The case for Islamic microfinance in Africa

Small business owner in Ghana (Photo Credit: World Bank)

Professor **Badr El Din A. Ibrahim**, President of the Microfinance Unit at the Central Bank of Sudan, discusses why Shari'ah-compliant financing is key

Islamic, or interest-free banking, is a form of financial intermediation that prohibits giving and receiving pre-determined interest (or rate of return), as money has no intrinsic value and financial providers have to share the risk and benefits on profit and loss sharing arrangements; but the system does not exclude sales-based and lease formulae.

Interest-free finance is receiving attention in Europe, Singapore, Hong Kong and many other non-Muslim countries. The UK Government has committed itself to making London the global hub of Islamic finance.

The 2008-09 financial crisis set Islamic finance as an option to the global financial system because of its stability, reducing fragility and volatility. Moreover, Islamic finance also emphasises poverty alleviation and reducing income inequalities.

Yet while interest-free finance has been documented in many regions of the world, little is written about its development in Africa. Therefore, assessing the state of interest-free microfinance in Africa is difficult, because of data limitation. Nevertheless, there seems to be a large un-met demand for interest-free microfinance products in Africa given the large number of Muslims, weak financial inclusion, and the limited Islamic microfinance providers.

In Sub Saharan Africa alone, the Muslim population was estimated to currently stand at 250 million people and to reach 386 million in 2030, according to a 2014 IMF paper on Islamic finance in the region, written by Enrique Gelbard, Mumtaz Hussain, Rodolfo Maino, Yibin Mu, and Etienne B. Yehoue. Muslims are estimated to be 53 per cent of the total population of Africa according to the website Muslimpopulation.com—the site states that 16 out of 47 states have a 50 per cent or more Muslim ratio; this includes Ethiopia, where 50 per cent of the 89.2 million people are Muslim.

According to CGAP estimates that nearly 70 per cent of population in Sub Saharan Africa falls below the $2 a day poverty line, and only 24 per cent (half of the global average) of the adult population have bank accounts at a formal financial institution. All of these indicators show that the Muslim population in Africa cannot be underestimated, and most of them fall within the estimated poverty line.

Yet the interest-free microfinance market penetration in Sub Saharan Africa has been slow. According to Accion's Allison Ehrich Bernstein, currently "just four of the 255 financial service providers offering Shari'ah-compliant microfinance products are in that region."

In another estimate as of end-2012, out of 38 interest-free finance institutions operating in Africa—comprising of commercial banks, investment banks, and Takaful operators—only 17 interest-free finance institutions are operating in Sub Saharan Africa. This number can be compared with more than 300 Islamic microfinance institutions, mainly NGO-based and charity models, working in 32 countries of the world. Yet Islamic microfinance institutions' share is only $1 billion, or less than one per cent of the world Islamic finance industry, estimated to be around $2 trillion.

In fact, despite the relatively huge Muslim population, and comparatively low financial inclusion, interest-free finance in Sub Saharan Africa is still at a nascent stage, although it has potential given the region's demographic structure and prospects for financial deepening, the authors of the IMF paper argue. They identify Botswana, Kenya, Gambia, Guinea, Liberia, Niger, Nigeria, South Africa, Mauritius, Senegal and Tanzania as Sub Saharan countries with Islamic banking activities. They add that there is also scope for development of Islamic banking activities in Zambia, Uganda, Malawi, Ghana and Ethiopia, as all but Zambia have relatively large Muslim populations.

For example, among African countries Kenya and Tanzania have already incorporated interest-free banking via Islamic windows by banks such as Standard Chartered. Kenya's Central Bank introduced Shari'ah-compliant bonds and interest-free finance currently accounts for about two per cent of the total banking business. In Tanzania, Islamic banking demand eventually far exceeded supply. This was due to both the large number of Muslims, and the lucrative services that Islamic banks have offered. Moreover, the proposed Islamic Banking Bill of 2014 in Uganda would provide a much needed regulatory framework to realise the benefits of this alternative banking model.

THE SIGNIFICANCE IN AFRICA

Overall, interest-free microfinance can expand its services in Africa side-by-side with conventional banking. There are many un-tapped microfinance opportunities that can be exploited by conventional and interest-free microfinance providers in Africa. Interest-free microfinance, we argued, need to be considered as an unconventional solutions to specific financial needs that are unmet by today's conventional microfinance services industry. In Africa it is possible for interest-free microfinance to open a new micro financing sub-division, at a time that Islamic formulae are appealing to conventional microfinance banks.

In a visit to Kenya Women Microfinance Bank in Kenya, the General Manager informed me that the bank decided to buy the cows and provide it to the client instead of money, while payment is made instalments with interest rate added to the total cost. This arrangement is made due to that women whom they asked to be financed to buy cows tend to use the fund in other purposes. This action resembles Islamic Murabaha which provides the assets on a sale-base arrangements, but the microfinance provider must first own the assets and then sell it to the client. In sum, some funding practices in Africa are Islamic therefore extension is possible.

Interest-free finance can capture un-tapped microfinance opportunities arising in the continent that conventional approach cannot. This conviction is not unfamiliar as interest-free microfinance is a new concept in African countries such as Ghana, Tanzania and Kenya, to name a few. And as the IMF paper pointed out, Sub Saharan Africa's growing middle class, combined with its young population, is an opportunity for interest-free finance to expand its services in Africa side-by-side with conventional banking.

This is part one of a two-part series on Islamic, or interest-free, microfinance. The second part, to be published in Issue #26, will explore options for introducing interest-free microfinance.