Institutions offering microfinance include traditional and Islamic rural banks. Although the country has a long history of rural banking, it was formally adopted in 1988 through a presidential decree known as the "Policy Package" (Paket Kebijakan) by Presidential Decree No. 38, National Law No. 7 of 1992 and National Law No. 10 of 1998.

- *Rural Banks*

Badan Berkreditan Rakyat Bank (BPR): Founded in 1989 as a traditional rural bank.

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Islamic Bank for Rural Finance (BPRS): Established in 1991 as an Islamic bank for rural finance, BPRS plays an important role in providing Islamic microfinance in Indonesia.

BPRS is regulated and supervised by the country's central bank, Bank Indonesia, which actively oversees BPRS.

- *Specifications*

Social Objective

Sibel (2005) notes that BPRS tends to have a social mission to help the poor and entrepreneurs, while seeking to cover the operating costs of the bank.

Ownership

BPRS has a variety of owners, which can be individuals, organizations, or companies. In some cases, the largest contributor also manages the BPRs.

Financing

BPRS provides financing using methods such as Murabaha, Musharaka and Mudaraba to clients with an existing business. For new entrepreneurs with no previous experience, BPRS uses Qard Hassan.

- *Performance and Indicators*

Deposits and Other Sources

BPRS relies on deposits from customers as its main source of financing, constituting 57.4% of the bank's total assets. Financing also includes equity (22.9%), bank deposits (11.5%) and borrowing (3.8%).

Funding Ratio

BPRS provides less funding than its conventional counterparts in terms of the number of depositors and borrowers and in terms of the average total funding.

Non-performing debt ratio (NPL): BPRS's NPL ratio was higher (4.6%) than that of Bank akyat Indonesia (BRI) which is considered the benchmark for microfinance in the country (2.5%).

Return on Assets (ROA)

The average return on assets (3.2%) for BPRs was lower than the average BRI (5.7%).

Overall, BPRS offers Islamic microfinance and contributes to supporting the poor and entrepreneurs in Indonesia, with a focus on Sharia values. However, it faces some challenges in terms of non-performing debt rates and financial performance compared to its conventional counterparts.

Rakyat Arrahnu Bank Programme , Malaysia (Co-operative Bank)

Bank Rakyat Malaysia (BR) is the largest cooperative bank in Malaysia, founded in 1954. The Bank has its members (depositors), and the directors are appointed by the Government. Since it is cooperative, it is registered with the Ministry of Cooperatives. In addition to offering deposit services, BR provides financing through other mechanisms such as personal loans and hire purchase.

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Although BR started as a traditional financial institution, it switched to Islamic finance in 1993. By the end of 2010, BR had 134 branches in the country and assets worth RM1.91 billion. Although BR is a cooperative bank, it acts like a trading company.

- *BR Services*

Miscellaneous Services

Services include savings, investment, consumer finance, trade finance, SME finance, financial planning, and e-banking.

ArRahnu Program

BR offers microfinance in the form of Islamic mortgage services under the ArRahnu Program through all its branches and 23 ArRahnu centers.

- *ArRahnu Software*

Funding

To request funding from the ArRahnu program, customers must use yellow gold jewelry. The authenticity of jewelry is verified and valued.

Qard Al-Hasan

For the first time, customers get 65% of the value of jewelry as an interest-free loan (Qard Al-Hasan), and existing customers get 70%.

Loan Term: The loan is granted for a period of six months, and can be extended for another six months.

Storage Fee

The storage fee is calculated based on the value of gold and is 65 cents per month per RM100, equivalent to approximately 13.8% per annum.

Loan Range

Most loans are small amounts ranging from RM10,000 to RM15,000. Loans larger than RM30,000 account for about 15% of loans and are often used for business.

- *Takaful Services*

Introducing Micro Takaful Products

BR offers Micro Takaful products as an agent to other Takaful operators.

Personal Takaful Programs

BR runs the Takaful Hayati Program in collaboration with Etiqa Takaful Berhad. For a payment of MYR 50 per annum, the scheme provides cover of MYR 13,000 for accidental death.

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Amani Takaful

It is a personal accident protection program in collaboration with Takaful Ikhlas Snd Bhd. For an annual contribution of RM50, the program covers up to RM40,000 for accidental death or permanent disability, and RM1,000 for funeral costs.

By providing a variety of Islamic financial services, BR plays an important role in supporting financial development and financial inclusion in Malaysia, especially in the areas of microfinance and takaful.

