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The Role of Islamic Finance in Enhancing Financial Inclusion in Organization of Islamic Cooperation (OIC) Countries

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Abstract

The core principles of Islam lay great emphasis on social justice, inclusion, and sharing of resources between the haves and the have nots. Islamic finance addresses the issue of "financial inclusion" or "access to finance" from two directions — one through promoting risk-sharing contracts that provide a viable alternative to conventional debt-based financing, and the other through specific instruments of redistribution of the wealth among the society. Use of risk-sharing financing instruments can offer Sharīʿah-*compliant microfinance, financing for small and medium enterprises, and micro-insurance to enhance access to finance. And redistributive instruments such as Zakāh, Ṣadaqat, Waqf, and Qarḍ-al-ḥasan complement risk-sharing instruments to target the poor sector of society to offer a comprehensive approach to eradicating poverty and to build a healthy and vibrant economy. Instruments offered by Islam have strong historical roots and have been applied throughout history in various Muslim communities.*

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The paper identifies gaps currently existing in Organization of Islamic Cooperation (OIC) countries on each front, that is, Sharīʿah-*compliant micro-finance and financing for small and medium enterprises and the state of traditional redistributive instruments. The paper concludes that Islam offers a rich set of instruments and unconventional approaches, which, if implemented in true spirit, can lead to reduced poverty and inequality in Muslim countries plagued by massive poverty. Therefore, policy makers in Muslim countries who are serious about enhancing access to finance or "financial inclusion" should exploit the potential of Islamic instruments to achieve this goal and focus on improving the regulatory and financial infrastructure to promote an enabling environment.*

Keywords: Islamic finance, financial inclusion, access to finance, risk sharing.
JEL Classification: G21, G22, G32

Introduction

There is voluminous literature in economics and finance on the contributions of finance to economic growth and development. Many factors qualify finance to matter for development and growth. Financial development and intermediation has been shown empirically to be a key driver of economic growth and development. Financial intermediation between savers and borrowers together with a combination of information, enforcement, and transaction costs in conjunction with different legal, regulatory, and tax systems gives rise to the structure if financial systems around the globe (Levine 2005). Financial systems motivate savers to save by offering them a range of instruments to fit their financial needs, channels savings to investors and in the process broadens investment opportunities, increases investment, ameliorates risk sharing, increases growth of the real sector, enables individuals and business entities to smooth income and consumption profiles over time. Recent empirical evidence showed that this process doesn't only lead to economic development but it also plays a positive role in reducing poverty and income inequality.

Although the linkage of financial development with economic development is established, a high degree of the financial development in a country is not necessarily any indication of alleviation of poverty in the country. There is growing realization that in addition to financial development, the emphasis should be to expand the accessibility to finance which can play a more positive role in eradicating poverty. Development economists are convinced that improving access and making basic financial services available to all members of the society in order to build an inclusive financial system should be the goal. Enhancing the access to and the quality of basic financial services such as availability of credit, mobilization of savings, insurance and risk management can facilitate sustainable growth and productivity, especially for small and medium scale enterprises. Although the research in this area is at its early stages it is already making promising progress. For example, Demirguc-Kunt, Beck and Honohan (2007) argue that finance is not only pro-growth, but also pro-poor.

Despite of its essential role in the progress of efficiency and equality in a society, 2.7 billion people (70% of the adult population) in emerging economies still have no access to basic financial services,[2] and a great part of the them come from countries with predominantly Muslim population. With growing interest in developing a financial system compliant with the Sharīʿah (Islamic Law), it would be worthwhile to explore what is Islam's perspective on financial inclusion and economic development. Islamic finance is growing at a fast pace all over the globe as the demand for financial products and services compliant with Sharīʿah keeps growing. However, the focus of such financial products and services is on financial intermediation through banking and capital markets activities but the availability of financial vehicles catering to the poor is either non-existent or still at very early stages.

This paper argues that the core principles of Islam lay great emphasis on social justice, inclusion, and sharing of resources between the haves and the have nots. Islamic finance addresses the issue of financial inclusion from two directions—one through promoting risk-sharing contracts which provide a viable alternative to conventional debt-based financing, and the other through specific instruments of redistribution of the wealth among the society. Both risk-sharing financing instruments and redistributive instruments such as *Zakāh*, *Ṣadaqat*, *Waqf*, and *Qarḍ-al-Ḥasan* complement each other to offer a comprehensive approach to eradicating poverty and to build a healthy and vibrant economy. Instruments offered by Islam have strong historical roots and have been applied throughout history in various Muslim communities. The paper concludes that Islam offers a rich set of instruments and unconventional approaches if implemented in a true spirit and can lead to reduced poverty and inequality in Muslim countries plagued by massive poverty. Therefore, the policy makers in Muslim countries who are

[2] WBG Financial Access 2009

serious about enhancing access to finance or "financial inclusion" should exploit the potential of Islamic instruments to achieve this goal.

Section I briefly discusses the concepts of financial inclusion and economic development in the conventional thinking. Section II provides theoretical background on the Islamic approach to financial inclusion and economic development. Section III examines various vehicles offered by Islamic finance to enhance access while section IV discusses main the gaps and challenges of implementing such techniques. Finally, section V offers policy recommendations and concluding remarks.

Section I
Financial Inclusion and Economic Development

In conventional finance, financial access is especially an issue for the poorer members of society including potential, or would be, entrepreneurs. They are commonly referred to as "non-banked" or "non-bankable" and in the case of potential entrepreneurs they invariably lack adequate collateral to access conventional debt financing. While access to finance may be important for economic growth, the private sector may not be willing to provide financing to some areas because of the high cost associated with credit assessment, credit monitoring and because of the lack of acceptable collateral.

Financial inclusion, a concept that gained its importance since the early 2000s, has been a common objective for many governments and central banks in developing nations. The concept initially referred to the delivery of financial services to low-income segments of society at affordable cost. During the past decade, the concept of financial inclusion has evolved into four dimensions: easy access to finance for all households and enterprises, sound institutions guided by prudential regulation and supervision, financial and institutional sustainability of financial institutions, and competition between service providers to bring alternatives to customers. Traditionally, the financial inclusion of an economy is measured by the proportion of population covered by commercial bank branches and ATMs, sizes of deposits and loans made by low-income households and SMEs. However, availability of financial services may not equal financial inclusion, because people may voluntarily exclude themselves from the financial services for religious or cultural reasons, even though they do have access and can afford the services (Beck and Demirguc-Kunt 2008).

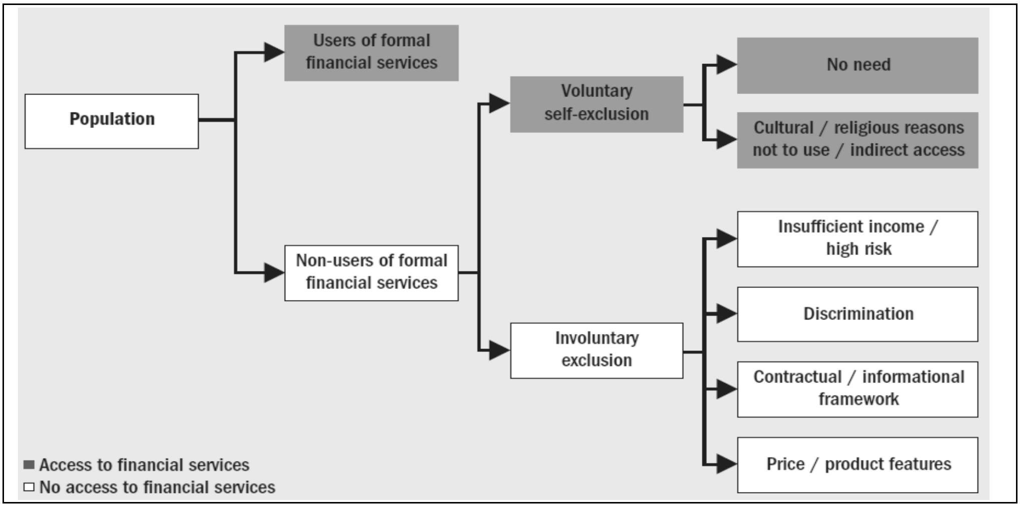
What distinguishes use of financial services from access to financial services? To what extent is lack of use a problem?

Figure-1 below illustrates the difference between access to and use of financial services. The users of financial services can be distinguished from non-users, who either cannot access the financial system or opt out from the financial system for some reason. Within the non-users, first, there is a group of households and enterprises that are considered un-bankable by commercial financial institutions and markets because they do not have enough income or present too high a lending risk. Second, there might be discrimination against certain population groups based on social, religious, or ethnic grounds (red-lining). Third, the contractual and informational framework might prevent financial institutions from reaching out to certain population groups because the outreach is too costly to be commercially viable. For example, in Bangladesh, Pakistan, and the Philippines, it takes more than a month to get a small business loan processed. In Denmark, the wait is only a day. Finally, the price of financial services may be too high or the product features might not be appropriate for certain population groups. While the first group of involuntarily excluded cannot be a target of financial sector policy, the other three groups demand different responses from policy makers. In addition, there could be a set of users who voluntarily exclude themselves from the system due to conflicts with their religious or ethical or moral value system.

Development economists suggest that the lack of access to finance for the poor deters key decisions regarding human and physical capital accumulation. For example, in an imperfect financial market, poor people may find themselves in the "**poverty trap**", as they cannot save in harvest time or borrow to survive a starvation. Similarly, without a predictable future cash-flow, the poor in developing countries are also incapable of borrowing against future income to invest in education or health care for children.

Without inclusive financial systems, poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities. Financial market imperfections, such as information asymmetries and transactions costs, are likely to be especially binding on the talented poor and the micro- and small enterprises that lack collateral, credit histories, and connections, thus limiting their opportunities and leading to persistent inequality and slower growth. However, this access dimension of financial development has often been overlooked, mostly because of serious gaps in the data about who has access to which financial services and about the barriers to broader access.

Figure-1
Factors of Financial Exclusion



Source: The World Bank (2008) Finance for All? Policies and Pitfalls in Expanding Access, A World Bank Policy Research Report, World Bank, Washington, DC. USA

The inevitable trade-off between wealth accumulation and social inequality in the early stage of economic development also implies the crucial role of access to finance in social equality progress. Galor and Zeira (1993) and Banerjee and Newman (1993) imply that financial exclusion not only holds back investment, but results in persistent income inequality, as it adds to negative incentives to save and work and encourages repeated distribution in a society. Beck, Demirguc-Kunt and Levine (2007) conclude that building a more inclusive financial system also appeals to a wider range of philosophical perspectives than can redistributive policies: redistribution aims to equalize outcomes, whereas better functioning financial systems serve to equalize opportunities. Empirical studies by Beck, Demirguc-Kunt and Levine (2007) show that countries with deeper financial systems experience faster reductions in the share of the population that lives on less than one dollar a day. Almost 30% of the cross-country variation in changing poverty rates can be explained by variation in financial development.

Section II
Concept of Economic Development and Inclusion in Islam

Islam is considered a rule-based system which specifies rules for social and economic activities of the society. In this respect, economic principles of Islam deal with (a) the rules of behavior (similar to the concept of economic institutions) as they relate to resource allocation, production, exchange, distribution and redistribution; (b) economic implications of the operations of these rules; and (c) incentive structure and policy recommendations for achieving rules compliance that would allow convergence of the actual economy to the ideal economic system envisioned by Islam.[3]

Islam asserts unambiguously that poverty is neither caused by scarcity and paucity of natural resources, nor is due to the lack of proper synchronization between the mode of production and the relation of distribution, but as a result of waste, opulence, extravagance and nonpayment of what rightfully belongs to the less able segments of the society.[4]

The concept of development in Islam has three dimensions: individual self-development, the physical development of the earth, and the development of the human collectivity, which includes both (Mirakhor and Askari, 2010). The first specifies a dynamic process of the growth of the human person toward perfection. The second addresses the utilization of natural resources to develop the earth to provide for the material needs of the individual and all of humanity. The third dimension of development refers to the progress of the human collectivity toward full integration and unity. Happiness and fulfillment in a person's life is not achieved by a mere increase in income, but with a full development of a person along all three dimensions. At the same time, economic progress and prosperity is encouraged in Islam since this provides the means by which humans can satisfy their material needs and thus remove the economic barriers on the path to their spiritual progress. Economic transactions are based on freedom of choice and freedom of contract, which, in turn, require property rights over possessions to be exchanged.

It is widely recognized that the central economic tenant of Islam is to develop a prosperous, just and egalitarian economic and social structure in which all members of society can maximize their intellectual capacity, preserve and promote their health, and actively contribute to the economic and social development of society. Economic development and growth, along with social justice, are the foundational elements of an Islamic economic system. All members of an Islamic society must be given the same opportunities to advance themselves; in other

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[3] Iqbal and Mirakhor (2011)
[4] Mirakhor and Askari (2010), Askari, Iqbal, Krichene, and Mirakhor (2011)

words, a level playing field, including access to the natural resources provided by God. For those for whom there is no work and for those that cannot work (such as the handicapped), society must afford the minimum requirements for a dignified life: shelter, food, healthcare and education.

One of the most important economic institutions that operationalizes the objective of achieving social justice is that of the wealth distribution/redistribution rules of Islam. Islam aims for just distribution of resources by creating a balanced society that avoids extreme of wealth and poverty, a society in which all understand that wealth is a blessing provided by the Creator for the sole purpose of providing support for the lives of all of mankind. To avoid a state of extreme wealth and extreme poverty, Islam prohibits unconstrained wealth accumulation and imposes limits on consumption through its rules prohibiting overspending (*isrāf*), waste (*itlāf*), ostentatious and opulent spending (*isrāf*). It then ordains that the net surplus, after moderate spending necessary to maintain a modest living standard, must be returned to the members of the society who, for a variety of reasons, are unable to work, hence the resources they could have used to produce income and wealth were utilized by the more able. Islam considers the more able as trustee-agents in using these resources on behalf of the less able. In this view, property is not a means of exclusion but inclusion in which the rights of those less able in the income and wealth of the more able are redeemed. The result would be a balanced economy without extremes of wealth and poverty. The operational mechanism for redeeming the right of the less able in the income and wealth of the more able is the network of mandatory and voluntary levies.

Islam emphasizes financial inclusion more explicitly but two distinct features of Islamic finance – the notions of risk-sharing and redistribution of wealth – differentiate its path of development significantly from conventional financial industry.

Redistribution refers to the post-distribution phase when the due share of the less able is collected through voluntary and involuntary levies. These expenditures are essentially repatriation and redemption of the rights of others in one’s income and wealth. It is the recognition and affirmation that the Creator has created the resources for all of mankind who must have unhindered access to them. Even the abilities that make access to resources possible are due to the Creator. This would mean that those who are less able or unable to use these resources are partners of the more able.

2.1. Inclusion through Risk-Sharing

One of the core economic principles of Islam is the notion of risk-sharing. This is based on the principle of liability, which states that profit is justified on the basis of taking responsibility, possibly even becoming responsible for the loss and the consequences. This legal maxim, said to be derived from a saying of the Prophet (pbuh) that "profit comes with liability," implies that Sharīʿah distinguishes lawful profit from all other forms of gain and that entitlement to profit only when there is also the liability, or risk, of loss.

Islam has long endorsed risk sharing as the preferred organizational structure for all economic activities, specifically the most comprehensive application of risk sharing and going beyond anything put forward by modern theories.[5] On the one hand, Islam prohibits, and without any exceptions, explicit and implicit interest-based contracts of any kind and requires mandatory risk sharing with the poor, the deprived and the handicapped based on its principles of property rights.

