



# ISLAMIC FINANCE SUPPORTS SOCIO-ECONOMIC DEVELOPMENT

The financial sector plays a critical role in the socio-economic development of any country. Of importance, Islamic finance was designed as a just and ethical financial system, supporting the efficient allocation of resources both for wealth creation purposes, as well as the betterment of society. Islamic finance is expected to further enhance socio-economic well-being in countries in which it operates, both through supporting the financial needs of households and businesses in a Shariah-compliant manner; as well as through additional support via zakat, waqf and Islamic microfinance.

**MALAYSIA**

WORLD'S ISLAMIC FINANCE  
MARKETPLACE

## Role of IFIs in Socio Economic Development

Today, the global economy is facing modest economic growth, amid heightened uncertainty and volatile financial markets. The International Monetary Fund (IMF) has recently revised down its global growth forecast for 2015, from 3.5% to 3.3% (2014: 3.4%)<sup>1</sup>. Recent developments warranting a lower growth expectation include weaker-than-expected first quarter growth figures, a rebound in oil prices and a rise in bond yields. Against this backdrop, the financial markets are consequently anticipated to remain in a state of heightened volatility during this year.

These cyclical developments in the global economy are expected to affect the wealth of households, as incomes are affected by slower growth. Nevertheless, a longer-term issue affecting the socio-economic development of households is the distribution of income and wealth. It has been found that lack of financial inclusion corresponds to income inequality and slower economic growth.<sup>2</sup> Hence, in line with the main aims of Islam, socio-

economic justice which has generally been known as critical in achieving financial inclusion is one of the main features of the Islamic financial system that should be given extra deliberation. It is noteworthy to inform that Islamic finance along with consequent product innovation has boosted Islamic financial institutions (IFIs) ability to serve the economy through Shariah-compliant instruments.

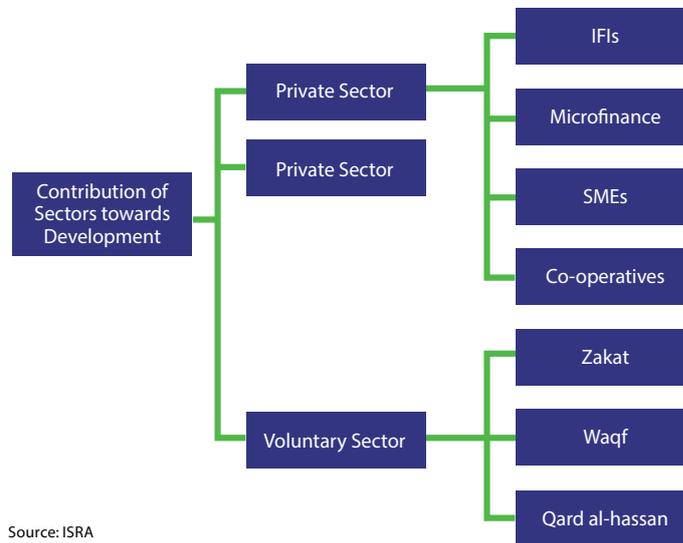
Nevertheless, both the growth of the IFIs and the expansions of the modes of financing can be further enhanced to maximize its impact on the lives of the both Muslim and non-Muslim individuals in key Islamic finance jurisdictions simultaneously achieving the socio-economic goals.<sup>3</sup> Various socio-economic instruments that IFIs can further tap into includes zakat, waqf and qard al-hassan alongside financial instruments that are designed to provide financial assistance to the poor such as Shariah-compliant microfinance and small and medium enterprises (SMEs).