Organizational Structures, Services, Communication, and Sustainability

Table 7.1 provides a comparison of the different features of organizations offering various Islamic financial services in different places. Legal forms include for-profit and non-profit types. For-profit organizations include IBBL and BPRS, while BR and TTTFS operate as cooperatives, while non-profit organizations include Rescue and Takmin.

- *Feature Comparison*

Legal Forms

For-profit organizations that include banks such as IBBL and BPRS, while BR and TTTFS are cooperatives. Rescue and Takmin are non-profit organizations.

Funding Sources

Funding sources include five categories:

Equity: Used by for-profit organizations such as banks.

Member contributions: used in cooperatives.

Deposits: Used by banks and cooperatives, and includes current deposits.

Funds Supported: Nonprofits rely on them.

Donations: Also used by nonprofits.

- *Some Services Provided*

Savings

Savings can be classified as restricted and unrestricted. Unrestricted saving includes current deposits, while restricted saving is illiquid and imposed on customers as part of the provision of financing.

Financing

It includes the provision of financing to clients in various forms such as conventional Islamic finance and microfinance.

Insurance

Insurance can be restricted when it is part of the provision of financing to protect against credit risk.

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- *Services Rating*

To evaluate the services provided by different organizations, a value of 2 is awarded for unrestricted services, 1 for restricted services, and 0 for not providing the service.

Highest Scores

Highest scores are scored by BR and Peramu, both non-profit organizations. BR is a cooperative while Peramu is an enterprise.

Restrictions on Regulated Organizations

The table shows that regulated organizations (with the exception of BR) face restrictions in the provision of all types of services, reflecting the regulatory constraints to which they are subject.

In general, different organizations provide diverse services that meet the diverse needs of customers, focusing on Islamic values and principles in providing these services.

Awareness and Sustainability

Analysis of the extent of financial coverage and sustainability of different organizations providing different Islamic financial services shows a difference in performance between organizations. Coverage is twofold: the width that shows how many clients the organization serves, and the depth of coverage that shows how poor the beneficiary clients are. The volume of financing is used as a criterion for depth of coverage; the smaller the volume of financing, the more accessible it is to the poor.

- Classifications from IO

Rating Criteria

The depth of coverage was rated according to good, medium and weak criteria, using the criterion of the volume of funding compared to GDP per capita, and the amount paid in case of risk.

Results of the Review

Table 7.3 shows that organizations adopting the poverty approach are able to achieve better coverage than organizations adopting the trade approach. The three NPOs in the sample (Rescue, TTFS and Peramu) received a good rating, while the commercial organizations (BPRs and BR) received a poor rating in terms of depth of coverage.

- *Sustainability*

Table 7.4 shows the sustainability rating of different organisations by looking at returns and accessing funding.

Sustainability Results

Business organizations perform better than organizations that adopt a poverty approach in terms of sustainability.

Sources of Funding

Commercial organizations rely on their own funds (especially deposits), while organizations with a backward approach rely on donations or subsidized funds.

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- *Zakat and Endowments*

Table 7.5 refers to the summary results of different organizations in terms of service provision, coverage, sustainability, use of zakat and endowments.

Review Findings

Nonprofits seem to serve the poor better than for-profit organizations. Obviously, poverty-focused organizations rely on funding from donations and subsidized funds, which may limit the expansion of their scope of operations. In contrast, commercial organizations rely on their own funding and achieve better results in terms of sustainability. These comparisons provide important insights into the influence of different funding models on serving the poor and the financial sustainability of organizations.

Table (1). Organizational Types and Services

organization	**Legal Format**	**Methodology**	**Organized**	**Funding Sources**	**Saving**	**Finance**	**of Insurance**	**Services rating**
• Rescue Team	quango	impoverish, ruin, be hemmed in	No	Donations, Subsidized Funds	[RESTRICTED]	Yes	Credit line	4
TTTFS	cooperation, cooperative	impoverish, ruin, be hemmed in	No	Member Contributions	[RESTRICTED]	No	Unrestricted (funerary)	3
Peramu	Not-for-profit organization	impoverish, ruin, be hemmed in	No	Donations, Member Contributions	Yes	Yes	Unrestricted (L/C)	6
RDS	Commercial Bank	Commercial	Yes	Equity, Deposits	unrestrained, unbounded, unbound	Yes	Credit line	5
BPRS	Country bank	Commercial	Yes	Equity, Deposits	unrestrained, Unrestricted,	Yes	No	4
BR (ArRahnu)	cooperation, cooperative	Commercial	Yes	Member Contributions, Deposits	Unrestricted,	Yes	Unrestricted	6

