

## Zakat and Microfinance

Rahana Abdul Rahman<sup>1</sup>, Mohamad Faizal Kamarudin<sup>1</sup>, Chamhuri Siwar<sup>2</sup>, Abdul Ghafar Ismail<sup>3</sup>,  
Hasan Bahrom<sup>4</sup>, Mohammad Mahyuddin Khalid<sup>4</sup>

<sup>1</sup> Business Management, Universiti Teknologi MARA, 40450 Shah Alam, Selangor D. E., Malaysia

<sup>2</sup> Institute for Environment and Development (LESTARI), University Kebangsaan Malaysia, Bangi 43600, Kajang, Selangor D. E., Malaysia

<sup>3</sup> Economics and Management, University Kebangsaan Malaysia, Bangi 43600, Kajang, Selangor D. E., Malaysia

<sup>4</sup> Institut Kajian Zakat Malaysia (IKaZ), Universiti Teknologi MARA, 40450 Shah Alam, Selangor D. E., Malaysia

**Abstract.** Microfinance achievements in poverty reduction, education improvement of the children of the poor, and creation millions of small businesses by becoming economically independent have been recorded around the globe. Recognition on its bold formalization and shifting from a grass-roots paradigm into inclusion in financial system paradigm were stated in MDG's 2020 Vision and 2006 Nobel Peace Prize to Mohammad Yunus and the Grameen Bank (Bangladesh). In case of Malaysia, Amanah Ikhtiar Malaysia (AIM), the most dominant and successful MFI in Malaysia, other than produced positive impacts to the borrowers, also managed to put itself highly competitive comparatively with other MFIs. In order to ensure its mission in the future, AIM's needs to secure its continuous access to financial sources both, at home and/or abroad. The objective of this paper is to provide a conceptual framework on how to channel Zakat to the poor through microfinance.

**Keywords:** Zakat, Microfinance.

### 1. Introduction

Poverty is a complex and inconclusive multi-dimensional phenomenon varies from the notion of income to social, economic and political deprivations perspective. Climbing out from poverty trap require creation of sustainable income for socio-economics improvements. The recognition of microfinance institutions (MFIs) importance was stated in MDG's 2020 Vision while its success is being highlight by 2006 Nobel Peace Prize Award winner, Mohammad Yunus and the Grameen Bank (Bangladesh). Amanah Ikhtiar Malaysia (AIM) records *positive impacts to the poor (the borrowers) and high FSS performance*. Until 31 October 2012, AIM has 325, 477 members, 123 branches and monitored by 2115 staffs. Total capital disbursed was RM7.89 billion with repayment rate around 99.35% while total zakat collection in Malaysia was RM1.3 billion. With appropriate framework, AIM be able of add it funding sources and depth of outreach (Norma, 2011; Rahana et al; 2011). The objective of this paper is to provide a conceptual framework on how to channel *zakat* collection to the poor through microfinance, by maintaining the characteristics of MFI and *zakat* itself. This paper, through structuring a multiplier effect model of microfinance, explains its sustainable expansion in poverty reduction in Malaysia. It also provides a friendly platform for academic and application professionals from crossing fields to communication together.

### 2. Islamic Financial and Banking (IFB)

#### 2.1. Development, Expansion and Acceptance

The development, expansion and acceptance of Islamic Financial and Banking (IFB) are strongly related to the issue prohibition of *riba'* and alternative system toward conventional banking system, whereby differences lies in term of operations, philosophy, principles and objectives of the system (Ziauddin 1991). IFB solve issues such as exploitation of the poor welfare, unproductive wealth accumulation by lenders, and efficiency and optimalization of resources allocation using the Profit and Loss Sharing (PLS) method. (Az-

Zuhayli, 2006; Qureshi, 1991; Siddiqui, 2001; Abdul, 2007). High repayment rate, low moral hazard and adverse selection problems (for ex-ante and ex-post) and global standard assessments make MFIs not only as an alternative investment in portfolio diversification<sup>1</sup> (Gibbons and Kassim 1990; De Aghion and Morduch 2005; Stiglitz, 1990; Abdul, 2007), but also sustainable means for poverty reduction. (Murdoch 1999; Ahmed, 2002; Nasim, 2006).