<sup>1</sup> "World Economic Outlook", IMF (July 2015)

<sup>2</sup> "A Big Step Forward for Bolstering Financial Inclusion", IMF direct, The International Monetary Fund's global economy forum (28th January 2015)

<sup>3</sup> "Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Finance: Examining the Overpowering of HomoIslamicus by Homoeconomicus", Asutay, M. (2007)

**Socio-Economic Development by Sectors**



Source: ISRA

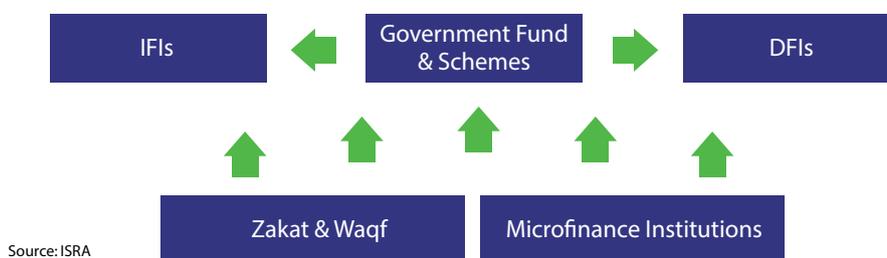
**Micro-Small Medium Enterprises (MSMEs) and Small-Medium Enterprises (SMEs)**

IFIs have taken steps to support both MSMEs and SMEs, which are designed to provide opportunity to the poor, as part of achieving the IFIs socio-economic agenda. However from the perspective of both the MSMEs and SMEs, they may somehow find it tedious to obtain funding or financing from IFIs due to various factors such as weak credit rating, lack of collateral, negligent financial record-keeping

or lack of documentations that are required by most formal financial institutions. But recognizing the importance of both MSMEs and SMEs to the economy, the available gaps shall be addressed with financial institutions (IFIs and development financial institutions (DFIs) becoming the bridging link between the MSMEs and SMEs and government funds, guarantees, schemes and etc. Other sources of financing for the MSMEs and SMEs also include zakat and waqf-based microfinance institutions.

**Linkages between Financial Institutions and both MSMEs & SMEs**

**FINANCIAL LANDSCAPE FOR MSMEs & SMEs**

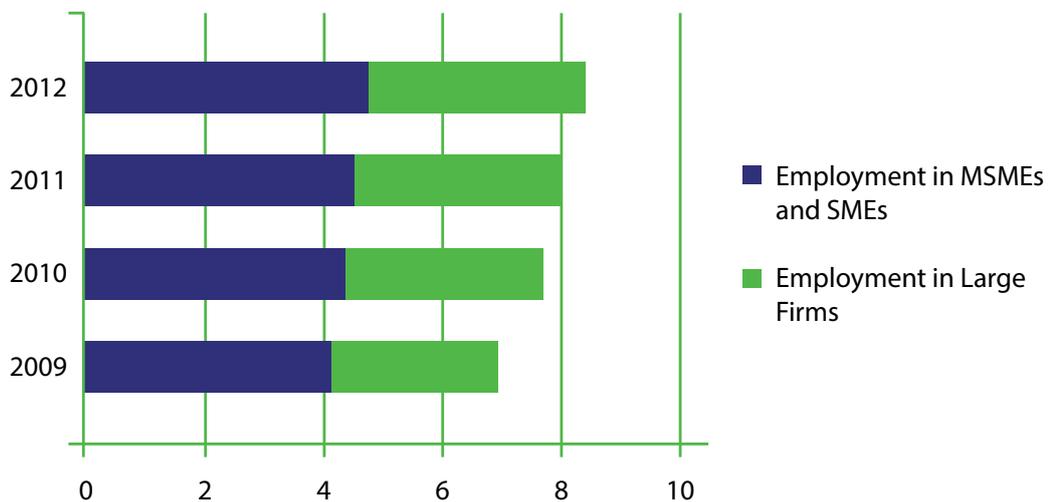


Source: ISRA

In Malaysia, both the MSMEs and SMEs are central to the country's economy development, as it employs more workers as compared to large firms.<sup>4</sup> In 2009, MSMEs and SMEs absorbed approximately 4.1 mln workers, whereas large firms absorbed approximately 2.8 mln workers only. Even though

growth rate of MSMEs & SMEs are lower than large firms for year 2010, it picked up its pace in 2011 and 2012, ahead of large firms. In 2012, MSMEs and SMEs absorbed approximately 4.8 mln workers, whilst large firms absorbed approximately 3.6 mln workers.