Since the central proposition of Islamic finance is risk-sharing, any debt-based instrument that is structured based on extracting a rent (interest) as a percentage of the principle that was loaned for a specific time period and without the full transfer of the property rights over the money loaned to the borrower, is eliminated from the financial system. One result of this type of debt-based transaction is that the risk is borne by the borrower. Rather, Islam proposes a mutual exchange (*al-bayʿ*) in which one bundle of property rights is exchanged for another, thus allowing both parties to share the risks of the transaction—something which is sanctioned. The emphasis on risk-sharing is evident from one of the most important verses in the Qur'ān with respect to economic relations (2:275).[6]

2.2. Inclusion through Instruments of Redistribution in Islam

Full compliance with the rules of Sharīʿah (Islamic Law) covering resource allocation, production, and exchange, and the distribution of resulting income and wealth not only ensures economic development and growth, it also ensures economic justice. The rules ensure that justice prevails before production takes

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[5] Askari, Iqbal, Krichene, and Mirakhor (2011)

[6] The verse states that: "... they say that indeed an exchange transaction (*bayʿ*) is like a *ribā* (interest-based) transaction. But Allah has permitted exchange transactions and forbidden interest-based transactions," (Qur'ān, 2:275). For further details on risk-sharing aspects of Islam, see Askari, Iqbal, Krichene, and Mirakhor (2011)

place, during the exchange, and in the distribution of resulting income and wealth. Justice before production is achieved by ensuring that all members of the society have equal opportunities with respect to access to and utilization of resources. This is achieved through the rules contained in the framework of Islam's property rights.[7] Basic axioms of property rights in Islam provide a firm foundation for the collectivity's right of legislative mandate that requires transfer from those more able to the less able and the individuals should be fully aware that there are members in the society who are unable, for a variety of reasons, to use the resources, but still have rights in them. Therefore, returns from the use of these resources by the more able must be shared with the less able. All these rights must be redeemed from the income and wealth which result from their use.

Various levies are imposed on the production or the income, to redeem the rights of those who are not able to participate in the economic activities. Islam places great emphasis on redistribution of income and wealth and legislates institutions for this purpose such as *Ṣadaqat, Zakāh, and Qarḍ-al-Ḥasan*. It is important to realize that in no way are these levies to be considered charity, as often misunderstood by laymen and scholars alike.[8] In the following section, we will briefly discuss three main instruments of redistributions including *Zakāh*, *Ṣadaqat*, and *Qarḍ-al-Ḥasan* for the poor, or the unbanked. These instruments are envisaged to enhance access to financing while addressing equity and contributing to poverty alleviation.

The first redistributive instrument is *Zakāh*.[9] An individual who earns more than what he or she consumes must pay *Zakāh*, which is calculated according to his or

[7] See Mirakhor (1989) and Iqbal and Mirakhor (2011). The first axiom of the Islam's property rights framework is that Allah is the Creator and the Ultimate Owner of all property. Man has been granted the right of possession of property only during his life time in this world. The second axiom is that the right of possession is a collective right, and individuals can only earn priority in the use of these resources. Individuals are to use these resources with the full understanding that Allah's ultimate ownership and the collectivity's prior right of possession remain intact.

[8] Mirakhor (2004) The fact that the general Qur'ānic terms for these levies, such as *Zakāh* or *Ṣadaqat* are translated into "charity" is an indication of this general misunderstanding. In fact, *Zakāh* indicates a cleansing of the resulting production, or income from the rights of others in them, i.e., *Zakāh* purifies the product or income resulting from an economic activity from the rights of others in the surplus.

[9] Mirakhor and Askari (2010). The etymological derivation of this important word has been traced to verbs that in English translate most closely as **''to be pure'' or ''to be pious**.'' *Zakāh* also signifies virtue in general, as well as—in the Qur'ān —giving and the pious gift. Thus, *Zakāh* is seen as an act of purification leading to self improvement. Others have emphasized its link to the verbs ''to grow''

her level of net worth (essentially a wealth tax). Business capital and housing are exempt from *Zakāh* taxation in order to promote investment in capital and construction and to encourage home ownership. It is important to note that *Zakāh*, is *not* a substitute for taxation by the state, which may institute other forms of taxation to finance additional social, economic, infrastructural, and related programs to attain social and economic goals.

Obviously, in theory *Zakāh* is to be given willingly, not to be paid grudgingly, if Divine Law is to be fulfilled. Its obligations are to the community as a whole: they are to be made specifically and directly to the community's less fortunate members, neither to an impersonalized government nor to its revenue-collecting agencies. According to the Qur'ān, poverty and denial of assistance to the needy is forbidden. The Qur'ān goes on to explain that material inequalities are not a manifestation of spiritual inequalities. Rather, such inequalities should be overcome through human effort and are thus meant to foster brotherhood, again stressing the importance of *Zakāh*.[10]

The second instrument of redistribution is *Ṣadaqat* (voluntary social spending). Researchers argue that according to Islam, poverty exists not because economic resources are scarce, but because they are misallocated, inefficiently managed, unproductively hoarded, and unevenly distributed. Independent social spending, according to Islam, is the best possible way for members of the Islamic social order to promote a more equitable distribution of wealth and resources. Muslims with the financial capacity to donate beyond their *Zakāh* requirements are therefore strongly encouraged to further invest in *Infāq* and *Ṣadaqat*.

The term *Ṣadaqat* (the plural of *Ṣadaqat*) is a derivative of the root word meaning truthfulness and sincerity because such contributions or payments are symbolizes the strength of the sincerity of a person's belief (Qur'ān, 2:26; 2:272). The rationale of *Ṣadaqat* payments is explained as the expenditures intended for redeeming the property rights of those who are excluded from the production cycle for any reason. The payment of such levies is considered a contractual obligation between the surplus producer and God—the ultimate owner, the instant an individual begins using resources created for all by Him. He is obligated to return to others what would have been rightly theirs, had they been able to fully

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and ''to increase,'' and have interpreted the giving of *Zakāh* as leading to a significant increase of blessings, both of material property in this world and of spiritual merit for the next.

[10] Proper collection, distribution, and governance of *Zakāh* contributions are considered the responsibility of government. This has been the practice in the past in several Muslim states..

participate in the use of resources in production and in exchange. On these grounds, it is argued that these levies cannot be considered charity.[11]

The third instrument of redistribution is *Qarḍ al-Ḥasan* (literally meaning a 'beautiful loan') which is a loan granted to the needy and is mentioned in the Qur'ān as "beautiful" (*al-ḥasan*).[12] It is a voluntary loan without the creditor's expectation of any return on the principal. Additionally, while the debtor is obligated to return the principal, the creditor, on his own free will, does not press the debtor for an exact timing of its return. Again, in the case of *Qarḍ al-Ḥasan*, God promises multiple returns to such a "beautiful loan." Unfortunately, the full potential of this institution to mobilize substantial resources for the empowerment of the economically weak or dispossessed has not been realized. While the first two instruments, i.e. *Zakāh* and *Ṣadaqat* are essentially gifts, *Qarḍ-al-Ḥasan* is designed to meet the financing needs of the poor and is a loan that has to be repaid. It is, however, a loan without interest and with the term of the loan determined by the borrower alone.[13]

To summarize, Islam recognizes claims based on equality of liberty and opportunity, which are reflected in the degree of access to resources, the degree and extent of the ability of persons to actualize their potential liberty and opportunity, and the right of prior ownership. The right that the less able have in the wealth of those who have greater ability and opportunity to produce greater wealth is redeemed through the various levies (*Zakāh, Khums*[14], *Ṣadaqat, Nafaqa*, and so on), the payment of which is not beneficence but a contractual obligation that must be met. Islam also encourages beneficence over and above these obligatory dues, but these levies are in the nature of returning to others what rightfully belongs to them. Shirking from this obligation causes a misdistribution of wealth, which Islam considers as the major source of poverty. In the morality of property rights, Islam unequivocally considers all individuals entitled to a certain

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[11] Askari, Iqbal, Krichene, and Mirakhor (2011). An incentive structure is designed by Islam by which there is a promise of multiple returns for *Ṣadaqat*. In fact, the Qur'ān promises the return to *Ṣadaqat* from God in an increasing rate (see verses 265 and 276 of Chapter 2 of the Qur'ān).

[12] It is speculated that the reason why it is called beautiful is because in all the verses in which this loan is mentioned, it is stipulated that it is made directly to God and not to the recipient (see, for example, verse 17, Chapter 64). Mirakhor (2004)

[13] . A number of verses in the Qur'ān stress the importance of this instrument. The Prophet is reported to have said that the reward for al- *Qarḍ al-Ḥasan* is eighteen fold while that for *Ṣadaqat* which is charity and does not have to be repaid is only tenfold.

[14] *Khums* denotes obligation to contribute one-fifth of income from specific sources to charity. There is disagreement on the sources between different schools of thought.

standard of life; and it is this entitlement that entails the satisfaction of their claim as a matter of equity and justice.

As we shall see, instruments of Islamic finance enable risk sharing and risk diversification through which individuals can mitigate their idiosyncratic risks. Levies—mandated or otherwise—such as *Zakāh*, *Ṣadaqat* and *Qarḍ-al-Ḥasan*, enable the idiosyncratic risks of the poor to be shared by the rich, thus helping to reduce the poor's income–consumption correlation. In other words, the poor are not forced to rely entirely on their low level (or no) income to maintain a decent level of subsistence living for themselves and their families. It is possible that at some point even these levies can be instrumentalized to be included in the full-spectrum menu of Islamic financial instruments for risk sharing. In that event, Islamic finance would become a risk manager for society (Askari, Iqbal, Krichene, and Mirakhor, 2011).

Section III
Enhancing Inclusion through Risk-Sharing Instruments

Empirical studies provide strong evidence that the proportion of the Muslim population using financial services is less than their non-Muslim counterparts (El Hawary and Grais, 2005). Lack of access of the poor to finance is undoubtedly the most crucial factor in the failure to bring about a broad-based ownership of businesses and industries and thereby realize the egalitarian objectives of Islam. As mentioned earlier, access to finance can be enhanced in Islamic economy through two approaches. The first is taking the same route as conventional finance and through replicating traditional modes of inclusion such as micro-finance, micro-SME, and micro-insurance (see Box 1). This section discusses the issues in each mode of financing and reviews how each is implemented to make it compliant with Sharīʿah. The second mode of enhancing inclusion is through Islam's redistributive mechanisms such *Zakāh*, *Ṣadaqat*, *Qarḍ-al-Ḥasan*, and *Waqf*. This is an area which is not formally developed in most of the modern-day Islamic countries.

Box 1 – Core Conventional Tools to Enhance Financial Access

Micro-finance:

Two important problems in access to credit services for households are lack of collateral or steady future income and high transaction costs. Microfinance institutions have tried to overcome these two constraints by innovations such as group lending schemes. Conventional literature focuses on how microfinance unleashes the productive potential of small and unbankable borrowers.

Small Medium Enterprises (SME):

Countries with a higher level of GDP per capita have larger SME sectors in terms of their contribution to total employment and GDP. (Ayyagari, Beck and Demirguc-Kunt 2003). As the largest providers of new jobs and major source of technological innovation in most countries, SMEs have functioned as the engine of growth for both developed and developing economies. As for poverty reduction, SMEs are more likely to employ poor and low-income workers then larger firms; sometimes, SMEs are the only source of employment in poor regions and rural areas. However, market failures may cause biases against SMEs. For example, high risks for cost-searching and coordination failure across sectors always prevent start-ups from entering a new market. Thus, industry policies favoring SMEs, such as credit subsidies and tax credits, are recommended for developing countries.

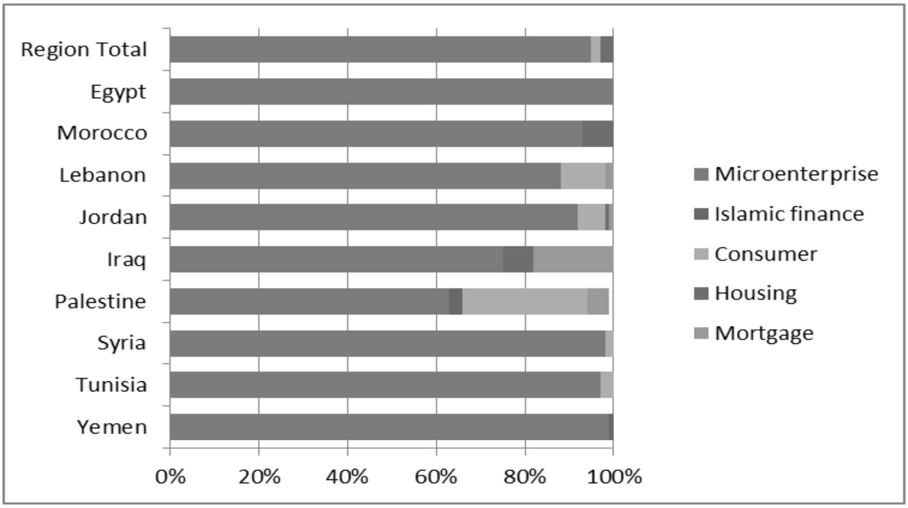
Micro-insurance:

(Outreville, 1990; Ward and Zurbruegg, 2002; Beck et al., 2007) provides evidence of a positive causal relationship between insurance penetration and economic growth. The policyholder benefits by increased access to a wider range of products with increased coverage and greater sustainability; and the partnering insurance company has access into a new market without taking extensive marketing, distribution, or administration costs. More importantly, the partner-agent model facilitates the pooling of risks between the formal and informal sectors.

3.1. Sharīʿah-*Compliant Micro-Finance*

In most OIC countries, Islamic financing instruments comprise only a small fraction of microfinance supply. In Syria for example, Islamic microfinance comprised only 3 percent of outstanding microfinance loans in 2006. Similar situations are also found in other MENA countries (See Figure-2). Since MENA countries are relatively more financially developed than the rest of the OIC countries, the figure implies an even lower coverage rate of Sharīʿah compliant microfinance in all the OIC countries. Providers of Islamic microfinance also tend to be small in size. 80 percent of the global outreach of Islamic microfinance concentrates in only three countries, Indonesia, Bangladesh, and Afghanistan. Islamic microfinance products are also limited in their diversity, e.g. over 70 percent of the Islamic finance products offered are *murābaḥah* (cost plus). The narrow range of products offered is continuously excluding low-income individuals and small enterprises from access to Sharīʿah-based finance.

Figure-2
Microfinance Products offered in MENA



Source: (Sanabel 2010)

However, there are some signs that this limited selection may increase: in Egypt, Bank Misr plans to introduce Islamic microfinance activities to its 33 Islamic branches, and also develop a *muḍārabah* (profit sharing agreement) product in addition to the *murābaḥah* product; in Yemen, Tadhamon Islamic Bank opened an MSE division in late 2006; and in the UAE, Noor Islamic Bank and

Emirates Post Holding Group announced plans to establish a company to offer Sharīʿah-compliant financial services to low-income clients. [15]

Table-1 provides a survey of different implementations of Sharīʿah-compliant microfinance institutions in Syria, Bangladesh, Iran, and Indonesia. Although the Islamic microfinance projects follow similar concepts of conventional microfinance, including group saving and monitoring, targeting female borrowers, etc., two characteristics distinguished them from conventional ones. First, Sharīʿah compliant microfinance institutions actively adopted various Islamic financial tools, such as trade and project finance, *Murābaḥah,* as well as non-financing instruments such as *Waqf and Qarḍ al-Ḥasan*, in the process of absorbing savings and making loans. Some of these institutions also gained funding support from *Zakāh* collection. Second, since interest income is prohibited, most institutions charged administrative/service fees plus a portion of the profit from the business venture. Looking back, the innovative combination of traditional and Islamic finance has been successful in most cases under study, as suggested by the relatively high recovery rate and fast expansion of their scale in recent years. Despite success in implementing Sharīʿah-compliant micro-finance, the practice has not spread as widely as one would have hoped. We discuss some of the challenges in the next sections of the paper.

