

Integrating Waqf via Microfinance to Alleviate Poverty in Malaysia

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ABSTRACT

Waqf is known as philanthropic or endowed institution that has played a significant role throughout Islamic history beginning from the time of the Prophet Muhammad s.a.w until the end of Ottoman Empire in 19th century. As an Islamic endowment institution, waqf has successfully contributed in providing good public utilities, health care, education and other aspects of socio economic development of the ummah (Muslim society). However after the collapse of Ottoman Empire, waqf seems to losing its power to serve the ummah. In Malaysia the institution of waqf still plays its role even though it is not as prominent during the period of Ottoman Empire. Besides waqf, micro financing or micro credit also plays a significant role in poverty alleviation programs. It is proven that micro credit is highly demanded and able to help "un banked" people to live out of poverty. One such example can be found in the practice of Grameen Bank in Bangladesh which gives small credit to the poor to start a business. This study aims to integrate the waqf into micro finance in alleviating poverty in Malaysia and their challenges. Recommendations on modes of financing under the waqf based micro finance will be suggested at the end of study in order to improve the way it serves the ummah.

Keywords: *waqf, micro financing, poverty alleviation*

Introduction

In Muslim world *waqf* is known as an endowment institution providing services similar to what modern states are offering today such as public utilities. Even though there are no specific or direct verses in the Quran mentioning about *waqf*, the practice however is inspired by Islamic enjoinder of doing good deeds and charity such as *sadaqah* as a way of devotion to God. Besides, the importance of *waqf* is also deduced from the prophetic tradition regarding charity and good deeds. A.M Sadeq (2005) demonstrates the importance of the institution of *waqf* in Islamic economic that plays a significant role along the Islamic history, especially in the time of Ottoman Caliphate.

Linguistically, *waqf* is an Arabic word from a verb *waqafa* which means to stop, contain or preserve. In Islamic term *waqf* refers to a religious endowment such as building mosque, school, public utilities and etc. which are used for the benefits of the *ummah*. The Islamic history has recorded, from the time of the Prophet Muhammad SAW until the end of Ottoman era, highs and lows of the practice of *waqf*. There were several factors accounted in explaining the above situations and the secular way of life is believed to be one of the contributing factors. This happened as a result of separating religion and life. Other reasons were lacking in development and management of *waqf* due to oppression, as well as biased policies imposed during colonization in almost all Muslim countries. As a result, the important roles of *Waqf* on socio economic development and poverty alleviation of the *ummah* appear to be neglected by the Muslims.

However, nowadays efforts have been undertaken by scholars and practitioners in order to put the *Waqf* institution back into practice. This is through developing some modern instruments for *Waqf* such as cash *Waqf* and *Waqf* bonds. Therefore in this studies, the major focus will be emphasized on the prospects and challenges in integrating *waqf* as a philanthropic endowment institution and micro financing for poverty alleviation. *Waqf* is seen as an effective tool for socio economic development of the *ummah* for several decades and micro finance also has proven success in giving financial services to the poor who are excluded from conventional financial institutions.

According to A.M Sadeq (1995), the concept of poverty alleviation basically is one of the primary goals of Islam together with the socio economic justice and equitable distribution of income. Through several research

and studies carried out previously, micro finance is engaged with conventional financial institution which involved with high interest rate charge to the borrower or customers. This has become burdensome to the borrowers to pay back the amount borrowed. Besides, conventional micro finance is also against the Islamic law and non shariah compliance which makes it being rejected by the Muslims.

However, it is undeniable that the concept of micro finances is still contributing large in reaching the poor through providing finance and increasing their income and wealth. Perhaps, it would be our responsible to change the structure of micro finance and make it in line with the shariah requirements. The big potential of Islamic micro finance would then best to be combined with *waqf* as it is also proven as prominent modes of financing during the time of Prophet s.a.w.