**Employment in MSMEs & SMEs and Large Firms (million)**

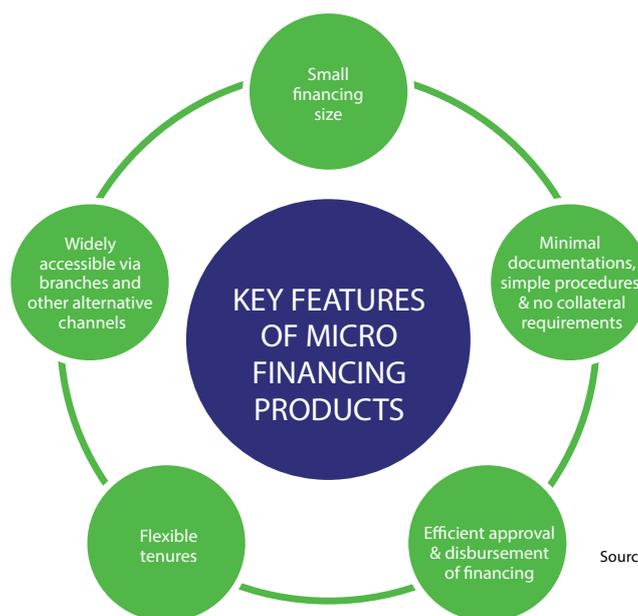


Source: Malaysia Islamic Finance Report 2015

Acknowledging the importance of MSMEs & SMEs, there has been considerable progress in Malaysian Islamic financial institutions (IFIs) in providing service to these types of enterprises. For example, Bank Pertanian Malaysia Berhad (Agrobank), which became a full-fledged Islamic bank this year, had allocated approximately USD63 mln for this year's micro financing activities. Moving to CIMB Islamic, the Bank

plans to start offering microloans this year to further complete its missing piece in becoming a universal bank.<sup>5</sup> And apart from the above, other IFIs in Malaysia that offer Islamic microfinance programmes include Bank Simpanan Malaysia (BSN), Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat) and EONCAP Islamic Bank.<sup>6</sup>

**Key Features of Micro financing Products**



Source: Nawaj, N. and Mohd Shariff, M.N. (2011)

<sup>5</sup> "CIMB Plans Microloans After Malaysian Megabank Deal Flops", Bloomberg Business (January 2015)

<sup>6</sup> "Financial Inclusion: The future of a sustainable economy", Islamic Finance News (May 2015, Volume 12, Issue 19)

Moving to Indonesia, there are various MSMEs & SMEs programmes presently offered by IFIs. For example, in 2010, due to the demand, PT Bank Syariah Mandiri has added its branches in Indonesian states such as Java and Sumatera to further offer its Shariah compliant micro financing loans.<sup>7</sup> The demand is due to the fact that more than 90 percent of Indonesia's approximate 50 mln small businessmen are not able to have access to regular bank financing.<sup>8</sup> Apart from PT Bank Syariah Mandiri, Bank Rakyat Indonesia (BRI) Syariah were also expected to triple its loans to micro, small and medium businesses in 2011.<sup>9</sup>

Elsewhere in the MENA region, a Yemeni-based Al-Amal Microfinance Bank has recently been awarded first place for the Localization Award from the GCC Council of Ministers of Labour and Social Affairs.<sup>10</sup> Officially started its operations in January 2009<sup>11</sup>, it is the first microfinance bank in the MENA region to offer only Shariah-compliant products. It is established with the purpose of improving the economic and social conditions of the Yemeni low/limited income households, especially those of MSMEs and SMEs by providing outstanding financial services. By end of