[15] (Pearce 2010)

Table-1
Survey of Islamic Micro-Finance Case Studies

Paper/ Country	Institution	Purpose	Business Size	Client size/volume	Islamic instrument of financing
(Asaad 2007) **Syria**	UNDP supported village funds	The village funds are self-managed and autonomous in their decision-making, which has included the adoption of financial practices consistent with local values.	• Between Sep 2000 and Dec 2002, 22 village funds were established. • UNDP contributed $370,000 in equity. • Repayment rate as of 31 Dec 2002 was 99.7%. ROE was 17%	• Average loan balance per borrower/per capita GDP is 61%. • Till the end of 2003, 5,674 loans were disbursed.	*Murābaḥah*
(Ahmed 2007) **Bangladesh**	Islamic Bank Bangladesh Limited (IBBL): Rural Development Scheme (RDS)	RDS is a Sharīʿah based microfinance model of poverty alleviating program, mainly for the poor woman of the rural area of Bangladesh. Target group includes destitute women, distressed people, and households with less than 0.5 acres of land.	• Up to Dec 2006, 1,368 Field Officers engaged in supervision • An investment amount of $135 mln • 118 branches in 8,057 villages • Recovery rate was 99%.	294,908 borrowers, 92% or which are woman.	*Bayʿ-Mu'ajjal, Bayʿ-Murābaḥah, Bayʿ-Salam*, and Hire Purchase under *Sherkatul Melk* (HPSM).
(Mannan 2007) **Bangladesh**	Social Investment Bank Ltd "SME programs" and "Family Empowerment Micro enterprise Program"	Helping poor family to purchase materials commodities for trading, manufacturing and service concern.	• As of 2005, the family empowerment micro credit program has a total outstanding of $0.3mln, with a recovery rate of 96% • SME program has a total outstanding of $1.1mln, with a recovery rate of 94%	n.a.	*Waqf* and Mosque properties, cash-*Waqf* certificate, joint-venture projects for management of Hajj affairs
(Kazem 2007) **Iran**	1,229 *Qarḍ-al-Ḥasan* Funds (GFs)	With the objective of helping low-income group through short-run credit grant, GFs provide Sharīʿah compliance services to individuals who are unable to fulfill banks loan collateral requirements and thus were deprived from obtaining credit.	• Total value of loans is $169 mln • Total value of deposits is $227 mln • 60% of the total loans had been paid back.	• 6,480,237 depositors • 1,777,583 borrowers	*Qarḍ-al-Ḥasan* Funds

Paper/ Country	Institution	Purpose	Business Size	Client size/volume	Islamic instrument of financing
(Arabmazar 2007) **Iran**	Bank keshavarzi of Iran "Hazrat Zeynab Project"	Finance women producers and farmers of agricultural sector with loans under $600 with the maximum repayment period of 5 years.	• A revolving fund is about $44 mln	• 117,322 women borrowers	*Qarḍ al-Ḥasan* funds, *Qarḍ al-Ḥasan* saving accounts
(Kholis, AG and SH 2007) **Indonesia**	BMT[16] Al-Ikhlas, BMT Bina Ummah, and BMT Dana Syariah	BMT is a unique Islamic micro finance institution established by Indonesian Muslims to abolish ceti or rentenir (Usurer) in Indonesian Muslim societies by providing many financing schemes for helping micro and medium entrepreneurs.	• Up to November 2006, there are more than three thousands BMTs in the country. • About 65 BMT's of them are located in Yogyakarta. • Only 42 BMT which reported their performance to PINBUK Yogyakarta regularly.	n.a.	*Murābaḥah* contract for SMEs, *Muḍārabah* saving account, Pendidikan saving account, HajiSaving Account, Qurban/Aqiqah saving account, *Walimah* saving account, *Wadīʿah Damanah Aidil Fitri*, Saving Account, *Amānah* saving account
(Nurahayati and Wahyuni 2007) **Indonesia**	BMT Masjid Al Azhar	Serving those under-developed areas. Helping in developing productive business by promoting saving activity and assist financing economic activities in those areas.	• In 2005, total financing given was $0.71 mln • Balance of outstanding loan was $0.21 mln • Total balance of savings was $0.23 mln	• In 2005, served 1,446 total debtors • 3,821 depositors	n.a.
	BMT Al Kariim	Helping the poorest of the poor, the poor, working poor and micro enterprises in the informal sector in the Pondok Indah neighborhood.	• In 2005, total financing given was $0.38 mln • Balance of outstanding loan was $0.08 mln • Balance of savings was $0.16 mln • Balance of fixed term savings was $0.21 mln	• In 2005, served 1,324 debtors • 5,075 saving account depositors • 87 fixed term saving users	n.a.

[16] BMT, *Baaitul Māl wat Tamwil*, or Islamic Savings and Loan Cooperatives

3.2. Sharīʿah-*Compliant SME Financing*

Islamic finance highlights the significance of profit-sharing finance, which can have positive economic effects similar to direct investment leading to strong economic development.[17] Promotion of entrepreneurship and risk-sharing are two key features of Islamic finance and given that SMEs require both encouragement to entrepreneurship and risk-sharing, there is a natural fit for Islamic finance and SME financing. Islamic SME finance concepts can be seen to provide a comprehensive asset-based economic and equitable model that fulfills expectations such as social justice and human centered sustainable development.

Tools required for SME's finance are not found to be different from the mainstream forms for Islamic financing in general. The necessary and sufficient conditions for full compliance with Sharīʿah should be satisfied, in terms of risk sharing (lenders and borrowers share profits and losses), in addition to the fact that return on capital shouldn't be fixed.[18]

Financing modes that best suit SMEs include *muḍārabah* (principle/agent) and *mushārakah* (equity partnership). Both forms serve a useful purpose: they provide investors with high liquidity at low risk. Islamic banks were recently encouraged to provide more profit-sharing finance and are developing arrangements to reduce risks and the costs of funding. Many innovative examples were provided in Asutay (2011), among which is setting up specialized institutions, as well as introducing new consistent products with the aim of reducing risks through pooling the funds and establishing *Wakālah* agencies to perform monitoring and to minimize moral hazard.

However, Sharīʿah compliant SME finance is not limited to these instruments; innovative approaches tend to involve more comprehensive financing schemes that mix the aforementioned saving as a tool for insurance hedging against future turbulence. *Ijārah* has been one of the most widely used forms of financing SMEs as it reduces the startup cost in addition to providing security to lenders.

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[17] For further detail, see work for Askari, Iqbal and Mirakhor (2008), Chapra (2008) and Asutay (2011),

[18] The three main forms of Islamic finance include *murābaḥah* (trust finance), *mushārakah* (partnership finance), and *muḍārabah* (markup contract sale). These are in addition to Salam contracts, *Ijārah* and *Qarḍ Ḥasan*, and *Awqāf*[18]. Other forms of long term and sophisticated forms include *salam* forward purchase credit and *istiṣnāʿ* project financing. See also Iqbal and Mirakhor (2011)

The issue with promoting SME financing is not the availability of appropriate tools but the challenge is to provide an enabling environment as we observe in the following sections.

3.3. Micro-*Takāful*, Risk Sharing and Poverty Alleviation

Takāful is a cooperative insurance mechanism that evolved in the late 1970s in Sudan and Egypt. The concept is similar to conventional mutual risk mitigation, in which risk sharing is expressed as ta'awuni (mutual protection). Based on the experience of conventional micro-insurance services and to complement Islamic microfinance products, the first Micro-*Takāful* scheme was established in 1997 in Lebanon. Micro-*Takāful* distinguish itself from *Takāful* by targeting the low-income individuals who are living slightly above the poverty line and usually work in informal sectors. As of January 2010 Micro-*Takāful* providers exist in Lebanon, Indonesia, Malaysia, Sri Lanka, Bahrain and Pakistan.[19]

Micro-*Takāful* has long been considered as one of the most promising segments among other Sharīʿah-compliant financial products. The main argument is that Micro-*Takāful* can play an important role in poverty alleviation through risk-sharing among low-income individuals. Deeper insurance penetration leads to faster economic growth.[20] Policyholders benefit by increased access to a wider range of products with increased coverage and greater sustainability; and the partnering insurance institutions gain access to a new market without taking extensive marketing, distribution, or administration costs. More importantly, the partner-agent model facilitates the pooling of risks between the formal and informal sectors. Like microfinance, Micro-*Takāful* helps under-privileged people sustain their financial wellbeing, provides them with a feeling of togetherness, solidarity, and security, and opens avenues for joint efforts for mutual benefits. In addition, as many micro-*Takāful* institutions raised their funding from *Zakāh*, they can also improve the redistribution efficiency and provide a financially sustainable approach to benefit the Islamic society at large.

[19] (ICMIF *Takaful*, 2010)
[20] (Outreville, 1990; Ward and Zurbruegg, 2002; Beck *et al*., 2007).

3.4. Islam's Redistributive Institutions to Enhance Inclusion

Use of Islam's redistributive institutions such as *Zakāh*, *Ṣadaqat*, *Qarḍ-al-Ḥasan* and *Waqf* has enormous potential to enhance access to finance.

How can *Zakāh* contribute to poverty alleviation?

The concept of *Zakāh* could be expanded to provide a sustainable source of income for the poor. It is seen as a significant tool for promoting financial inclusion and economic growth. If '*Zakāh*' funds are managed properly, pooling these funds and encouraging the poor/beneficiaries to direct the funds towards starting a micro/small business would contribute to a more conducive developmental impact and help reduce disparities within the economy. '*Zakāh*' is also perceived as an important tool for continually circulating liquidity in the system. Imposing it on aggregate wealth, including gold and silver and idle balances, benefits the system from unutilized resources and induces more investment and employment. This in turn paves the way for innovations to introduce alternative financial products that would achieve both effective accommodations to the nature of micro and small businesses in addition to poverty alleviation. Practical examples could include *muḍārabah* agreements with institutional investors and facilitating access to dedicated *Zakāh* funds. No doubt, introducing such financial instruments to direct '*Zakāh*' resources promotes more social equity and equality in a sustainable and productive manner and could maximize the value added of such resources.

Zakāh has great potential as the main resource of social spending supporting poverty alleviation in Islamic society. The argument is not only theoretically true, but can be supported by statistical evidence. Here we used the method adopted by (Shirazi and Fouad 2010) to estimate the *Zakāh* collection in OIC member countries. Besides updating the data source, we also took the potential *Zakāh* collation in the form of incoming remittances into consideration. Table 2 shows estimates of the percentage of *Zakāh* proceeds to GDP according to different economic structures of selected Muslim countries based on the methodology by (Kahf 1989).

Tabler-3 estimates the resource shortfall to fill the poverty gap while Table-4 estimates the *Zakāh* collection based on domestic and remittance contributions[21] and determines whether the *Zakāh* collection is sufficient to cover the estimated shortfall. Using this estimation, we find supporting evidence that 20 out of 39 OIC countries can actually alleviate the poorest living with income under $1.25 per day out of the poverty line simply with domestic and remittances *Zakāh* collection.

This does not mean that it is a totally new source of poverty reduction mechanism using *Zakāh* as it is already distributed to the poor in several Islamic countries but we can make an argument that proper collection, streamlining, accountability, prioritization, and allocation to productive activities can have significant impact on enhancing access and opportunity for the poor segment of the society which will ultimately lead to reduction in poverty.

Table-2
Percentage of estimated *Zakāh* proceeds to GDP in selected Muslim countries

	Z1[22]	Z2	Z3
Egypt, Arab Rep.	2.0	3.9	4.9
Indonesia	1.0	1.7	2.0
Pakistan	1.6	3.5	4.4
Qatar	0.9	3.7	3.2
Saudi Arabia	1.2	3.7	3.4
Sudan	4.3	6.3	6.2
Syria	1.5	3.1	3.1
Turkey	1.9	4.9	7.5
average	1.8	3.9	4.3

Source: (Kahf 1989)

[21] *Zakāh* collected from remittances is estimated by the 2.5% of the remittances saved domestically (2.5%*domestic savings rate*incoming remittances).

[22] (Kahf 1989): "Z1 was estimated accordance with the majority traditional view according to which *Zakāh* was levied on agriculture, livestock, stock in trade, gold, silver and money. Z2 was based in according with the views of contemporary Muslim scholars where *Zakāh* can be deducted from net returns of manufacturing concerns and building rents and from net savings out of salaries. Z3 was based on Malikite views, where *Zakāh* base includes buildings and other fixed assets except those assigned for personal and family use.

Table-3
Resource Shortfall to Fill the Poverty Gap[23]

(1) Country name	(2) Survey year	(3) GDP (PPP) current USD (million)	(4) Total pop. (million)	(5) Poverty gap at $2 a day (PPP) (%)	(6) Poverty gap at $1.25 a day (PPP) (%)	(7) Resource shortfall under $2 per annum (million)	(8) Resource shortfall under $1.25 per annum (million)	(9) Resourc e shortfall under $2 per annum as % of GDP	(10) Resourc e shortfall under $1.25 per annum as % of GDP
Group 1: countries with moderate resource shortfall (<=1.0 percent of GDP)									
Malaysia	2009	384,878.87	27.47	0.16	0.00	32.08	0.00	0.01	0.00
Kazakhstan	2007	169,633.06	15.48	0.26	0.05	29.39	3.53	0.02	0.00
Jordan	2006	26,142.82	5.54	0.62	0.10	25.08	2.53	0.10	0.01
Albania	2008	26,449.68	3.14	0.85	0.19	19.50	2.72	0.07	0.01
Azerbaijan	2008	76,730.04	8.68	1.52	0.25	96.31	9.90	0.13	0.01
Maldives	2004	1,197.43	0.29	2.53	0.14	5.33	0.18	0.44	0.02
Iran	2005	643,503.42	69.09	1.80	0.34	907.80	107.17	0.14	0.02
Kyrgyz Rep	2007	10,620.40	5.23	5.46	0.08	208.65	1.91	1.96	0.02
Syrian Arab Republic	2004	70,017.06	18.51	3.28	0.20	443.24	16.89	0.63	0.02
Gabon	2005	17,839.03	1.37	5.02	0.90	50.18	5.62	0.28	0.03
Turkey	2005	781,243.40	71.17	2.64	0.88	1,371.57	285.74	0.18	0.04
Egypt, Arab Rep.	2005	333,218.41	77.15	3.45	0.39	1,943.13	137.29	0.58	0.04
Morocco	2007	127,848.85	31.22	3.15	0.54	718.00	76.93	0.56	0.06
Iraq	2007	94,969.20	29.95	5.55	0.60	1,213.32	81.98	1.28	0.09
Group 2: countries with Intermediate resource shortfall (>=1.0 percent of GDP and >= 6 percent of GDP)									
Algeria	1995	129,750.66	28.27	23.60	1.40	4,869.54	180.54	28.27	0.14
Cameroon	2007	39,768.07	18.66	8.21	1.20	1,118.35	102.16	18.66	0.26
Indonesia	2009	965,571.03	229.96	15.48	3.62	25,986.93	3,798.15	229.96	0.39
Suriname	1999	2,018.46	0.46	11.74	5.90	39.48	12.40	0.46	0.61
Yemen, Rep.	2005	46,125.24	21.02	14.76	4.18	2,265.26	400.95	21.02	0.87
Guyana	1998	1,538.50	0.76	6.94	3.90	38.37	13.48	0.76	0.88
Pakistan	2005	340,262.06	155.77	18.74	4.35	21,309.92	3,091.59	155.77	0.91
Djibouti	2002	1,239.64	0.76	14.58	5.29	81.20	18.41	0.76	1.49
Tajikistan	2004	8,774.25	6.45	16.76	5.06	789.55	148.98	6.45	1.70
Cote d'Ivoire	2008	34,295.23	20.59	17.79	7.50	2,674.13	704.61	20.59	2.05
Senegal	2005	18,208.36	11.28	24.66	10.80	2,030.84	555.89	11.28	3.05
Uganda	2009	39,813.64	32.71	21.25	8.26	5,074.12	1,232.71	32.71	3.10
Uzbekistan	2003	42,757.17	25.57	33.18	15.04	6,192.85	1,754.46	25.57	4.10
Gambia, The	2003	1,457.33	1.44	24.88	12.05	260.87	78.97	1.44	5.42
Bangladesh	2005	163,728.14	153.12	33.81	13.08	37,792.51	9,137.94	153.12	5.58
Benin	2003	9,135.56	7.36	33.50	15.73	1,799.43	528.08	7.36	5.78
Group 3: countries with severe resource shortfall (>=6.0 percent of GDP)									
Togo	2006	4,962.81	6.14	27.92	11.37	1,252.43	318.77	25.24	6.42
Guinea	2007	9,777.15	9.62	31.03	14.96	2,178.00	656.28	22.28	6.71
Mali	2006	12,672.38	12.12	36.50	18.79	3,228.87	1,038.88	25.48	8.20
Guinea-Bissau	2002	1,256.42	1.37	34.83	16.52	347.96	103.15	27.69	8.21
Nigeria	2004	224,618.00	137.54	46.89	29.57	47,080.76	18,556.44	20.96	8.26
Niger	2007	9,248.52	14.14	30.59	11.92	3,157.49	768.99	34.14	8.31
Comoros	2004	628.48	0.59	34.18	20.82	146.70	55.85	23.34	8.89
Burkina Faso	2003	12,090.91	12.85	39.26	20.27	3,683.78	1,188.71	30.47	9.83
Mozambique	2008	18,885.83	22.38	42.91	25.18	7,011.17	2,571.39	37.12	13.62
Sierra Leone	2003	2,722.93	4.73	37.53	20.30	1,296.57	438.32	47.62	16.10

23 (2)-(6): Data source: World Bank Databank; (7) = 2*(5)*365*(4)/100; (8) = 1.25*(6)*365*(4)/100; (9) = (7)/(3)*100; (10) = (8)/(3)*100

Table-4
Zakāh Estimation to Fill the Poverty Gap[24]