In integrating *waqf* based micro finance, several modes of financial instruments can be applied. According to M. Kabir Hassan (2010), the Islamic system engages with three categories of financing modes, among which participatory mechanisms can be relevant for Islamic microfinance, which are Non-Profit And Loss Sharing Modes (eg. Qard al Hasanah, Bai' muajjal, Bai' salam, Ijara wa iqtina, murabah and Jo'alah) and Profit And Loss Sharing Modes (eg. Mudarabah, musharakah, musaqat, muzar'ah and direct investment).

The most important aspect to be discussed in this study is integrating of *waqf* into microfinance and their challenges in alleviating poverty. This paper attempts to look into possibilities for endowment institution such as *waqf* to help the socio economic development of the *Ummah* and integrate with micro financing as a tool for poverty alleviation while at the same time to ensure participation of every Muslim in the spirit of Islamic charity.

Literature Review

Poverty Alleviation/ Eradication from Islamic Perspective

Poverty has been a part of society for a long time. Efforts in finding ways and means to improve the living conditions of the poor in the community are part of poverty alleviation. The economic environment, cultural backgrounds as well as social responsibility awareness play a role in poverty reduction efforts.

“And hold firmly to the rope of Allah all together and do not become divided. Remember the favour of Allah upon you when you were enemies and He brought your hearts together and you became brothers. You were on the edge of a pit of the Fire, He saved you from it. Thus Allah makes it clear to you His verses that you may be guided” (Quran, 3:103)

Apart from needing aid for the underprivileged society, funds are required for mosques, education institutions, and senior citizens, victims of abuse, orphans, rehabilitation centers and health care among others. At the same time, the beneficiaries of zakah are limited; therefore the community depends on voluntary donations and fund-raising efforts for financial support.

We need to willingly come to aid other beings in need and, take care of the financial needs of the less privileged through *waqf* microfinance. This paper discusses readings of *waqf* and how its system is used to ensure distributive justice in society and eradicate economic inequalities to eliminate poverty.

Waqf as a Tool for Poverty Alleviation

Qahaf (2005) explains that *waqf* is a holding property, used to benefit the public. It can be a permanent or a temporary process as long as it is utilized towards the intention of helping the underprivileged.

There are two dimensions to *waqf*; religious and social economics. Religious dimension is where *waqf* is seen as an obligation to Allah. Social dimension reflects mutual cooperation between the wealth distributor and the needy, without the government intervention. Kahf (2007) claims that before the 20th century the cash *waqf* allocation was made priority to manage the mosques. Then the next set of allocation would be for the

education sector that included teachers' salary and books. The remaining of the allocation was for the needy, orphans and the rest was for the hospitals.

Mannan (2001) says that it is possible to allocate the *waqf* funds to fund public facilities like construction of bridges, purchase of public transportation. The funds could also be allocated for private-owned projects which are meant for public use. It all depends on the priority of the *waqf* allocation, if they are for a good cause, enable for public use and can redistribute income, then the *waqf* has served its function.

However, Masyita (2003) sees the allocation of *waqf* funds as means for five sectors: the poor, education and culture, victims of natural disaster, social service, health and cleanliness. To a certain extent, it is agreed that this distribution will result in poverty alleviation, if managed responsibly. Also, the funds can yield double or triple for the prosperity of society, hence hold the economic implications.

"It is not far-fetched to surmise that the role of *waqf* is likely to increase in countries with Muslim minorities but not in countries where the majority of the population is Muslim. The reason for a more active role for *waqf* in the former lies in the realization that, with a state which is at best indifferent to their religion and to many of their special socio-economic needs, they have to use *waqf* for the fulfillment of these needs and for the protection and promotion of Islam." (Siddiqi 1996)

Since *waqf* enhances the socio-economic welfare of a society, its contributions to Muslim communities must not be misjudged.

