



MICROFINANCE AND THE DEVELOPMENT OF ISLAMIC FINANCE

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1. INTRODUCTION

Financial exclusion is not an unknown concept: is a problem that affects millions people and prevents these people to access financial services and products. Over 2 billion people around the world do not use standard or “normal” financial services (The World Bank, 2015), so there are almost 30% of global population who are out of financial or banking system. This is a problem if society wants to fight against poverty or hunger using financial instruments as tools for helping the most disadvantaged population segment: for that reason the concept of Microfinance was developed with the main objective of to deliver financial services to this segment of the population excluded. We can observe the work of organizations like Grameen Bank or Banco Bolivariano, which main mission is give poor people the chance of enjoy of opportunities for leave poverty back and create and develop new models of businesses.

But helping just poor population to arrive to financial services could have a main problem that affects all over the world: the religion. There are millions people that could not be confident on banks or lenders because their religion prohibit any type of interest or usury; in that point is where Islamic finance appears. Islamic finances have had an incredible growth during the last decades, being the main alternative to traditional banking in Islamic countries like Pakistan, Saudi Arabia or Turkey.

I want to explain the importance and the products that Islamic Banking offer to their clients as a viable alternative for that segment of population who, to follow Islamic rules (Sharia), cannot enjoy financial products which are offered by traditional banks. According with my experiences lived during 9 months in Istanbul I will explain in this project how could be possible to work with another types of banking model and another ways of financing which can deal with some problems that traditional bank cannot.

Another important point which I want to talk about Islamic Finances is their incredible growth during the years of economic crisis (2009-2013) with a growth of more than 17% and it is provided that in 2018 their assets will be 3 times bigger than in 2013 (El Orden Mundial, 2013).

For these reasons and for more other reasons that I will explain in this project, I chose Islamic Finance and Microfinance as main topic of my final project.

ABSTRACT

In this project I will explain the concept and history of Microfinance, focusing on the origin of Grameen Bank, and later I will explain how Islamic Finance and Banking works, which products offer and the differences with traditional banking system. At the end I will explain the answers of a survey that I realize about the knowledge of Islamic finance and the entrepreneur spirit, with two different samples: Spanish university students and Erasmus students in Bahcesehir University in Istanbul.

2. MICROFINANCE

2.1 CONCEPT

The concept of “microfinance” can be defined as *“Microfinance refers to an array of financial services, including loans, savings and insurance, available to poor entrepreneurs and small business owners who have no collateral and wouldn't otherwise qualify for a standard bank loan. Most often, microloans are given to those living in still-developing countries who are working in a variety of different trades, including carpentry, fishing and transportation.”* (Brooks, 2013). The main objective of this services is provide of loans and liquidity to people or communities who are in risk of social and financial exclusion, to give them the chance to be self-sufficient on their own business.

Microfinance are mostly present in development countries where is harder to find good financial instruments or products which can help to the small firms or business, and usually help poor people to access to financial products with more security than with usurers.

Microcredits are the credits which are provided to the small entrepreneurs for their activities. These microcredits respond to the characteristics of that the beneficiary of the credit is someone who cannot generate financial resources by his/herself, and this “microcredit” give the chance to not only start the activity, but it lets him the chance to return the credit with interests, and winning profit from the business. Grameer bank defines microcredit program as *“Microcredit programs extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families”* (Grameen Bank, 2012)

Microcredits are loans with huge differences with the conventional credits: the borrowed quantities are usually smaller than the conventional ones, and these credits

must be shackled up with a financial education and capability from the entities which borrow the money, so at the end it could incur in bigger costs for the entities; for these reasons interests use to be higher than current loans.

In most cases, the banker or moneylender is a professional who has relation with the community, who knows people personally, their employees and their business. Moreover in these cases, there are just a few clients of these loans who have any bank account or something similar, so they have to visit the clients to collect the money and interests.

2.2 HISTORY

We can find the origins of microfinance in 15th century, in Italy, when the first pawnshop was created for the help of avoid usury. In 1515, Pope Leo X finally authorized pawnshops to earn interests with the main objective of financing Catholic Church.

But we have to move until 17th century for finding the first bank which main objective was help poor farmers with small loans without demanding any endorsement or guarantee: Irish Loan Fund System, created by Jonathan Swift.

In 19th century in Germany, Friedrich Wilhelm Raiffeisen with other people created the concept of financial cooperative with the same objective as their predecessors: help rural people in access of financial resources and avoiding pawnbrokers.

At the end of World War II in West Europe, governments tried to help the improvement of their economies and first measures were directed to agricultural sector for improving the production, but farmers understood these loans as presents so defaults were common.

During 20th century, banks were looking for the lack of risk from their customers, so it excluded poor people without any guarantee because banks didn't want to assume default risks.

At the same time, in Latin America the concept of savings and credit were starting to be known and banks helped people to invest and away feudalism which was in force. It was carried out in big cities in where banks were controlled by governmental agencies, so owners were their clients.

However, these new concepts were not useful for giving credits to most vulnerable population, besides following of payments was useful for banks to reduce their expenses and were able to reduce their interest rates (Ortega, 2008).

Grameen Bank

Speaking about the history of the concept of *microfinance* is speaking about Muhammad Yunus and the bank which he created: Grameen Bank.

Muhammad Yunus was doctorated in economics by the University of Vanderbilt, in Nashville, Tennessee before coming back to Bangladesh (The country where he was born) in 1974 for being named as Economics' professor in Chittagong University. He suffered the famine that affected Bangladesh in 1974, so he decided help poor people from his country.