(1) Country name	(2) Survey year	(3) GDP PPP Current USD (Billion)	(4) Muslim pop. (%)	(5) Adjusted GDP PPP USD (Billion)	(6) Domestic *Zakāh* (Billion USD)	(7) Incoming remittances (Billions USD)	(8) Domestic savings rate (% of GDP)	(9) *Zakāh* considering Remittances (% of GDP)	(10) resource shortfall under $1.25 per annum as % of GDP	(11) Does *Zakāh* cover (10)?
Albania	2008	26.45	79.9	21.13	0.38	1.50	1.60	1.44	0.01	y
Algeria	1995	129.75	98	127.16	2.29	1.12	28.11	1.77	0.14	y
Azerbaijan	2008	76.73	99.2	76.12	1.37	1.55	64.89	1.82	0.01	y
Bangladesh	2005	163.73	89.6	146.70	2.64	4.31	18.06	1.62	5.58	n
Benin	2003	9.14	24.4	2.23	0.04	0.06	5.98	0.44	5.78	n
Burkina Faso	2003	12.09	59	7.13	0.13	0.05	4.51	1.06	9.83	n
Cameroon	2007	39.77	17.9	7.12	0.13	0.17	18.53	0.32	0.26	y
Comoros	2004	0.63	98.3	0.62	0.01	0.01	0.00	1.77	8.89	n
Cote d'Ivoire	2008	34.30	36.7	12.59	0.23	0.20	17.85	0.66	2.05	n
Djibouti	2002	1.24	96.9	1.20	0.02	0.01	4.87	1.75	1.49	y
Egypt	2005	333.22	94.6	315.22	6.30	5.02	15.71	1.90	0.04	y
Gabon	2005	17.84	9.5	1.69	0.03	0.01	58.35	0.17	0.03	y
Gambia	2003	1.46	95	1.38	0.02	0.06	11.05	1.72	5.42	n
Guinea	2007	9.78	84.4	8.25	0.15	0.15	9.68	1.52	6.71	n
Guinea-Bissau	2002	1.26	42.2	0.53	0.01	0.02	0.00	0.76	8.21	n
Guyana	1998	1.54	7.2	0.11	0.00	0.01	16.94	0.13	0.88	n
Indonesia	2009	965.57	88.2	851.63	8.52	6.79	33.76	0.89	0.39	y
Iran	2005	643.50	99.4	639.64	11.51	1.03	41.09	1.79	0.02	y
Iraq	2007	94.97	99	94.02	1.69	0.00	0.00	1.78	0.09	y
Jordan	2006	26.14	98.2	25.67	0.46	2.88	0.00	1.77	0.01	y
Kazakhstan	2007	169.63	56.4	95.67	1.72	0.22	43.84	1.02	0.00	y
Kyrgyz Republic	2007	10.62	86.3	9.17	0.16	0.71	0.00	1.55	0.02	y
Malaysia	2009	384.88	60.4	232.47	4.18	1.13	36.03	1.09	0.00	y
Maldives	2004	1.20	98.4	1.18	0.02	0.00	46.15	1.77	0.02	y
Mali	2006	12.67	92.5	11.72	0.21	0.21	14.75	1.67	8.20	n
Morocco	2007	127.85	99	126.57	2.28	6.73	23.37	1.81	0.06	y
Mozambique	2008	18.89	22.8	4.31	0.08	0.12	1.57	0.41	13.62	n
Niger	2007	9.25	98.6	9.12	0.16	0.08	0.00	1.77	8.31	n
Nigeria	2004	224.62	50.4	113.21	2.04	2.27	0.00	0.91	8.26	n
Pakistan	2005	340.26	96.3	327.67	5.24	4.28	15.21	1.55	0.91	y
Senegal	2005	18.21	96	17.48	0.31	0.79	14.09	1.74	3.05	n
Sierra Leone	2003	2.72	71.3	1.94	0.03	0.03	0.00	1.28	16.10	n
Suriname	1999	2.02	15.9	0.32	0.01	0.00	11.25	0.29	0.61	n
Syrian Arab	2004	70.02	92.2	64.56	0.97	0.86	20.20	1.39	0.02	y
Tajikistan	2004	8.77	84.1	7.38	0.13	0.25	0.61	1.51	1.70	n
Togo	2006	4.96	12.2	0.61	0.01	0.23	0.00	0.22	6.42	n
Turkey	2005	781.24	98	765.62	14.55	0.89	16.49	1.86	0.04	y
Uganda	2009	39.81	12.1	4.82	0.09	0.75	12.52	0.22	3.10	n
Yemen	2005	46.13	99.1	45.71	0.82	1.28	0.00	1.78	0.87	y

Source: World Bank Databank

[24] (4) data source: wikipedia.org. (3) (7) (8) data source: World Bank Databank. (8) Savings rate is floored to zero if negative (5) = (3) * (4) (6) = (5)*reference ratio of Z1 from

Table-2 (9) = ((6) + (7) * (8) * 2.5%) / (3) (10) = Column (10) from Table 3 (11) = Y if (9) > (10), N otherwise.

Qarḍ-al-Ḥasan **as a tool for financial inclusion**

Qarḍ-al-Ḥasan (QH henceforth) is defined in Sharīʿah as an interest free loan. It is usually granted from well off lenders to poor borrowers. It can also be directed from borrowers to intermediaries that can redirect it on their behalf to poor borrowers. QH is therefore a non rewarding loan (with no expected return) and the borrower is under obligation to repay the loan depending on the borrower's financial capacity to do so. Loan procedures are usually informal and social capital is the basic collateral for this instrument.

The main objectives of *Qarḍ al-Ḥasan* could be:

- To help the needy fellow people.
- To establish better relationship among poor and the rich.
- The mobilization of wealth among all people in the society.
- To perform a good deed that is encouraged and appreciated by the *Allah* (SWT) and His messenger.
- To strengthen the national economy.
- To facilitate the poor to create new jobs market and business ventures by using their merits, skills and expertise.
- To establish a caring society.
- To eradicate unemployment problem from the society.
- It can remove social and economic discrimination from the society, and

While the conventional microfinance industry has been globally growing at 13 percent per annum since early 1990s, only very limited information is available on micro finance institutions (MFI's) operating under QH. A relatively small number of interest-free loans are operating in Pakistan (www.akhuwat.org.pk) and there are some small-scale micro-/rural banks in Indonesia. However, no organized institutions are known to be operating on the basis of QH except in Iran where QH has been utilized effectively to provide finance for the needy and where these institutions are widespread throughout the country.

Also QH funds have been operating in Iran since the Islamic Revolution they have enjoyed phenomenal growth and a successful track record. QH funds in Iran, by and large, provide small consumer and producer loans and, in some cases, engage in profit-sharing activities with small producers and firms, thus supplementing the fund's capital. These funds are usually associated with local mosques or other religious organizations and sometimes with guilds or professional associations. The capital is contributed by the more well-to-do who are at liberty to withdraw their funds at any time. These funds operate with reasonably low administrative costs since most are managed on a voluntary basis by the people within the group.

A recent survey on QH based finance that has been operating with the objective of helping low-income group through short-run credit in Iran shows that there exited 1,229 *Qarḍ-al-Ḥasan* Funds (Kazem 2007). Total loans amounted to $169 mln, and deposits totaled to $227 mln with 60% of the total loans had been paid back (please see table 1 for a comprehensive survey on literature).

Conventional micro finance (MF) and *Qarḍ-al-Ḥasan* Microfinance (QHMF) have both similarities and differences. MF charges interest, an abomination from an Islamic perspective, and MF schemes resort to collective punishments for defaulting, yet under QHMF, usually donors/subscribers introduce the borrowers and cosign for their loan, yet no collective punishment is usually imposed in case of default. On the other hand both instruments target the same income groups and they have both effectively contribute to avoiding informational problems by relying on peer monitoring, as well as good knowledge of the borrower reputation. In addition, neither requires collateral as a prerequisite for a loan.

QH can also be considered an excellent venue for supporting SME's and penetrating to lower income levels that are deprived of financial resources that is not properly tapped in Islamic countries. It provides a reliable source of funding to economic development and targets minimizing the lending risk as it build on pooling and social collateral. In addition, it commends payback and therefore benefits from the potential recirculation of funds in poor and extremely low tiers of the economy. While the social cost of QH funds lies mainly in the opportunity cost of using these funds in alternative projects, the social benefits of availing funding to MFI's at zero cost acts a good catalyst for growth and provide an extremely high social benefits through creating jobs and generating incomes to the poor, deprived and unprivileged.

***Waqf* (endowment) as a tool to enhance financial inclusion**

Waqf (pl. *Awqāf*) are basically real non perishable properties that are voluntarily donated for philanthropic purposes. *Awqāf* are dominated by fixed property mainly land or buildings, but can be applicable also to cash, shares, stocks, and other assets. The concept of *Awqāf* is a well-practiced phenomenon in recent times in both the Muslim and non-Muslim world. *Awqāf* are usually named endowments in Non Muslim countries and are providing a wide range of services especially in education and community services[25]. '*Awqāf* by definition needs an institutional setup to ensure perpetuity and good governance..

In a nutshell, a *Waqf*, whether in North Africa or India, functions as follows: a founder who has accumulated private wealth decides to endow his personal property for a specific, often pious, purpose. The amount of the original capital, corpus, the purpose for which it is endowed and all the other conditions of management are clearly registered in a deed of endowment submitted to the authorities. In this way the privately accumulated wealth of a pious Muslim becomes God's property. The founder strictly stipulates how the annual revenue of the *Waqf* should be spent. This revenue (usufruct) may be allocated completely for a social welfare purpose (*Waqf* khayri), or to a group of beneficiaries.

The management of the *Waqf* is entrusted to trustees, whose functions may be fulfilled by the founder himself during his lifetime. Thus, there are four major components of any *Waqf*: the three groups of individuals; the founder, the beneficiaries, the trustees and the endowed capital itself, or the corpus. The cash *Waqf* was a special type of endowment and it differed from the ordinary real estate *Waqf* in that its original capital, (*aṣl al-māl*) consisted purely or partially, of cash. Historically, *Awqāf* was so popular in Islamic countries especially amongst the well off tier of the society especially in early seventh and eighth century (ÇIZAKÇA 1998). However, it didn't serve as a sustainable tool for economic development due to some social and political turbulence. Sustainability of *Awqāf* institution was closely correlated to the persistence of political systems.

In modern Islamic economics, *Awqāf* are mainly directed to provision of social services health, education, municipal, etc. *Awqāf* Institutions (AI's) provided such

[25] As per earlier work of ÇIZAKÇA 1998, It is well known that charitable endowments have a history considerably older than Islam and it is also very likely that Islam may have been influenced by earlier civilizations. Ancient Mesopotamia, Greece, Rome as well as the pre-Islamic Arabs certainly knew of charitable endowments. The extent to which Islamic *awqāf* were influenced by these ancient institutions and the extent to which they were the product of the genius of Islam is a question that is still not resolved: while Roman origins have been rejected, primarily Byzantine, but also Mesopotamian, Sasanid, Jewish and Buddhist influences have been accepted as plausible. Thus, we have a fairly clear situation; Muslims were urged strongly to endow their assets in the service of mankind and they knew how to do it from the earlier civilizations, which had dominated the geography they had found themselves in.

services in at no cost whatsoever to the government given AI's are properly governed and administrated. On the macroeconomic front, AI's are seen serving the ultimate goal of reducing government spending, which contributes to reducing the budget deficit, inflation and government borrowing (other things equal).

This is sensed through setting up a dedicated institutional setup with the purpose of providing free services at to the society in order to contribute to maximizing welfare. This is efficiently achieved while fully binding to resource constraints as the main operational feature of this setup builds on maintaining the property itself and not consuming it through the process. In addition to helping achieve inter-generational equity, *Awqāf* help also achieve intra generational equity through supplying services to much consecutive generations. This setup needs simple pre-requisites to ensure optimal social returns; this includes honesty of caretakers, entitled legal identity and finally efficient administration. This in turn alters Timur Kuran's imprecise judgment and assessment to *Awqāf*. Kuran thinks the nonprofit setup of *Awqāf* wasn't intended as it was initially proposed for corporatization[26]. This is not necessarily right as, *Awqāf*; since its inception, were meant to provide non-fee charitable services to contribute to overall welfare of society. Another significant feature is that it is intended by construction to facilitate access to assets and social services and hence is not by any mean perceived as structural stagnation.

Section IV
Gaps and Challenges of Enhancing Inclusion through Islamic Finance

Although the OIC countries have experienced rapid economic growth and financial expansion during the past decade, low level of financial inclusion is still constraining the development of many Islamic economies. The argument is based on our analysis of two recent databases, the Doing Business Report 2011 by the World Bank and the Financial Access Report 2010 by the CGAP. In order to obtain a comprehensive analysis of the financial inclusion status of OIC countries, we calculated and compared the financial access related indicators of OIC countries with those of other groups of countries, i.e., GCC, OPEC, OECD, OIC excluding GCC, MENA region, low Income countries, and developing countries.[27] We use the data from OECD countries as benchmark, because OECD countries have

[26] (Kuran 2011)

[27] The low income countries and developing countries are defined by the country classification by the World Bank published in January 2011.

achieved a highly developed financial environment after overcoming many similar issues facing OIC countries currently.

We also separately examined financial inclusion in GCC and non-GCC among the OIC countries to see the dispersion of the financial inclusion status among all OIC countries. GCC are economically more developed and thus more comparable to its counterparties, such as OPEC and MENA region countries, whereas a comparison between non-GCC and low-income countries should provide more meaningful implication regarding the financial inclusion gap of the poorer OIC countries. We also included the developing countries in our analysis as another benchmark to see whether the OIC countries are lagging behind the average developing economies on a global level in terms of financial inclusion enhancement.

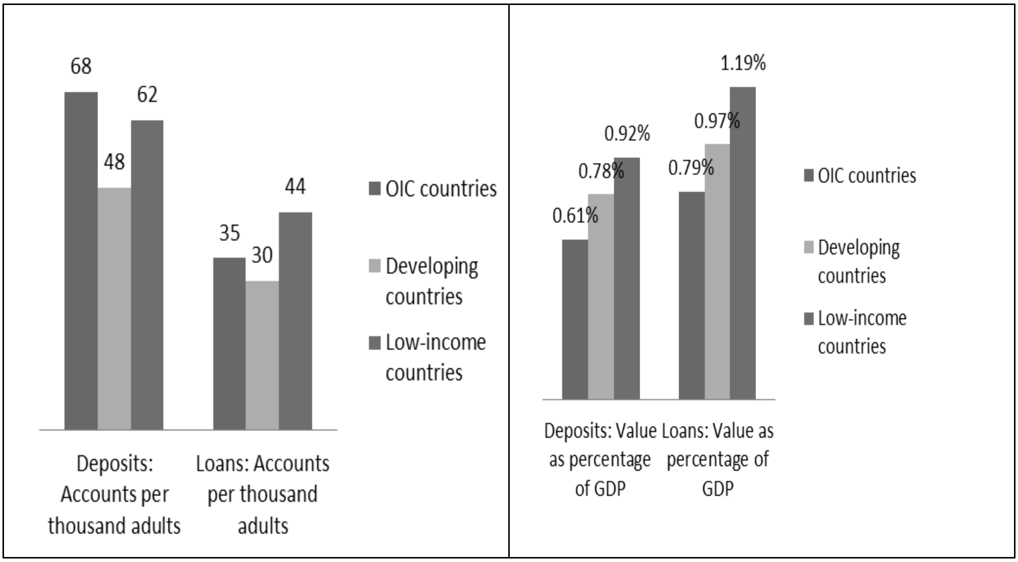
Below, we discuss main gaps in current implementation of Sharīʿah-compliant micro-finance, SME, and micro-insurance which are hindering their effectiveness to enhance the financial inclusion.

4.1. Gaps in Financial Inclusion – Microfinance (MF)

Strong demand for Islamic microfinance services in OIC countries is not met by the supply. An IFC-commissioned market studies in the MENA region suggest that between 20 and 60 percent of interviewed microenterprises and low income individuals indicated a preference for Sharīʿah-compliant products. For some, the lack of Sharīʿah-compliant products is an absolute constraint to financial access, while for others, this is a preference and they continue to use conventional financial services in the absence of competitive Islamic ones.[28] This gap is supported by statistics in Figure-3, which suggests that despite the fact that OIC countries have more MF deposits and accounts per thousand adults, values of MFI deposits and loans as percentage of GDP are still much lower in OIC countries (0.61% and 0.79%) compared with developing countries (0.78% and 0.97%) and low income countries (0.92% and 1.19%).