### **Voluntary Sectors Fulfills the Social Agenda of IFIs**

Apart from the above, voluntary sectors such as zakat and waqf are also essential tools towards achieving socio-economic development. If properly implemented, it can play a major role towards unemployment and poverty eradication, eventually contributing towards the socio-economic progress of the Muslim communities. Through proper distribution among the recipients of zakat, each and every individual can then be assured of a minimum standard of living.<sup>16</sup> In relation to corporate zakat in Malaysia, Malaysian Accounting Standard Board (MASB) has released zakat accounting for IFIs called the "Financial Reporting Standard: Presentation of Financial Statements of IFIs" (FRS i-1). The standard focuses on presenting an IFI's financial statements that pays zakat which includes the definition of zakat, the provision of

2013, the Bank has a gross loan portfolio of USD8.9 mln, deposits of USD13.5 mln, and assets of USD46.1 mln.<sup>12</sup> The total number of depositors are 53, 375 whilst the total number of active borrowers are 34, 366.

Nevertheless unlike the somehow positive response of MSMEs and SMEs in both Malaysia and Indonesia as highlighted above, similar sentiment has not been properly echoed in the MENA region. Instead, the microfinance sector in the region is still small where the microcredit accounts for only 0.2% of the region's GDP.<sup>13</sup> While Morocco and Egypt have the highest number of MFIs, the microcredit loans remain nascent at less than 1% of the total bank credit in Morocco. Broadly, the growth of microfinance in the MENA region needs to be supported by further improvements to the regulatory infrastructure. At present, MFIs face some constraints in accepting deposits in many of the region's markets, amidst underdeveloped financial infrastructure, and low levels of financial literacy among potential beneficiaries.<sup>14</sup> It is noteworthy to inform that in total, there were 255 Islamic microfinance institutions around the world in 2013, with total outstanding loans of \$628 mln.<sup>15</sup>

zakat as part of other liabilities and highlighting the needs for IFIs to disclose their zakat obligations.<sup>17</sup> IFIs in key Islamic finance jurisdiction such as Malaysia have thus far played its role towards the fulfilment of zakat. Bank Islam Malaysia Berhad (BIMB), Malaysia's maiden Shariah-based institution has expanded its zakat services through online.<sup>18</sup> BIMB will be collaborating with the state's zakat collection centre to provide this service to the state. Apart from BIMB, Maybank Islamic also offers online zakat services. It is hoped that through this service, this will further help both the IFIs and the Muslim society to fulfil their obligations and create greater awareness on the importance of zakat towards achieving the community social agenda. In Malaysia, the average figures for distribution of zakat among the recipients presents a stable scenario,

<sup>7</sup> Microfinance Dominates Indonesian Shariah Loans: Islamic Finance", Bloomberg Business (November 2010)

<sup>8</sup> "Microfinance Dominates Indonesian Shariah Loans: Islamic Finance", Bloomberg Business (November 2010)

<sup>9</sup> "Microfinance Dominates Indonesian Shariah Loans: Islamic Finance", Bloomberg Business (November 2010)

<sup>10</sup> www.alamalbank.com

<sup>11</sup> Grameen-Jameel Microfinance Ltd.

<sup>12</sup> http://www.mixmarket.org/mfi/al-amal-bank

<sup>13</sup> World Bank MENA Financial Sector Flagship Report

<sup>14</sup> "Voices and Views: Middle East and North Africa", The World Bank (August 2013)

<sup>15</sup> "CIMB Plans Microloans After Malaysian Megabank Deal Flops", Bloomberg Business (January 2015)

<sup>16</sup> www.ikim.gov.my

<sup>17</sup> Malaysia Islamic Finance Report 2015

<sup>18</sup> www.bankislam.com.my

where around 40% of the total zakat is channelled to the poor and needy.<sup>19</sup> In addition, the zakat distribution and collection have also grown consistently over the years, where the distribution of zakat as a percentage of collection is 80% on average over time, and has further improved to approximately 85% over the last five years.<sup>20</sup>