Table (2). Criteria Used to Rank Communication and Sustainability

Estimates	**Depth of coverage (volume of funding/GDP per capita)**	**Return on assets (ROA)/operating surplus**	**Access to financing**
Weak	Above 0.50	ROA Negative/Deficit	Reliance on donations
Average	0.11–0.50	Low/surplus yield	Reliance on subsidized funds
Good	0.0–0.10	High return	Reliance on own funds

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Table (3). Communication with Different Organizations

Organization	Methodology	Coverage Depth (Depth)	Estimates
• Rescue Team	impoverish, ruin, be hemmed in	0.10	Good
TTTFS	impoverish, ruin, be hemmed in	0.04	Good
Peramu (Takmin)	impoverish, ruin, be hemmed in	0.10	Good
RDS	Commercial	0.42	Average
BPRS	Commercial	0.65	Weak
BR (ArRahnu)	Commercial	0.73	Weak

Table (4). Sustainability of Different Organizations

Organization	Methodology	Return on assets (ROA)/operating surplus	Access to financing	Overall ranking
• Rescue Team	impoverish, ruin, be hemmed in	ROA = −3.57 (less than Grameen Bank)	Reliance on subsidized funds	Weak
TTTFS	impoverish, ruin, be hemmed in	moderate	Limited to member contributions	Average
Peramu	impoverish, ruin, be hemmed in	moderate	Reliance on donations	Average
RDS	Commercial	spill; spillover	Resources	Good
BPRS	Commercial	ROA = 3.2 (less than BPR)	Resources	Average
BR	Commercial	By 20%	Resources	Good

Table (5). Inclusive Finance, Connectivity, and Sustainability

Organization	Methodology	PROVISION OF SERVICES	coverage	Sustainability	Zakat/Waqf
• Rescue Team	impoverish, ruin, be hemmed in	4	Good	Weak	No
TTTFS	impoverish, ruin, be hemmed in	3	Good	Average	Yes
Peramu	impoverish, ruin, be hemmed in	6	Good	Average	Yes
RDS	Commercial	5	Average	Good	No
BPRS	Commercial	4	Weak	Average	No
BR	Commercial	6	Weak	Good	No

Nonprofits face sustainability problems partly because they serve the poor and partly because they lack access to funding. The sustainability problem can be solved by integrating Zakat and waqf with inclusive financing. Of the six organizations understudy, only two use these tools with financial services. TTTFS has embedded the Waqf in its operations, with poor claimants being awarded an additional TT $1,000 from the Waqf Fund to cover funeral expenses. Peramu has incorporated Zakat into its funding program. While IBBL collects Zakat and uses it for various socio-economic activities, it has not integrated Zakat with its

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microfinance program. This shows that incorporating Zakat and waqf into inclusive finance programs can help improve the sustainability of nonprofits by providing additional funding sources and easing the financial burden on the poor.

Conclusion

The present study concludes that the provision of financial services to the poor is an important tool for poverty alleviation. Given the complex nature of poverty, there have been calls to shift from microfinance to inclusive finance, which includes savings, finance and insurance services for the poor. These services enable the poor to break out of poverty, where they can invest money in productive projects, manage various risks, and increase their income and savings.

Balance Challenge

Providing services to the poor is costly and risky, creating a challenge in balancing the scope of coverage and sustainability of services.

The Two Main Approaches

- The first approach is the poverty approach, which focuses on universal coverage but needs subsidies to support activities.
- The second approach is commercial, where for-profit organizations are partially sustainable because they exclude poor customers.

Role of Organizations

NPOs typically adopt the first approach and achieve good ratings in coverage, but face sustainability issues. By contrast, for-profit organizations are sustainable but achieve low ratings in coverage.

The Role of Zakat and Awqaf

Zakat and Awqaf can be integrated into Islamic inclusive finance to solve coverage and sustainability problems. Zakat and waqf can be used as supplementary funds to support the activities of NPOs. For-profit organizations can expand their coverage using funds from these sources to provide financial services to the poor.

Potential Use

The use of these two tools in Islamic inclusive development finance appears to be limited in the sample of six organizations only. Thus, further research and practice is required to explore how these tools can be used to solve the balance between coverage and sustainability in inclusive Islamic finance.

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