[28] (Pearce 2010)

Figure-3
Limited scale of Microfinance deposits and loans



Box 2 provides more examples of the strong and unmet demand for Islamic microfinance in selected OIC countries.

Box 2 – Strong demand for Islamic microfinance in different countries

- In the West Bank and Gaza, more than 60% of low-income survey respondents prefer Islamic products to conventional products, and more than half of them still do if the Islamic products come at a higher price. (PlaNet Finance 2007)

- In Jordan, 24.9% and 32%, respectively, of those interviewed cite religious reasons for not obtaining conventional loans. 18.6% of those interviewed rank religious reasons as the single most important factor in obtaining a loan. (IFC and FINCA 2006)

- In Algeria, a 2006 study by Bankakademie International revealed that 20.7% of micro enterprise owners do not apply for a loan primarily due to religious reasons. (Bankakademie International 2006)

- In Yemen, it is estimated that 40% of the poor demand Islamic financial services, regardless of a higher price. (source: Phone interview with Executive director of the National Microfinance Foundation, Yemen)

- In Syria, an IFC survey revealed that 43% of respondents considered religious reasons to be the largest obstacle to obtaining a microcredit. In addition, 46% of respondents who had never applied for a loan stated that religious reasons were the primary reason they had never applied. Nearly 5% of current borrowers said they would not apply for another loan for religious reasons. (IFC/ The World Bank 2007)

- In Indonesia, according to a 2000 Bank Indonesia report, 49% of the rural population of East Java considers interest prohibited and would prefer to bank with Sharia-compliant financial institutions.

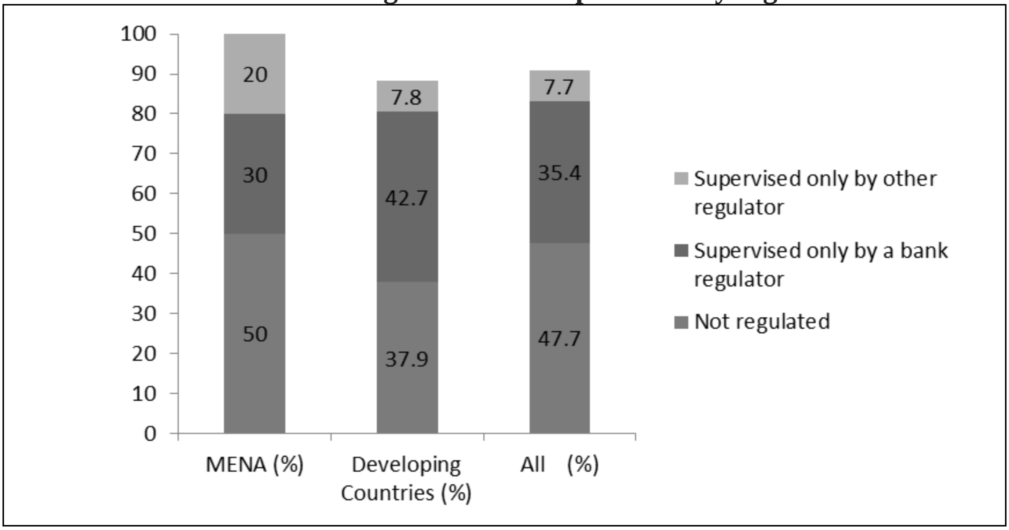
- In Lebanon, the success in outreach of Islamic programs relative to conventional MFIs strongly suggests that large numbers of poor people prefer Sharia-compliant finance.[1] In addition, microfinance practitioners report that many of the Lebanese poor refuse financial services unless they are Sharia-compliant. (Hamze 2001)

- Microfinance practitioners working in certain regions in Afghanistan, Syria, and Indonesia report similar results from their market surveys. (The Dubai Islamic Bank)

Source: World Bank Memoriam

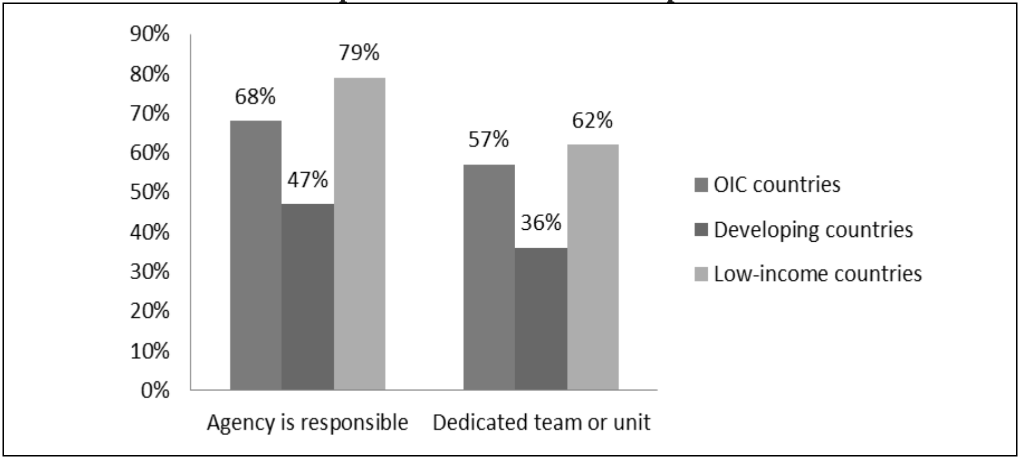
The gap of microfinance in OIC is not only demonstrated by its limited scope, but also by the lack of regulation in OIC countries compared to other developing countries. In MENA region for example, only Egypt, Morocco, Syria, Tunisia, and Yemen have specific legislation for Microfinance institutions (Figure-4). Also, according to the CGAP financial access database (Figure-5), 68% of the covered 37 OIC countries have appointed agencies to promote access to finance in rural areas, while 57% of the countries have dedicated team or unit in charge of the task. The ratios are above the developing countries average, but below the low-income countries average.

Figure-4
Microfinance regulation and supervision by region



Source: Peace (2010), M Khaled, CGAP (2010)

Figure-5
Who is responsible for rural finance promotion?



Source: CGAP(2010)

Although the Islamic microfinance institutions emerged in different forms and structures in different regions (See Table-1), the industry faces similar key challenges across countries.

First, absence of accounting standards has substantially constrained the expansion of Sharīʿah-compliant microfinance institutions in OIC countries. Although Islamic microfinance is developing fast, most central banks have not yet incorporate the special category into the existing regulatory and accounting framework. For example, up to Nov 2006, there are more than three thousands BMTs in Indonesia, 65 of them are located in Yogyakarta. Only 42 BMTs reported performance to PINBUK Yogyakarta regularly (Kholis, AG and SH 2007). In addition to the accounting standards, information technology assistance, risk management supervision, and infrastructure provision are also major concerns of Islamic microfinance providers.[29]

Second, knowledge gap regarding Sharīʿah rules among working staff challenges the development of many institutions. Since the whole industry is still in its infant stage, most employees have little background in Islamic finance before.

[29] Notes on risk management issues: Rise and fall of SGGFs in 2003 resulted from their stepwise lending scheme, non-separation of depositors from borrowers, and the housing recession. There is no single institution which can provide guarantee in the case of liquidity problem for BMTs in Indonesia. (Kholis, AG, & SH, 2007).

The knowledge gap increased the risk of the institution's deviation from Sharīʿah rules and deterred Sharīʿah-compliant financial product innovation. –Many evidences support this concern. For example, (Ahmed, 2007) found that RDS of the IBBL in Bangladesh extensively uses financial tools such as *Bayʿ-Mu'ajjal* and *Bayʿ-Murābaḥah* without knowing the Sharīʿah implication of the terms. The knowledge gap may also trigger reputational risks of the institutions: found that in Indonesia, society prejudice toward operations of BMT that are not in line with Sharīʿah rules may cause trust degradation among potential and current clients.

Third, the Sharīʿah rules increase the complexity of Islamic microfinance products and innovation process. The essence of Islamic finance is its close connection with real economy. In some cases, this central rule has brought problems for development of Sharīʿah-compliant microfinance business in certain countries. In the BMT case in Indonesia, no leading competitive commodity can be financed even though the funding channel has been well-established. In other cases, the strong linkage between Islamic finance and real economy also led to promising produce innovation. For example, (Kaleem 2007) argues that *Bayʿ Salam* contract, a deferred delivery contract where delivery of commodity occurs at some future date in exchange of some advanced price fully paid at spot, may help enable 5.44 mln small farmers to gain money to grown their crops and feed their families up to the time of harvest. Similarly, (Isnaji 2007) claims that formulating an "Islamic micro finance version program" under regular investment fund will also help coconut farmers in under-banked Muslim areas.

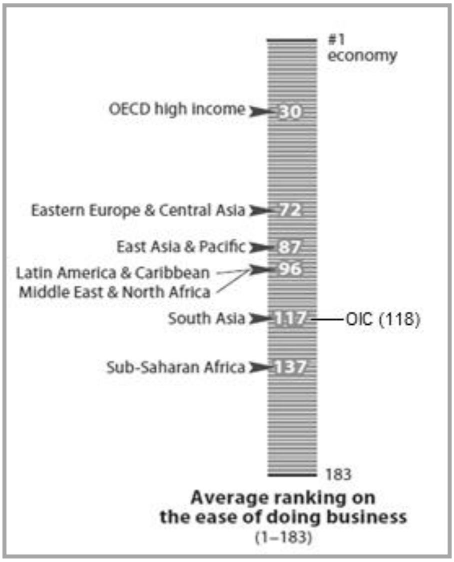
Fourth, how to attract more Islamic clients to enter the market is a big issue for both government and microfinance institutions. While further expansion of the Sharīʿah-compliant microfinance would be constraint by the growth of demand for such services, society's understanding of Islamic financial products is still limited. In order to tap larger proportion of potential market, both institutions and governments should exert more efforts to educate low income Islamic individuals and invite them to use available services.

4.2. Gaps in Financial Inclusion – SMEs

SMEs in OIC countries still lack easy access to credit on general. As the most comprehensive measurement of business environment faced by SMEs across countries, the Doing Business Report 2011 shows that OIC countries rank 118 on average, much lower than the average developing countries (100) in terms of ease of doing business (See Figure-6). This statistics imply that the business regulation and their enforcement in OIC countries are dragging OIC economies behind other developing economies, especially in the aspect of providing credit for SMEs. If we exclude GCC countries from the OIC countries, the average rank of the group drops even lower, approaching to the average level of low income countries covered in the survey. Many reasons contributed to the lack of financial access for SMEs in OIC countries. Among them, SME transparency, reliable collateral by SMEs, credit information systems, and weak creditor rights are the four largest issues emphasized by interviewed banks. (See Figure 7).

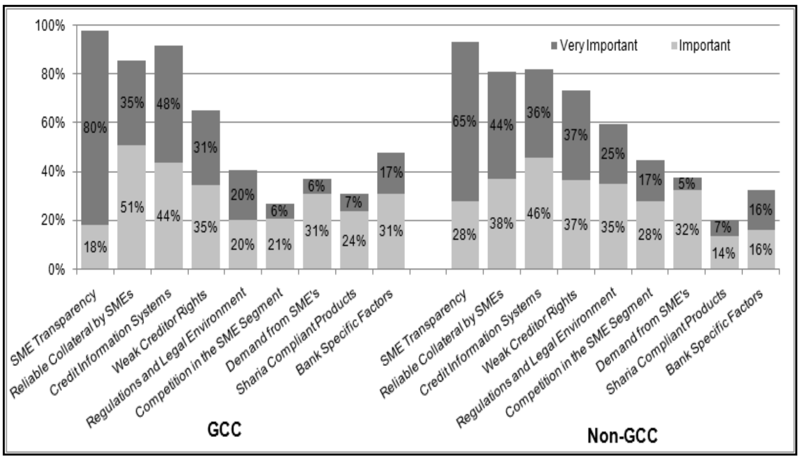
The detailed statistics shown in Figure-8, suggests that the OIC countries lag far behind in all four aspects of ease of getting credit. First, collateral and bankruptcy laws protection is weak. The OIC group score 4 in strength of legal rights index, compared with the benchmark of 7 among OECD countries. Second, the credit information kept by public credit registry and private credit bureau are inaccessible for the public. OIC countries score only 2 in the depth of credit information index compared to the benchmark of 5 of the OCD countries. Third, both public and private credit information system are still underdeveloped. In OIC countries, only 5% of adults have credit histories covered by public registry, while only 6% of the adults have credit histories covered by the private credit bureau. For GCC countries, although they outperform the OIC average in the overall ranking significantly (43 compared to 118), such gap is more likely to be attributed to the shorter time and lower costs of starting a business or enforcing contracts, rather than the easier credit environment. In other words, all OIC countries, regardless of GCC or non-GCC, face similar challenges in credit provision.

Figure-6
Average ranking on the ease of doing business



Source: Initial graph based on (Solf 2011)

Figure-7
Percentage (%) of Banks responding that Obstacle is Very Important or Important for SME Financing: GCC vs. Non-GCC



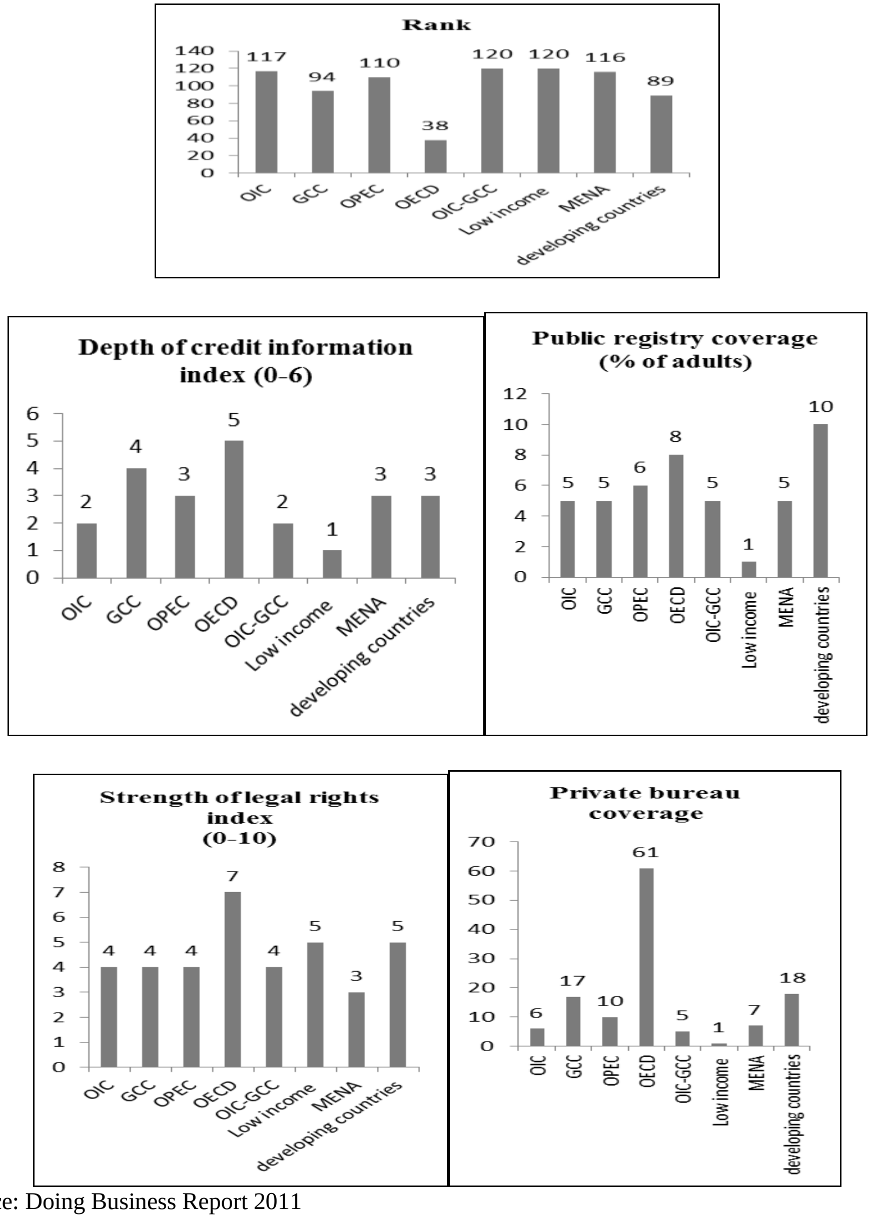
Source: (Rocha, et al. 2011)

Box 3 Key Indicators from the Doing Business Report

- Starting a business: all procedures that are officially required for an entrepreneur to start up and formally operate an industrial or commercial business.
    - Procedure is defined as any interaction of the company founders with external parties (for example, government agencies, lawyers, auditors or notaries).
    - Time is recorded in calendar days. The measure captures the median duration that incorporation lawyers indicate is necessary to complete a procedure with minimum follow-up with government agencies and no extra payments.
    - Cost is recorded as a percentage of the economy's income per capita. It includes all official fees and fees for legal or professional services if such services are required by law.
    - The paid-in minimum capital requirement reflects the amount that the entrepreneur needs to deposit in a bank or with a notary before registration and up to 3 months following incorporation and is recorded as a percentage of the economy's income per capita.
- Getting Credit: the legal rights of borrowers and lenders with respect to secured transactions through one set of indicators and the sharing of credit information through another.
    - The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.
    - The depth of credit information index measures rules and practices affecting the coverage, scope and accessibility of credit information available through either a public credit registry or a private credit bureau. The public credit registry coverage indicator reports the number of individuals and firms listed in a public credit registry with information on their borrowing history from the past 5 years.
    - The private credit bureau coverage indicator reports the number of individuals and firms listed by a private credit bureau with information on their borrowing history from the past 5 years.
- Enforcing contracts: the efficiency of the judicial system in resolving a commercial dispute.
    - The list of procedural steps compiled for each economy traces the chronology of a commercial dispute before the relevant court.
    - Time is recorded in calendar days, counted from the moment the plaintiff decides to file the lawsuit in court until payment.
    - Cost is recorded as a percentage of the claim, assumed to be equivalent to 200% of income per capita.