Moving to waqf, it is a type of institution that creates a sustainable entity, administered by the essential principles of perpetuity, inalienability and irrevocability. It is widely known that through proper management of waqf, the existing gap between contemporary Islamic finance and its socioeconomic aspects can therefore be addressed. Through the creation of community assets, the institution of waqf has the potential to create robust not-for-profit entities that may address education, healthcare, and other social needs in the Muslim societies, thus unlocking both its economic potentials and philanthropic objectives. IFIs in key Islamic finance jurisdiction such as the GCC have accordingly played its role towards waqf development. For example, the Central Bank of Bahrain and the IFIs together established the waqf fund in 2006, proceeds from which were allocated to finance training, education and research at various levels in the Islamic finance

## Conclusion

The financial sector plays a critical role in the socio-economic development of any country. Of importance, Islamic finance was designed as a just and ethical financial system, supporting the efficient allocation of resources both for wealth creation purposes, as well as the betterment of society. In this regard, IFIs have a dual role to play: (1) by facilitating the effective mobilisation and allocation of savings, and; (2) by leveraging on redistributive mechanisms available in Islamic finance, such as waqf and zakat. To date, encouraging developments have been made in key Islamic finance jurisdictions such as Malaysia, Bahrain, Dubai, Saudi Arabia, Indonesia and Yemen on the involvement of IFIs towards achieving socio-economic goals through creating opportunities for the MSMEs and SMEs, appropriate corporate zakat payment

industry.<sup>21</sup> In 2007, both DIFC Investments and Dubai Islamic Bank (DIB) established 'Waqf Trust Services' – the first Islamic trust services provider in the world offering Shariah-compliant services exclusively.<sup>22</sup> Waqf Trust Services offers a diverse array of trust services for both corporate and individual clients, primarily encompassing the provision of tools to assist clients in the protection of assets, succession planning and the preservation of family wealth. The Jeddah based Islamic Development Bank (IDB) established the World Waqf Foundation (WWF) in 2001 in collaboration with waqf organizations, governmental organizations, NGOs and philanthropists from the private sector with an aim to promote awqaf to contribute to the social and economic development of member countries and Muslim communities and to alleviate poverty.<sup>23</sup> For instance, recently, the 304th meeting of the Board of Executive Directors of the Islamic Development Bank (IDB), held in Jeddah, has approved three grants for a total of USD540, 000 under the IDB Waqf Fund for educational projects for Muslim communities in Australia, Germany and India.<sup>24</sup> Elsewhere, realizing the solid potential of mobilizing waqf for the development and progress of the socioeconomic Muslim society has also inspired Islami Bank Bangladeshi Limited (IBBL) to establish the cash waqf certificate in 1997.<sup>25</sup>

method, enhancement of the waqf sectors, and etc.

Nonetheless, Islamic finance being at a fairly embryonic stage, further progress can still be made to support the achievement of these goals. Going forward, the growth prospects of Islamic finance is expected to remain bright, which is expected to benefit socio-economic welfare developments in key Islamic finance jurisdictions. As such, Islamic finance is expected to further enhance socio-economic well-being in countries in which it operates, both through supporting the financial needs of households and businesses in a Shariah-compliant manner; as well as through additional support via zakat, waqf and Islamic microfinance.

<sup>19</sup> Malaysia Islamic Finance Report 2015

<sup>20</sup> Malaysia Islamic Finance Report 2015

<sup>21</sup> "Waqf Can Be Financing Source For Wealth Distribution: Perak Regent", Bernama (November 2014)

<sup>22</sup> <http://www.difc.ae>

<sup>23</sup> <http://www.idbgbf.org>

<sup>24</sup> Thomson Reuters Zawya

<sup>25</sup> Banking Model of Corporate Waqf: An Analysis of Wakaf Selangor Muamalat

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