Integration of Islamic Microfinance into Waqf

Since the early 90s, the emergence of microfinance has attracted the attention of various parties including the government, bankers, academicians and researchers. This revolution in finance for alleviating poverty across the globe is attributed to the mechanism used particularly the group-based lending scheme that allows the poor to access to financial services previously denied.

According to Ahmed (2004), the Islamic models of micro financing use the strengths of the conventional micro financing institutions (MFIs) and adapt the operations into Islamic principles. This Islamic micro financing use the group-lending and weekly collections of dues to resolve the credit risk problem. Khan (2005) also supports the significance of microfinance from the Islamic perspective. With the large inflow of capital into the Islamic banking sectors, Islamic micro-financiers alleviate poverty with sustainable, replicable, and inexpensive transactions, without the risks and costs associated with conventional microfinance.

Although Islamic micro financing has been slowly developing, it is gaining recognition globally due to its innovative interest-free system and greater flexibility where risks and rewards are shared based on equity. There is a need to clarify the interest-free system where Islamic micro financing is concerned. While interest is prohibited in Islam, there is no objection if return on capital is gained based on a partnership with an entrepreneur and the risks of the business are shared (Khan, 2005). The partnerships would be based on the emotional, technical and financial supports given to each other.

Furthermore, Gustina and Hidayatul (2010) also state that *waqf* fund can be used as one of the external sources for microfinance. Thus, this integration is expected to be mutualism as certain portions of profit generated from that fund will be distributed back to the beneficiaries of *waqf*. In addition it could also encourage the *waqf* institution to manage the fund efficiently.

The main aim of this *waqf* using Islamic microfinance is to look at how this mechanism will help the poor micro-entrepreneurs. Moreover, the *waqf* fund may be used as investable fund in providing capital investment and working capital financial for the micro-businesses, by (M.Kabir Hassan, 2010). 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, apart from interest free loan (*qardal-hasan*), the Islamic contract can be broadly classified as partnership and contract of exchange. One example of applicable partnership/contract is *mudarabah* where the financial institution or *waqf* institutions itself provide working capital to the borrower as a micro credit financing in order to help them start a business. Three features distinguish microfinance from other formal financial products. "These are: first, the smallness of loans advanced and or savings collected, second, the absence of asset-based collateral and third, simplicity of operations". (*Microfinance Policy, Regulatory and Supervisory Framework for Nigeria, 2005*).

Integrating *Waqf* Based Microfinance for Poverty Alleviation - Challenges

The concept of *waqf*-based micro financing can be used today to serve the social objectives in the society. Cizakza (2004) suggests that one use of *waqf* is to provide microfinance to the poor. Kahf (2004) and Ahmed (2003) suggest that the returns from *waqf* funds can be used to finance other smaller enterprises as a subsidy. Therefore, not only the poor benefits from *waqf* based microfinance, but also for startup entrepreneurs who are in need of capital investment assistance.

Adopting *waqf* microfinance would mean to reduce global poverty. At the same time, it enhances the profile of underprivileged communities (Hossain 2001). The application of Islamic finance to microfinance was first discussed in depth by Rahul and Sapcanin (1998). They demonstrated that Islamic banking, with its emphasis on risk sharing and, for certain products and collateral-free loans, was compatible with the needs of some micro-entrepreneurs.

According to Dr. Abbas Mirakhor, Executive Director of the IMF as referred by Chaudhri (2006): "[An] important function of Islamic finance that is seldom noted ... is the ability of Islamic finance to provide the vehicle for financial and economic empowerment ... to convert dead capital into income generating assets to financially and economically empower the poor..." Microfinance is already more structurally aligned to applying Islamic equity financing structures. As mentioned previously, microfinance programs are based on group sharing of risk and personal guarantee while maintenance of trust and honesty is tied to the availability of future funds (Chaudhri, 2006).

The application of integrating this instrument has many challenges which are:

1. Payment Systems

The transferring of money among participating financial institution like banks is possible through payment systems.