Source: The World Bank, Doing Business

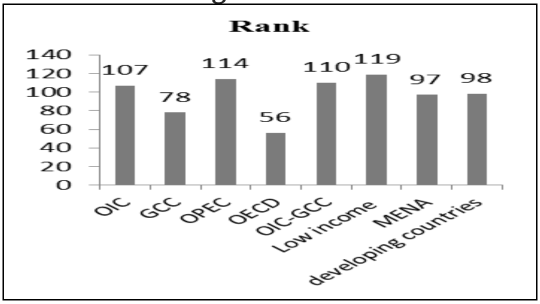
Figure-8
Getting credit

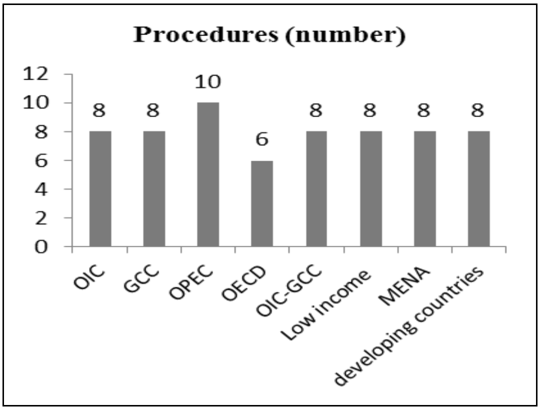


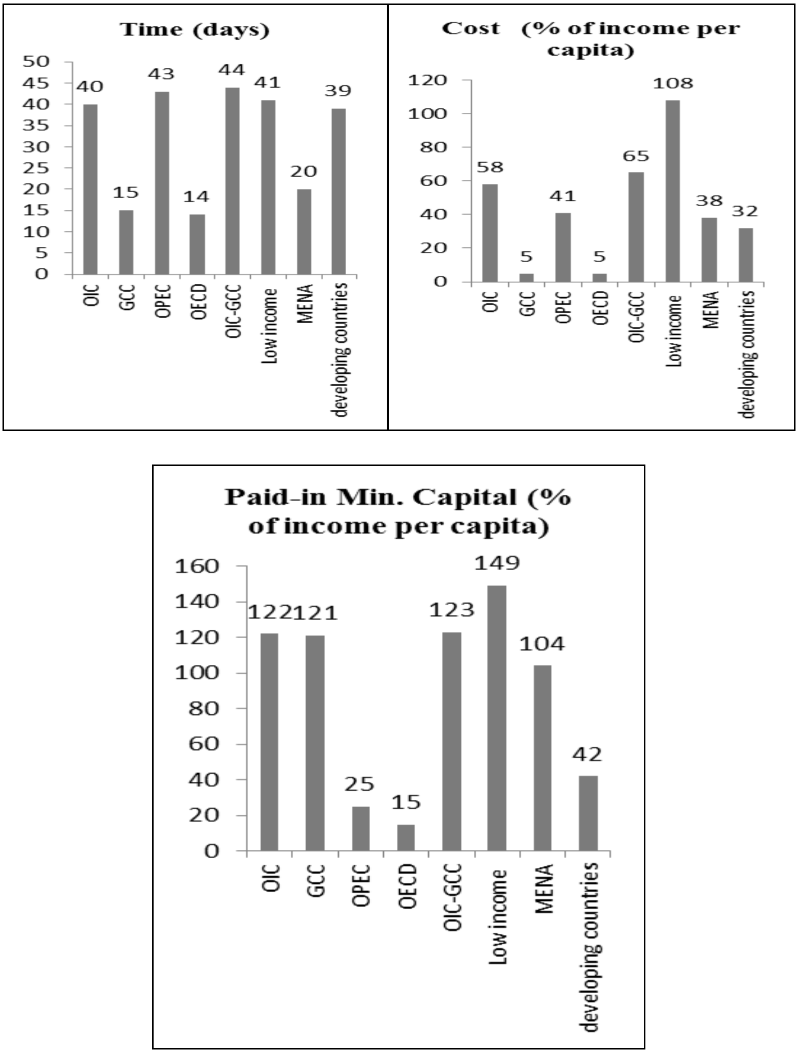
Source: Doing Business Report 2011

In addition to the challenge of access to credit, SME in OIC countries also suffer from difficulties to start a business and enforce contracts, which further slow down the life cycle of SMEs and becomes obstacles for them to obtain financial investment. Starting a new business requires 40 days and 8 procedures on average in OIC countries. The official fees for legal procedures and professional services required by law amount to 58% of income per capita, and the opportunity is only open to those business with a minimum capital equals to 122% of income per capita. On comparison, in OECD countries, it only takes 14 days and 6 procedures to start a new business, and both cost (5% of income per capita) and paid-in minimum capital (15% of income per capita) are insignificant (See Figure-9 and figure 10).

Figure-9
Starting a new business

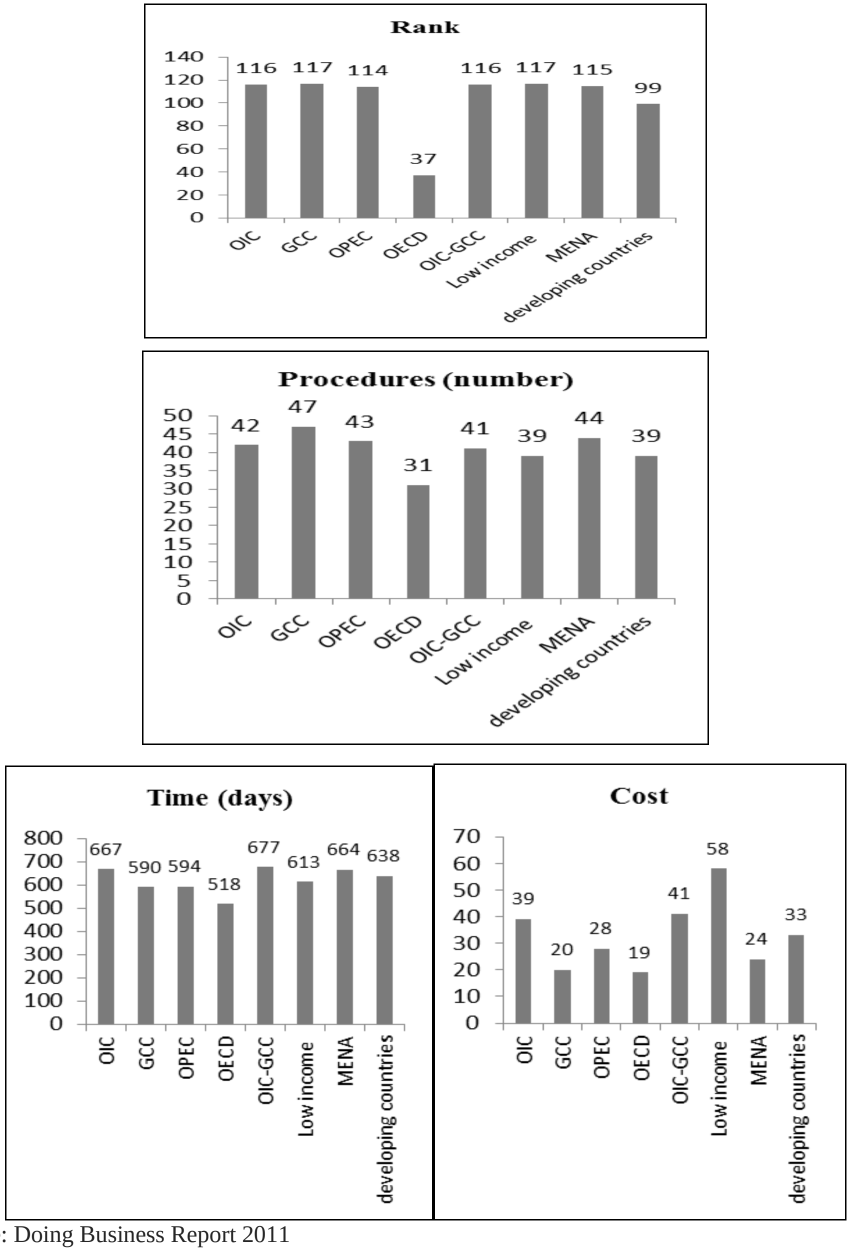






Source: Doing Business Report 2011

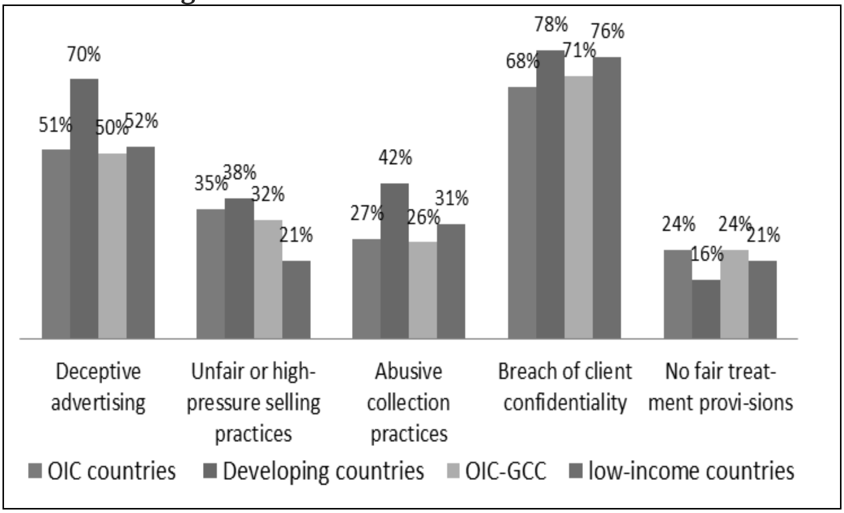
Figure-10
Enforcing contracts



Source: Doing Business Report 2011

Weak regulatory framework for financial agencies and business disputes resolution underscored the strong demand for financial inclusion reform in OIC countries. The statistics show that OIC countries fell behind other developing countries in terms of regulatory supervision coverage. For example, only 59% of microfinance institutions are under regulation compared with the average level of 72% in low income countries (Table). Current laws are also insufficient to provide enough protection for disputes resolution. Take the instance of client confidentiality protection, only 68% of OIC countries provide laws to restrict such unfair treatment, while 78% of developing countries do (See Figure-11).

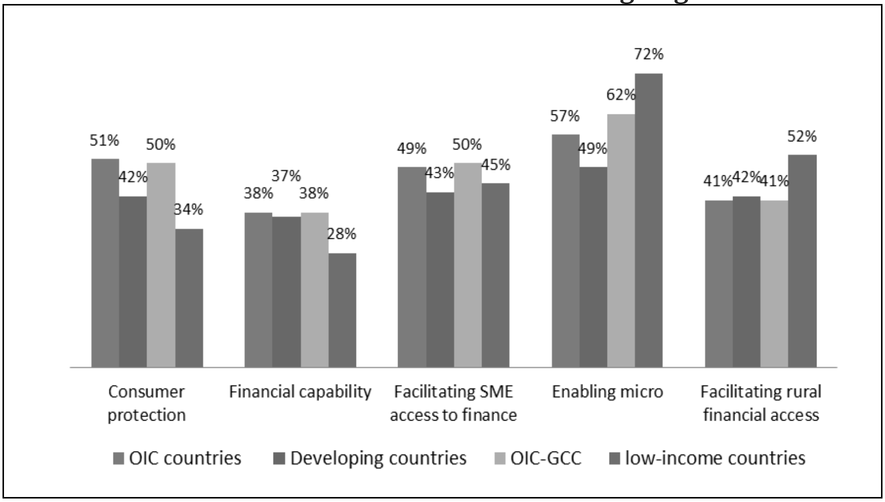
Figure-11
Disputes resolution: provisions in existing laws and regulations to restrict unfair treatment



Source: CGAP (2010)

However, the statistics also shows that OIC countries have been aware of the issue and taking actions more actively than other developing countries. According to the CGAP survey, OIC governments have been more actively promoting reforms in all aspects of financial inclusion, especially in fields of financial consumer protection and microfinance expansion. The proportions of countries taking reforms on financial capability (38%) and SME financial access (49%) are also higher than those of developing countries (37% and 43%), much higher than low-income countries (28% and 45%). What is surprising is that non-GCC governments are even more active in financial inclusion reforms than GCC governments, especially in microfinance development (62% for OIC-GCC vs. 57% for OIC) (See Figure-12).

Figure-12
Financial inclusion reform undergoing

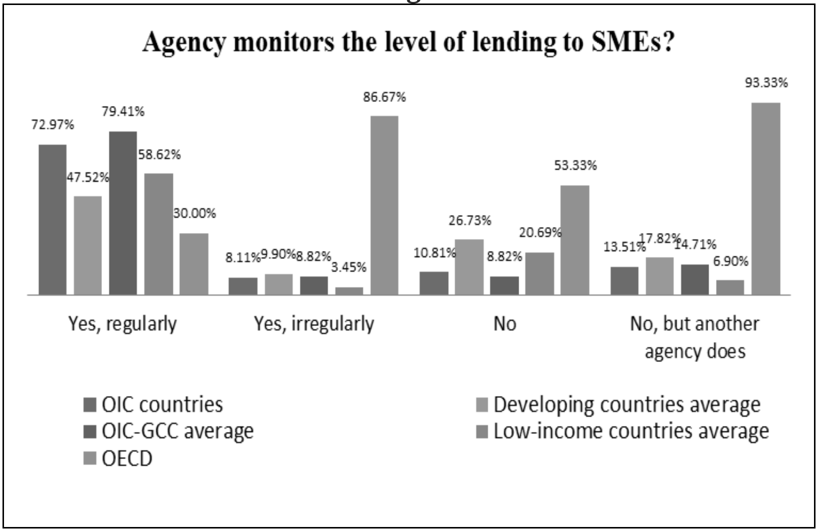


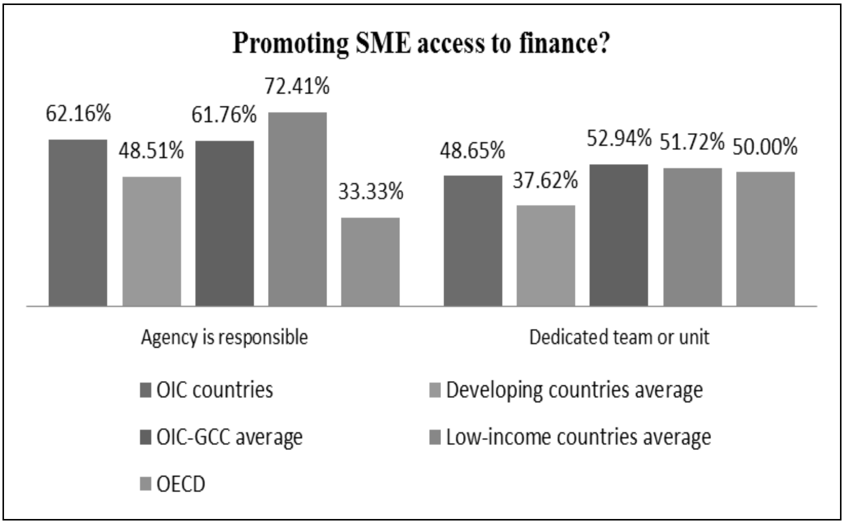
Source: CGAP (2010)

Financial inclusion gap in OIC countries can also be reflected by governments' heavy investment in SME policy reforms. According to the CGAP financial access database (

Table), OIC countries are more likely to monitor the level of lending to SMEs through specific dedicated agencies than developing countries (73% vs. 48%). Also, 62% of OIC countries designated an agency to promote SME access to finance specifically, compared to the figure of 49% in developing countries. However, the SME lending as proportion of GDP in OIC countries is still far behind the OECD level (7.43% vs. 24.47%), which indicates that there is a huge gap in terms of SME funding between the two groups (See Figure-13).