## 2.2. Development, Expansion And Sustainability of Amanah Ikhtiar Malaysia (AIM)

Amanah Ikhtiar Malaysia (AIM) was started as a Projek Ikhtiar in 1986 by Universiti Sains Malaysia (USM), focused on the application of Grameen model. AIM established via the AIM Deed of Trust, and registered under 1954 Trustees Act (Incorporation) (amendment 1981) Act 258 on 17<sup>th</sup> September 1987. Modifications were made to cater the needs and the culture of the poor in Malaysia. The main objective is to reduce poverty among the poor and poorest household in Malaysia by funding, facilitating and provide appropriate guide/training to borrowers (known as *Sahabats*). AIM vision is to be a progressive, dynamic and world-class micro-credit institution in eradicating national poverty and uplift society's well-being. Three main products of AIM are Capital Financing (main product), Compulsory Saving and Members Welfare and Well-being Fund (Mamun et al, 2010; Norma, 2010).

For best practice purposes, AIM received MS ISO 9001:2000, certified by SIRIM QAS International on 28 August 2009 through Micro-Credit Funding Management. AIM also signed an MOU with Malaysian Institute of Microelectronic Systems (MIMOS Bhd) for the development of intergrated microcredit accounts and transactions system. For Syariah Compliance purposes, AIM has reactivate it's Syariah Committe (lead by Dato' Hasan L. Din Al-Hafiz). A close-monitor of the Key Performance Index (KPI) and Sahabat Satisfaction Index (IPS) since 2009, and the introduction of new method of Ijab Qabul (IQC) and Cash Payment beginning 2010. (EPU, 2009; Conroy, 2003)

AIM successfully maintains its repayment rate had around 95% since 1988 and 99.36% in 31 October 2012. The outreach of AIM's loan programme grown exponentially from 3415 in 1990 to 325,477 in 2010, growth of 9431 % for the year 1990-2010. AIM produced increasing total households income, shifting of Sahabats' economic status (lowest to the better-off), increasing diversification sources of income, better survival skills and wider influence of non-monetary aspects (4<sup>th</sup> IS, pg 318)<sup>2</sup>. From FIB perspective, AIM increased institution ability to mobilize external funds and saving; the inclusion elements of *zakat*, *sadeqah* and *waqaf*; maximize social services of the clients; and efficient application of Profit and Loan Sharing (PLS) schemes. Various Islamic instruments under the Islamic MFI for the poor effectively used such as *mudarabah* and *musharakah* for the microentrepreneurs (Ahmed, 2002; Abdul Rahim, 2007).

## 2.3. Zakat and Aim

*Zakat*, the third of the five basic pillars of Islamic faith, is a levy normally at the rate of 2.5% charged on certain types of wealth such as business wealth, personal income etc to those only the Muslims who own the wealth beyond the minimum limit. The poor's weakness, vulnerability and scarcity (capital and knowledge) make them exist persistently in current vicious circle of poverty (Nasim, 2006; Khan, 2008; Hassan, 2010; Ismail and Bayu, 2013). Abdul Hakim Amir (2007) found that the estimated collection of Zakat in the end 2010 was RM 5.5 billion (see Table 1) while a study conducted by AIM in 2007 found that there are still 244,877 potential borrowers uncater by AIM (see Table 2)<sup>3</sup>.

<sup>1</sup> MFIs' method of lending including disbursement of small size loan, flexible terms and condition, and consistent monitoring.

<sup>2</sup> Increase average income for "three-time borrowers" at RM 670, RM 609 for "two-times borrowers" and RM 325 among the "single loan borrowers". (4<sup>th</sup> IS, pg 198). Cost-benefit analysis of 1989/90 that stood at 1:10 (for every RM spent on operation, a RM 10 in monetary benefit could be derived) while in 1994/1995 was at 1:115 times five years later (4<sup>th</sup> IS, pg 318).

<sup>3</sup> Furthermore, the data on potential outreach of AIM based on housing index shows that there are about 162,795 respondents whose housing index are considered as B or "bad /buruk" (Table 2). With an 80 percent of them having the potential to qualify for AIM programmes, it is estimated that 130,236 respondents could be outreached. However, AIM's record shows that 117170 members of this category have been outreached, leaving a potential gap of 45,625 respondents that could be outreached or a potential gap of 28 percent. If, the marginal poor are considered, consisting of S1 and S2 categories with 50 percent and 20 percent to be outreached respectively, the total potential gap could reach 244877 respondents or 53 percent [Total (C) = Total (A) – Total (B)].