The effectiveness of a functioning financial system very much relies on the safety, efficiency and reliability of payment systems. Although with that being said, most Islamic MFIs or their conventional counterparts do not possess these features.

Systems for example electronic funds and real time gross settlement system are found out to be carried out only in some of the top Islamic banks. Meanwhile, the smaller microfinance institutions based on the less fortunate ones are in no position to gain access to systems as such.

2. Transparency and Information Infrastructure

The widespread availability of relevant, accurate, timely and comparable information about the performance of financial institutions is the core definition of financial transparency. Funders are basically attracted to transparency. The fact that transparency offers accurate and standardized information, private investors and public donors are encouraged to make informed funding choices. Plus, it keeps the clients well informed, thus leading to a very competitive atmosphere among financial service providers for they gain knowledge and comparison shop among their options.

Transparency and its advantages relies on the availability of a suite of related services and tools, varying from trustworthy information software to top quality auditors and rating agencies, to acknowledge bureaus that attracts clients' credit background. However, these services are hardly available for Islamic microfinance institutions.

3. Education and Training

The lack of education and training among clients and organizations personnel pose a huge setback for the Islamic microfinance sector. The biggest constraint for its growth, expansion and consolidation is the lack of trained manpower. Currently, only a handful of resources centres are available; and less training programmes in the first language. Therefore, the immediate need for resources centres development and training material in the first language is understandable.

4. Networking

Another challenge that poses a setback for this issue is the lack of effective networking. Networks are crucial especially for activities that cannot operate individually but collectively due to economies of scale and scope- for example, making the first attempt on legal frameworks, regulations and taxes; forming and keeping the information on an up to date basis; carrying out training programs and so on. There is no apex coordinating body in the Islamic world including in the area of Islamic microfinance but there are 43, few regional networks. Their numbers are however comparatively small to the size of the Islamic world and there is a little coordination between them which consequently results in ineffectiveness and duplication.

Recommendations

If the financial services are made accessible to the public, it can be involved in the development process and perhaps gain from it. Islamic finance enables financial services to be suitable for the big part of world population. Unfortunately, even with all the developments being made to each sector of the Islamic financial services industry, Islamic microfinance institutions do not offer many options in terms of presence and outreach. To enhance the reach and richness of Islamic microfinance, it is crucial to analyse the big challenges facing this segment as a whole and perhaps gauge in partnership with many stakeholders strategic solutions to take on the challenge from a different angle.

The ultimate aim of the current document is to develop a guideline for organized dialogue and help in the formation of practical policies encouraging the delivery of a multiple range of financial services that are widely available, client responsive, reasonably priced and Shariah compliant. Credit is not limited to products and services only but also to savings, cash transfers and insurance.

As Islamic financing modes are based on profit-and-loss sharing principles, there will not be any fixed interest payment burden for the borrowers. All these factors will lead to lower default rates and graduation from poverty will be higher. The proposed Islamic micro-financing modes will yield more benefits towards the overall social welfare.

To develop an institutionally, financial sustainability, microfinance industry that incorporates cultural respect and religious sensitiveness towards the Muslim society is the general aim of this strategy. It takes on the view that Islamic microfinance is the key to alleviate poverty and develop socioeconomic in the Muslim society.

Intensive efforts are required to ensure the effectiveness of a strategy for microfinance development. This would very much demand effort from all stakeholders-the less fortunate, the cooperatives/NGOs, the Islamic banks, the awqaf/zakah funds, the apex bodies, IsDB and IsDB-sponsored institutions as well as the government agencies, such as Ministries of Finance, Cooperation, the monetary authority and the capital market authority to enhance the awareness towards how waqf can help the betterment of ummah development.

Non-profit organizations should have linkages with Islamic banks so that the poor can be reached, and microfinance can be recognized and lastly the government agencies such as Ministries of Finance, Cooperation, the monetary authority and the capital market authority are strongly advised to create encouraging policy and a dynamic environment alongside supportive infrastructure.

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