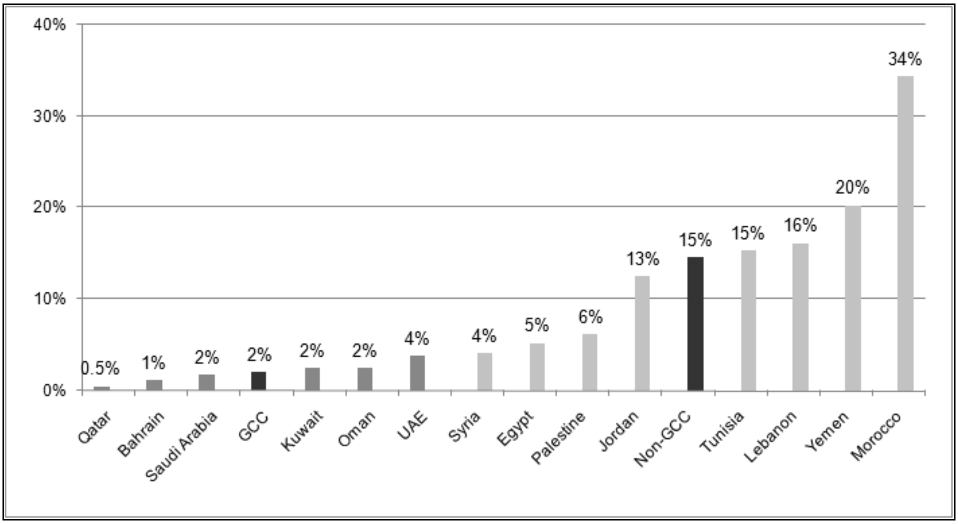
Figure-13
SME regulation





Despite all the reform efforts exerted so far, the SME loans are still small in their sizes in OIC countries suggests that OIC the total value of SME lending in OIC countries is only 7.43% on average, much lower the benchmark of Malaysia (17.43%) and OECD (24.47%), and the severity of the issue is similar in both GCC and non-GCC countries. The argument is also supported by the Figure-14, which provides the SME loans as percentage of total loans in MENA region on country level.

Figure-14
SME Loans/Total Loans (%): MENA Countries



Source: (Rocha, et.al., 2011)

4.3. Gap – Micro-Takāful

Despite its large potent in poverty reduction, Micro-*Takāful* institutions are still significantly underdeveloped in OIC countries. UNDP study in 2006 reveals that the low income people in Indonesia still rely heavily on informal risk management strategies. Sharīʿah-conform insurance that was available to the low income households were reluctant to enter the market. Similar to low-income individuals, SMEs are also less covered by insurance services in poorer OIC countries. In MEAN region, 34% of SMEs in GCC countries have the access to insurance services, while the figure fells sharply to 19% if the SMEs in Non-GCC countries in the same region are consider. [30]

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[30] (Rocha, et al. 2011)

Two reasons may have contributed to the lack of momentum of the market expansion. First, the slow expansion of Micro-*Takāful* may be linked to the fact that microfinance institutions in Muslim populous countries are less likely to offer insurance services. [31]Second, some form of *Takāful* model require policy premium to be reimbursed to policy holders if they do not file a claim. The AAOIFI's ruling in 2006 claims that policyholders have the exclusive rights to the surplus has held back the penetration of *Takāful*. This may have played a role in discouraged the entrance of new firms.

Section V
Policy Recommendations and Concluding Remarks

Financial inclusion is becoming an increasing priority for policy makers around the world and there is growing realization that measures should be undertaken to i) stimulate private sector investment in favor of low income individuals and SMEs, ii) remove institution and infrastructure barriers to help financial service providers to sustainably expand services, and iii) encourage product diversification and improved risk management.[32] Box 4 lists key guiding principles drafted by G20 for innovative financial inclusion. These principles are good starting point for the policy formulation for designing a comprehensive framework to address the issue of financial inclusion.

In this section, we propose five dimensions of policy recommendations that could be considered for the enhancement of financial inclusion for countries interested in developing Islamic financial system led development in OIC countries.

[31] (Kwon 2010)
[32] (Pearce 2010)

Box 4 - G20 Principles for Innovative Financial Inclusion

Innovative financial inclusion means improving access to financial services for poor people through the safe and sound spread of new approaches. The following principles aim to help create an enabling policy and regulatory environment for innovative financial inclusion. The enabling environment will critically determine the speed at which the financial services access gap will close for the more than two billion people currently excluded. These principles for innovative financial inclusion derive from the experiences and lessons learned from policymakers throughout the world, especially leaders from developing countries.

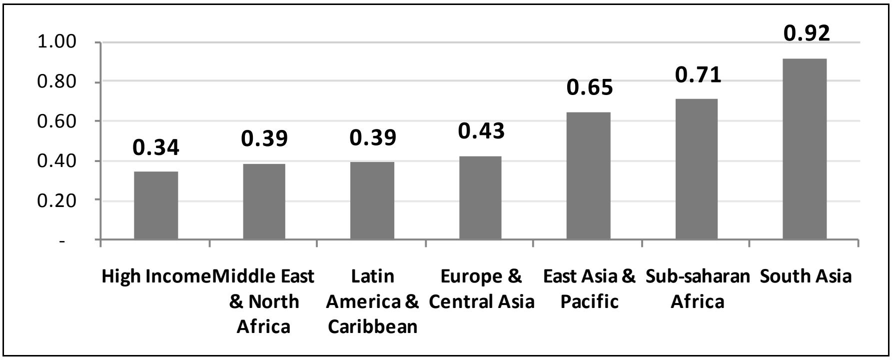
1. **Leadership**: Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.
2. **Diversity**: Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.
3. **Innovation**: Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.
4. **Protection**: Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.
5. **Empowerment**: Develop financial literacy and financial capability.
6. **Cooperation**: Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.
7. **Knowledge**: Utilize improved data to make evidence based policy, measure progress, and consider an incremental “test and learn” approach acceptable to both regulator and service provider.
8. **Proportionality**: Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
9. **Framework**: Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

Source: Pearce (2010)

5.1. Policy Recommendation I - Need for Developing Supportive Regulatory and Supervisory Framework

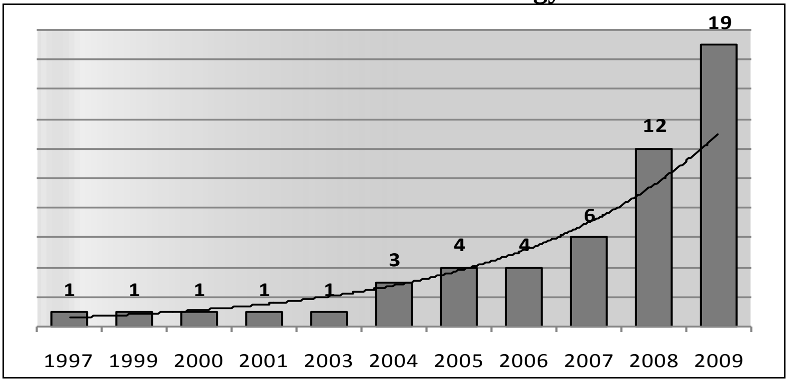
Improved access to finance in many developing countries is constrained by inappropriate regulations, a lack of specialist supervisory capacity, and inadequate institutional models in general for financial inclusion and particularly for Islamic finance in OIC countries. Despite the significance of financial inclusion, it is observed that financial inclusion is still not a priority for financial regulators in most of OIC countries. For example, financial regulators in MENA have the second lowest degree of involvement in promoting financial inclusion, ahead only of high income countries where financial exclusion is at much lower levels (Figure-15). Almost half of all the countries covered by the CGAP and World Bank Financial Access 2010 report (48 percent) have a strategy document for the promotion of financial inclusion, with 90 percent of those introduced within the last 6 years. (Figure-16).

Figure-15
Index of Regulator's involvement in Financial Inclusion



Source: CGAP and World Bank Financial Access 2010

Figure-16
Countries with a Financial Inclusion Strategy Document



Source: CGAP and World Bank Financial Access 2010

OIC countries need to develop a regulatory and supervisory framework that supports wide financial inclusion based on sound risk management and with sufficient consumer protections. During this process, governments and regulators need to take the lead in supporting improvements in access to finance, especially through Sharīʿah-compliant financial tools, displaying the *Leadership* called for in the G20 Principles (See Box 4). Financial inclusion, especially Islamic financial inclusion, should be considered as a goal alongside prudential regulation and financial system stability. The CGAP and World Bank Financial Access survey (2010) of financial regulators worldwide found that regions that include financial access in their strategies and mandate their financial regulators to carry such agendas are also the countries that reform the most. Regulators with a financial inclusion strategy are more likely to have more financial inclusion topics under their purview and more resources and staff dedicated to working on these matters.[33]

Practical measures that can be taken by regulators (as has been the case in Indonesia and Pakistan) include: licensing Islamic banks, supporting centers for training and certification on Islamic financial operations to staff and managers of financial service providers, and developing guidelines setting out requirements for licensing and appointment of Sharīʿah advisers to rule on Sharīʿah compliance. The political climate for Islamic finance also affects investor and lender decisions about whether to offer Sharīʿah-compliant products, and acts as an incentive or disincentive to its growth.

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[33] (Pearce 2010)

In addition, consumer protection is also increasingly important as access increases, so that new customers, and existing customers with access to new services, can take well informed decisions about how best to manage and use Islamic financial services. In some countries, customers stay away from Sharīʿah-compliant services because of lack of education about authenticity and credibility of products. Consumer protection can help remove such perceptions and can lead to enhanced inclusion. Therefore, it is essential that consumer laws and regulations are developed and put in place: i) to protect against unfair or deceptive practices ii) to improve transparency through disclosure and plain language requirements for products and pricing, in a way that allows consumers to easily access to Sharīʿah-compliant products and services, and iii) to establish a low cost, efficient, and fair mechanism for resolving customer complaints and disputes.

5.2. Policy Recommendation II - Strengthen Financial Infrastructure for Financial Inclusion[34]

Improving financial infrastructure, especially the improvement of current credit informational system, should be the priority item in the policy agenda of OIC countries. Deficiencies in financial infrastructure are one of the major obstacles for further SME lending in MENA region, as confirms by the survey result in Figure-7 Percentage (%) of Banks responding that Obstacle is Very Important or Important for SME Financing: GCC vs. Non-GCC.

Improving financial infrastructure will entail expanding the range of collateral, improving registries for movables, and improving enforcement and sales procedures for both fixed and movable assets. It also entails upgrading public credit registries, and more importantly, introducing private credit bureaus capable of significantly expanding coverage and the depth of credit information.[35] Financial infrastructure improvements will reduce the information asymmetry that constrains access to credit and raises the costs and risk of financial intermediation.

Core components of the financial infrastructure such as credit information, investors' rights, insolvency regimes, etc. are essential irrespective of type of financing, i.e. conventional or Islamic. For this purpose, it is suggested that, first, regulated financial entities should be required to share credit information, ideally

[34] For more details, please refer to (Pearce 2010)
[35] (Rocha, et al. 2011)

through national credit registries. Sharing borrower information is essential to lowering costs and overcoming information constraints. As mentioned earlier, lack of access to credit information and low coverage ratio of credit history of individuals are two main features that contribute to the financial exclusion in OIC countries especially for SME financing. By integrating Sharīʿah-compliant products and customers information into credit bureaus, the coverage and utility of data in the credit bureaus can be improved. Financial institutions of all types can extend access to new customers, while managing risks and costs more effectively. This will also help Sharīʿah-compliant financial institutions to expand their funding source and enhance their risk-sharing mechanism, as institution with its clients' credit information available to the public can establish its reputation much easier than those with an informal credit history system.

Second, data on financial inclusion and unbanked markets/customers (especially those due to religious reason) is also needed to improve to underpin a sustainable expansion in access to finance, as emphasized by the G20 Principle for Financial Inclusion. Household and enterprise-level survey questions can provide governments and regulators with the data they need for designing reforms and then monitoring the effectiveness of those reform measures. For example, OIC governments can encourage Islamic banks to launch financially inclusive accounts, shifting G2P payments (increased transaction volume) through such accounts to enhance their viability.

5.3. Policy Recommendation III - Ensure a Level Playing Field for Islamic Microfinance, SME, and Micro Takāful

The lack of Sharīʿah-compliant micro-finance services is constraining financial inclusion to a proportion of the population. The growth of Islamic microfinance will depend to a large degree on whether financial institutions can develop sufficiently attractive financial products and services, which are competitive with conventional products in terms of pricing, transparency, processing time, and burden on the client. This will be determined in part by their capacity and systems, but regulators can also provide a more level playing field for Islamic microfinance. This extends beyond financial sector regulation to the tax code, as Islamic financing that involves additional transactions such as passing on a property title, may have tax implications such as capital gains tax, which are not applicable in conventional deals. OIC governments should also extend access to a broader range of financial services through existing branch networks of Islamic banks, which can offer a unique network of existing outlets as a delivery mechanism for Sharīʿah-compliant financial services.

When designing the financial inclusion reform plan, OIC governments should take three points into their consideration specifically i) allowing banks to expand access through agents and use of technology (e.g. mobile phones), ii) providing a Sharīʿah-compliant finance company model for microfinance and microinsurance, and iii) removing interest rate caps for microcredit and strengthen customer protection laws.

Competition policy can also contribute to further SME lending. (Rocha, et al. 2011) suggests that private banks are more efficient in lending technologies and are able to generate and manage a significant SME portfolio, even within weak enabling environments. The entry of these banks into OIC countries could contribute to more SME lending, both directly and through spillover effects. Therefore, the policy implication is to ensure that entry requirements for Islamic financial institutions are not overly restrictive and that Islamic banking markets remain contestable.[36] In addition, the impact of the entry of foreign banks on Sharīʿah-compliant SME lending can be magnified if these new foreign banks have access to substantive credit information on potential SME borrowers.

Governments should play a critical role in promoting an enabling environment in which private banks can fulfill their SME finance targets prudently and responsibly. In the case of non-GCC countries, there is huge potential for expanding SME finance, with large numbers of smaller enterprises underserved and low levels of bank competition to serve them. In the case of GCC countries, the size of the SME sector may remain more constrained by the nature of oil economies, but there is also scope for further SME finance, especially if access to finance is also expanded for resident non-nationals. [37]

5.4. Policy Recommendation IV - Institutionalization of Islamic Redistributive Instruments

Islamic finance advocates risk sharing and equity finance, while prohibiting debt financing and leveraging. Given the emphasis on social and economic justice and the eradication of poverty, we would expect Islamic instruments that targeted to address inequity, such as *Zakāh*, *khairat*, *Waqf*, and *Qarḍ-al-Ḥasan*, to play an important role if the required institutional structures are developed. Therefore,

[36] (Rocha, et al. 2011) show that there is a higher rejection of banking licenses in MENA than in other regions.
[37] Maddedu provides a review of credit reporting systems in MENA (2010). (Rocha, et al. 2011)

there is need to formalize or institutionalize Islamic redistributive mechanisms designed to empower the economically weak segments of the society.[38]

By institutionalization, we mean to build nation-wide institutions and surrounding legal infrastructure to maximize the effectiveness of these redistributive mechanisms. This institution-building exercise can take place in three steps. First, is the development of institutions. An institution is nothing more that the legalization of the rules of behavior and therefore, would require crafting rules pertaining to these instruments as envisioned by Sharīʿah. The next step would be to establish these institutions and to integrate them with the rest of the economic and financial system. In this process, either existing channels of distribution, i.e. banks or post offices can be utilized to interact with the customers, or new means can be introduced leveraging of new technologies. Finally, there should be mechanism to ensure enforceability of rules through transparent means.