Table 1: Collection of Zakat in Malaysia, 2007-2010

Year	Collection of Income (RM bill)	Collection of Business (RM mill)	Collection of - Others (RM mill)	Collection of Property (RM bill )	TOTAL (RM bill)
2007	1.068	958.08	359.28	2.385	4.771
2008	1.117	997.74	383.37	2.498	4.997
2009	1.169	1,039.04	409.13	2.617	5.235
2010	1.223	1,082.05	436.67	2.742	5.485

Source: Abdul Hakim Amir (2007)

Table 2: Potential Outreach in 2009

Potential Outreach of AIM based on Housing Index (2003-2005) – in number and percentage		
Malaysia	Potential Outreach AIM*	Potential Gap 2009
	B(80%)	B(80%)
<b>Total</b>	<b>162,795</b>	<b>-45,625 (-28%)</b>

Note\*: B = Bad (*Buruk*) - 80 % of this category have the potential to qualify for AIM programme;  
 \*\*The categorization of B, S1 and S2 follows the method by AIM in calculating the potential outreach. The total number of Sahabat 2009 is given by AIM. For example, for the state of Kedah, B(80%) Sahabat 2009 = [(80/150) x 31,908 = 17,017].

Source : Calculated from data communicated by AIM (23 April 2010)

AIM’s potential to expand its outreach is highly related to funding - staff and budget. With appropriate funding AIM could target its outreach further to the B category of respondents, especially in states with higher potential gap such as Kedah (30%), Kelantan (37%), Terengganu (70%), Southern states (44%), Sabah1 (31%) and Sabah2 (30%). In this way AIM can still maintain its original aim of reducing the hardcore poor, while extending its outreach. Table 3 is a simulation on how *Zakat* able to help the poor in the country. Based on information in Table 1 and Table 2 before, and current cost per loan faced by AIM (RM253 per loan), simple calculation above stated that AIM will be able to cater 244, 877 potential borrowers if *Zakat* institution able to provide fund worth RM61,953,881. This simple simulation shows that *Zakat* is a highly potential funders to AIM in alleviating national poverty (Fig 1).

Table 3: Simulation of Zakat Contribution to AIM

Total Zakat Collected in 2009 = RM 5,235,710,770 (1.2%)				
Total Potential Gap ('000 person)	45.6	153.6	45.6	<b>244.8</b>
Cost per loan (RM)	253	253	253	<b>253</b>
Total cost to cover (RM mill)	11.543	38.871	11.538	<b>61.953</b>

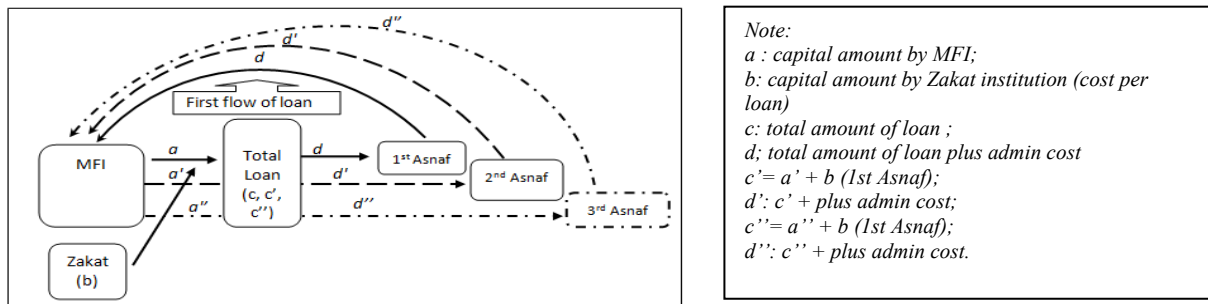


Fig. 1: Simulation of Zakat and AIM

With *Zakat*, the Muslim society will be able to give it to the destitute and needy in proper ways and channels since all resources belong to God while wealth is held in trust. With *zakat* as additional source of fund, it is believe that improvement will be seen in term of human capital development, education and skills development; better provision of physical capital (like sewing machine); wider access to microcredit for the productive members and periodic stipend for the unproductive members (such as the elderly, handicapped, single-parent etc.) of the poor.

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