The objective of institutionalization of redistributive instruments is to formalize and standardize the operations to facilitate each instrument. For example, for *Zakāh*, *Khairat*, and *Qarḍ-al-Ḥasan*, a formal network of institutions needs to be developed to collect, distributed, and recycle the funds in most efficient and the most transparent fashion. In some countries, point of sale such as Automatic Teller Machines (ATM) or cash dispensing machines are used to give choice to the customers to make donations or contribution at the spot to make it easy for the customer to make such contributions. The financial institution can collect and aggregate funds and then disburse to needy through selected channels.

Several scholars have put forth ideas of formalizing and institutionalizing Islamic modes of redistributions through an integrated approach by combining different modes. For example, Elgari (2004) proposes establishing a nonprofit financial intermediary, the *Qarḍ-al-Ḥasan* bank that gives interest free loan (*Qarḍ al-Ḥasan*) to finance consumer lending for the poor. The capital of the bank would come from monetary (cash) *Waqf* donated by wealthy Muslims. Kahf (2004) and

[38] (Mirakhor 2004) argues that given the number of poor in Islamic countries, critics argue that, a priori, Islamic institutions, which were meant to redistribute income and wealth from the more well-to-do to the weaker segment of the society, have not shown the necessary potency in performing their function, and they could be right. It is a serious problem that very little effort has been expended by our researchers and scholars in empirically investigating the behavior of Muslims vis-à-vis these institutions, i.e., why the latter have failed to achieve the objectives for which they were designed, and how the situation could be remedied. Admitting that these institutions have, by and large, failed to alleviate poverty in Muslim countries does not obviate the need to consider their potential..

Ahmed (2003) propose establishing a microfinance institutions based on *Zakāh*, *Awqāf*, and *Ṣadaqat*.

Developing a hybrid model or an integrated one is practical and has several advantages. Taking micro-finance example, one can envision developing Universal Islamic Micro-Finance Structure to construct a portfolio of three basic and traditional Sharīʿah compliant financial products, *Awqāf*, *Zakāh* and micro-*Takāful* in order to support and foster Islamic Micro-finance under a unified framework. Islamic microfinance can be more effective in diverting borrowers' propensity to consume through providing a micro-*Takāful* mandatory component to the micro lending service as the main mitigate for moral hazard. Besides this, charging no interest would help mitigate credit rationing, redlining and adverse selection (Stiglitz and Weiss 1992).

Although creating such a unified institution may be premature given the present context, in this paper we attempt to outline the basic concept of such a singular Islamic MFI by using funds from the *Zakāh* and *Awqāf*, in addition to complementing this with providing micro-*Takāful* to micro enterprises. The IMFIs may use the *Zakāh* fund in disbursing funds to fulfill basic consumption needs for the hard-core poor target group in the first place, as on principle no return can be realized from *Zakāh* fund and *Zakāh* fund should be disbursed within one financial year. *Zakāh* funds may alternatively be directed towards funding small businesses, and support theor initiation at no funding cost.

However, the *Awqāf* funds may be used as investable fund in providing capital investment and working capital financing for the micro-businesses. Such an integrated model may reduce the chances of loan default because the basic inherent tendency of the poor to use the loan fund for consumption purpose will be met. As their basic consumption needs are covered, the poor micro-entrepreneurs may be in better position to focus on their business alone. Moreover, the IMFI may initiate financing through different Islamic Sharīʿah compliant modes.

a) Mitigating Credit Risk: As mentioned above, the innovative operational format of MFIs suits the poor, whose lack of physical collateral disqualify them to borrow from traditional commercial banks. *Waqf*-based Islamic MFIs will retain the innovative format of operation of conventional MFIs and oriented the program towards Islamic principles and values. Thus, like their conventional counterparts, Islamic MFIs have largely resolved the credit risks through social collateral of groups and weekly repayments.

b) Resolving Moral Hazard Problem: Islamic MFIs have some inherent characteristics that can resolve the moral hazard problem faced by conventional MFIs pointed above. The main mode of financing used by the Islamic MFIs is *murābaḥah*/ *Bay*ʿ *Mu'ajjal* or *ijārah* (leasing). These instruments involve real transaction and instead of cash being given out, asset/good is exchanged. As a result, the opportunity of diverting funds for non-productive uses other than that requested for is reduced, if not eliminated. This increases the profitability of the MFI by decreasing the default rate.

c) Economic Viability: In cases where Islamic MFIs get funds from traditional interest-based outlets, the financing costs appear to be high. For example, the financing costs of two small Islamic MFIs, Noble and Rescue in Bangladesh, were 35.8 percent and 12.5 percent of the total expenditures respectively (Ahmed 2002). As the bulk of the *Waqf*-based Islamic MFIs funds will come from *Waqf* endowment, the financing costs of these institutions will be significantly lower than their conventional counterparts. Given the philanthropic nature of these funds, no returns are expected by contributors. While Islamic MFIs will pay returns on funds coming from external sources like deposits and beneficiary savings, the *Waqf* component of funds will significantly reduce the financial costs and improve financial viability of the institution.

In short, above-mentioned structure is one of several innovative ways to revive Islamic institutions of redistribution which has great potential to overcome the problem of financial exclusion and to contribute to alleviation of poverty in OIC countries.

5.5. Policy Recommendation V - Financial Engineering

Financial innovation and application of financial engineering have changed the face of global landscape in the last three decades. Although, some of the innovations have been criticized and have been the source of volatility in the markets, yet their positive contribution cannot be denied. There is no reason why the financial engineering cannot be used in the area of financial inclusion and to enhance the financial access. One way could be to introduce the application of securitization to securitize assets generated by micro-finance and SMEs. Sukuk (Islamic bonds) are a successful application of securitization and working on the same lines, a marketable instrument can be introduced to provide funding for much needed Mirco-finance and SME financing. With the introduction of securitization of Micro and SMEs, financial institutions would be able to pool their assets and issue marketable securities. In this way, they will share the risks with the market as well as free-up the capital for further mobilization of micro and SME financing.

While sustainability of funding represents a major challenge for *Awqāf*, researchers proposed a hybrid structure that targets integrating *Zakāh* and *Awqāf* to promote microfinance. Sadeq (1995) presents an integrated approach on how traditional institutions of *Awqāfs* may be revitalized through proposing innovative Sharīʿah compliant structures. *Awqāf* certificates of different denominations could be issued to raise sustainable funding for *Awqāf*. Special funds are then to be raised for financing economic development. As *Awqāfs* are generally applied on fixed assets, such assets are often under-utilized. On the other hand, if cash *Awqāfs* are raised by issuing *Awqāf* certificates, they could be used more efficiently in a wide range of development projects. This structure relies on the fact of encouraging the flow if cost-less funding of *Zakāh*, that can be directed to underwritings and subscriptions in the pooled funds as a potential tool for Islamic microfinance (Hassan 2010). Yet still, inadequacy of governance and Sharīʿah compliant accounting principles to support such structures are the main challenges for widespread implementation.

Annex – Supporting Data for Charts

Table-5
Microfinance Regulation and Supervision by Region[39]

	MENA (%)	Developing Countries (%)	All (%)
Not regulated	50.0	37.9	47.7
Supervised only by a bank regulator	30.0	42.7	35.4
Supervised only by other regulator	20.0	7.8	7.7
Supervised by both	0.0	11.7	9.2
Number of countries	10	103	130

Source: M Khaled, CGAP, 2010

Table-6
Microfinance indicators from CGAP financial access database

	Financial inclusion: Promoting access in rural areas		Deposits: Accounts per thousand adults			Deposits: Value as percentage of GDP			Loans: Accounts per thousand adults			Loans: Value as percentage of GDP		
	Agency is responsible (Yes/No)	Dedicated team or unit (Yes/No)	Coope-ratives	SSFIs	MFIs	Cooperatives	SSFIs	MFIs	Cooperatives	SSFIs	MFIs	Cooperatives	SSFIs	MFIs
Malaysia	√	√	2.78	1,146.06	n.a.	0.04	13.71	n.a.	87.26	113.07	19.03	0.63	12.09	0.22
OIC countries average	68%	57%	30.86	224.11	68.14	3.98	5.33	0.61	24.94	31.00	34.68	2.59	3.62	0.79
Developing countries average	47%	36%	100.53	216.71	48.93	1.99	4.27	0.78	27.54	25.01	30.14	1.71	3.35	0.97
Low-income countries average	79%	62%	32.65	18.17	62.44	0.68	1.74	0.92	16.42	8.46	43.87	0.69	1.70	1.19

Source: CGAP financial access report data 2010

[39] (Pearce 2010)

Note: The CGAP Financial Access Database covers questionnaires sent to 151 economies: 13 in East Asia and the Pacific, 27 in Europe and Central Asia, 20 in Latin America and the Caribbean, 14 in the Middle East and North Africa, 6 in South Asia, 40 in Sub- Saharan Africa, and 23 in the high-income OECD countries. Among them, 37 OIC countries are covered. For practical purposes, most small islands and economies at war were not included. The sample covers more than 94 percent of the world's population and nearly 98 percent of global GDP.

Selected questions are presented in the first and second rows of the table. The row for OIC countries means the percentage of OIC countries that replied yes to the questions (for Yes/No questions), or means the average value for OIC countries. The same calculation applied to the groups of developing countries, OIC-GCC, and low incoming countries. OIC-GCC means OIC countries excluding the GCC countries covered by the CGAP database.

Table-7a
Doing Business Indicators Comparison

	Ease of Doing Business Rank	Starting a Business				
		Rank	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in Min. Capital (% of income per capita)
OIC	118	107	8	40	58	122
GCC	43	78	8	15	5	121
OPEC	110	114	10	43	41	25
OECD	30	56	6	14	5	15
OIC-GCC	128	110	8	44	65	123
Low income	140	119	8	41	108	149
MENA	96	97	8	20	38	104
Developing countries	100	98	8	39	32	42

Source: Doing Business Report 2011, The World Bank

Ease of doing business rank: World Bank index that measures business regulations and their enforcement across countries Index.
Starting a business: all procedures that are officially required for an entrepreneur to start up and formally operate an industrial or commercial business. Procedure is defined as any interaction of the company founders with external parties (for example, government agencies, lawyers, auditors or notaries). Time is recorded in calendar days. The measure captures the median duration that incorporation lawyers indicate is necessary to complete a procedure with minimum follow-up with government agencies and

no extra payments. Cost is recorded as a percentage of the economy's income per capita. It includes all official fees and fees for legal or professional services if such services are required by law. The paid-in minimum capital requirement reflects the amount that the entrepreneur needs to deposit in a bank or with a notary before registration and up to 3 months following incorporation and is recorded as a percentage of the economy's income per capita.

Table-7b
Doing Business Indicators Comparison (continued)

	Getting Credit					Enforcing Contracts			
	Rank	Strength of legal rights index (0-10)	Depth of credit information index (0-6)	Public registry coverage (% of adults)	Private bureau coverage (% of adults)	Rank	Procedures (number)	Time (days)	Cost (% of claim)
OIC	117	4	2	5	6	116	42	667	39
GCC	94	4	4	5	17	117	47	590	20
OPEC	110	4	3	6	10	114	43	594	28
OECD	38	7	5	8	61	37	31	518	19
OIC-GCC	120	4	2	5	5	116	41	677	41
Low income	120	5	1	1	1	117	39	613	58
MENA	116	3	3	5	7	115	44	664	24
Developing countries	89	5	3	10	18	99	39	638	33

Source: Doing Business Report 2011, The World Bank

Getting Credit: the legal rights of borrowers and lenders with respect to secured transactions through one set of indicators and the sharing of credit information through another. The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending. The depth of credit information index measures rules and practices affecting the coverage, scope and accessibility of credit information available through either a public credit registry or a private credit bureau. The public credit registry coverage indicator reports the number of individuals and firms listed in a public credit registry with information on their borrowing history from the past 5 years. The private credit bureau coverage indicator reports the number of individuals and firms listed by a private credit bureau with information on their borrowing history from the past 5 years.

Enforcing contracts: the efficiency of the judicial system in resolving a commercial dispute. The list of procedural steps compiled for each economy traces the chronology of a commercial dispute before the relevant court. Time is recorded in calendar days, counted from the moment the plaintiff decides to file the lawsuit in court until payment. Cost is recorded as a percentage of the claim, assumed to be equivalent to 200% of income per capita.

Table-8
CGAP indicators for financial inclusion – regulation, disputes, and financial inclusion reforms

	Under regulation agency's supervision? (Yes/No)			Disputes resolution: provisions in existing laws and regulations to restrict unfair treatment? (Yes/No)					Financial inclusion reform undergoing (Yes/No)					Financial inclusion: Consumer protection (Yes/No)	
	Cooperatives	MFIs	SSFIs[40]	Deceptive advertising	Unfair or high-pressure selling practices	Abusive collection practices	Breach of client confidentiality	No fair treatment provisions	Consumer protection	Financial capability	Facilitating SME access to finance	Enabling micro finance	Facilitating rural financial access	Agency is responsible	Dedicated team or unit
Malaysia		√		√	√	√	√		√	√	√	√	√	√	√
OIC countries	35%	59%	65%	51%	35%	27%	68%	24%	51%	38%	49%	57%	41%	76%	65%
Developing countries	44%	59%	57%	70%	38%	42%	78%	16%	42%	37%	43%	49%	42%	64%	51%
OIC-GCC	35%	59%	71%	50%	32%	26%	71%	24%	50%	38%	50%	62%	41%	79%	71%
low-income countries	41%	72%	86%	52%	21%	31%	76%	21%	34%	28%	45%	72%	52%	79%	55%

Source: CGAP Financial Access Report Data 2010

Note: The CGAP Financial Access Database covers questionnaires sent to 151 economies: 13 in East Asia and the Pacific, 27 in Europe and Central Asia, 20 in Latin America and the Caribbean, 14 in the Middle East and North Africa, 6 in South Asia, 40 in

[40] Specialized state owned financial institutions

Sub- Saharan Africa, and 23 in the high-income OECD countries. Among them, 37 OIC countries are covered. For practical purposes, most small islands and economies at war were not included. The sample covers more than 94 percent of the world's population and nearly 98 percent of global GDP.
Selected questions are presented in the first and second rows of the table. The row for OIC countries means the percentage of OIC countries that replied yes to the questions. The same calculation applied to the groups of developing countries, OIC-GCC, and low incoming countries. OIC-GCC means OIC countries excluding the GCC countries covered by the CGAP database.

Table-9
SME data from CGAP financial access database

	Agency monitors the level of lending to SMEs				Promoting SME access to finance		SME definition			SME lending
	Yes, regularly (Yes/No)	Yes, irregularly (Yes/No)	No (Yes/No)	No, but another agency does (Yes/No)	Agency is responsible (Yes/No)	Dedicated team or unit (Yes/No)	Number of employees (max.)	Sales	Loan size	Loan value (% of GDP)
Malaysia	√				√	√	150.00	7,093,199.00	..	17.43
OIC countries average	72.97%	8.11%	10.81%	13.51%	62.16%	48.65%	151.00	4,008,095.95	284,592.68	7.43
Developing countries average	47.52%	9.90%	26.73%	17.82%	48.51%	37.62%	141.19	9,150,287.27	168,779.94	7.44
OIC-GCC average	79.41%	8.82%	8.82%	14.71%	61.76%	52.94%	155.33	3,837,600.94	138,565.15	7.43
Low-income countries average	58.62%	3.45%	20.69%	6.90%	72.41%	51.72%	66.43	1,018,377.27	72,356.47	5.58
OECD	30.00%	86.67%	53.33%	93.33%	33.33%	50.00%	274.00	56,203,661.64	2,080,697.75	24.47

Source: CGAP financial access report data 2010

Note: The CGAP Financial Access Database covers questionnaires sent to 151 economies: 13 in East Asia and the Pacific, 27 in Europe and Central Asia, 20 in Latin America and the Caribbean, 14 in the Middle East and North Africa, 6 in South Asia, 40 in Sub- Saharan Africa, and 23 in the high-income OECD countries. Among them, 37 OIC countries are covered.

Selected questions are presented in the first and second rows of the table. The row for OIC countries means the percentage of OIC countries that replied yes to the questions (for Y/N questions), or means the average value for OIC countries. The same calculation applied to the groups of developing countries, OIC-GCC, and low incoming countries. OIC-GCC means OIC countries excluding the GCC countries covered by the CGAP database.

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