His first loan was in 1976 in Jobra, near to the university. He had observed during months how women from Jobra were manufacturing bamboo furniture and they took money from usurers for buying bamboo, so they couldn't collect any profit from this activity. He lent US\$27 to 47 women to buy all the material for prepare stock ready for being sold, but without demanding a big amount of interests as the usurers used to do. Yunus did this with the idea of "*making such loans available to a larger population could stimulate businesses and reduce the widespread rural poverty in Bangladesh*" (Grameen Bank, 2013). He just demanded the people that they have to return it. These people were so glad with the loans, so Yunus thought that why if he could do that, banks could not? Was it not the main objective of banks?

Yusun went to the bank which was in the campus where he was working and ask the director and board of directors, but they refused it saying that poor people did not have any guarantee, so Yunus offered himself as guarantor of loans, for an amount of US\$300.

For the surprise of the director of the bank, Yunus recover all his money, so he decided to enlarge to 5, 10, 20, 50 groups successively, picking up all the money that he borrowed.

But instead of accepting the evidence, the director blamed the success of credits to a "windfall", so Yunus decided to create his own bank, but with some special characteristics. The government was not in accordance with the simple argument that "*if rich people cannot return the loans, how poor people can?*"; Yunus was insisting during 2 years until he could open Grameen Bank.

Muhammad Yunus created the doctrine of Grameen Bank (Grameen Bank in Bengali means “Bank of the Villages”) with the idea that he had done with the women of Jobra: give small loans to small groups for starting up their own business.

This bank has special characteristics:

- They give preferably loans to women. *“As of October , 2011, it has 8.349 million borrowers, 97% of whom are women. With 2,565 branches, Grameen Bank provides services in 81,379 villages, covering more than 97% of the total villages in Bangladesh (Grameen Bank, 2011).”*
- Interests are similar as a “normal” bank
- They just have a 3% of non-payment rate.
- They give loans to groups of 5 people
- There are no lawyers or judgments for non-payment.
- For asking to a loan it is not needed to have a job or guarantee
- Workers of Grameen Bank usually go to visit their clients to recover the payments from the credits and for helping them.

One of the reasons that the bank becomes successful was the work of their workers going to the poorest neighborhoods of Bangladesh to convince women of getting loans from them. At the beginning when they went to visit the women they refused the help because they told that they didn’t know what to do with money, assuming that it is men’s business.

After 6 years the bank achieved equality between men and women, and they observed a curious fact: money provided to women gives them more benefits than money provided to men. Yunus blamed this to the capability of women to being better resources managers.

But for being able to receive a loan, they have to follow the “16 decisions” of Grameen Bank which are:

1. *“We shall follow and advance the four principles of Grameen Bank --- Discipline, Unity, Courage and Hard work – in all walks of our lives.*
2. *Prosperity we shall bring to our families.*
3. *We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.*
4. *We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.*
5. *During the plantation seasons, we shall plant as many seedlings as possible.*

6. *We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.*
7. *We shall educate our children and ensure that they can earn to pay for their education.*
8. *We shall always keep our children and the environment clean.*
9. *We shall build and use pit-latrines.*
10. *We shall drink water from tube wells. If it is not available, we shall boil water or use alum.*
11. *We shall not take any dowry at our sons' weddings; neither shall we give any dowry at our daughters' wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage.*
12. *We shall not inflict any injustice on anyone, neither shall we allow anyone to do so.*
13. *We shall collectively undertake bigger investments for higher incomes.*
14. *We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.*
15. *If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline.*
16. *We shall take part in all social activities collectively.*(Grameen Bank, 2008)”

This model of banking has been exported to some parts of Africa, Asia and South-America and some first world countries banks have adopted this type of banking, creating exportation from Third World to First.

For all of these work for battle against poverty in Bangladesh and helping people for realize their dreams, The Nobel Peace Prize 2006 was awarded jointly to Muhammad Yunus and Grameen Bank "for their efforts to create economic and social development from below" (Nobel Peace Prize, 2006)

3. ISLAMIC FINANCE

3.1 PRINCIPLES OF ISLAMIC FINANCE (SHARIA)

Islamic Finance is finances which follow Islamic principles for develop their activity. It means that all the activities of banks and firms must follow Sharia's principles, which claims the equal distribution of benefits and richness in investments and businesses. The main example is that when an Islamic Bank earn profits, It must share it with their clients; otherwise, if the bank loss, clients' accounts will be reduced.

At the same time that benefits must be shared, losses and risks are not an exception. Islamic finances ban all earning which not come from effort, work or an acceptable distribution of risks (F.E. interests), and activities which are prohibited by Islamic law as alcohol, pornography, pork...

Interest is considered *haram*, according with Koran "*Allah has permitted trade and forbidden usury*" (Quran (2:275)). In West, usury is considered the extremely excess of interest, but for Islamic world, usury is any type of interest. Speculation is forbidden, money is just a means, not an end. According with Islamic law, if you want to earn profit, it has to be accompanied with any kind of work.

It doesn't mean that if you are going to ask for a loan in an Islamic bank, they will give you without earning any profit: Islamic banks put a fixed commission at the beginning of the operation. For example, if we want to buy a flat, Bank will buy it and It will sell us with a higher price. But if we just want to use that good in a specific period of time, bank will buy the good, establishing the quotes and period that the good is going to be used: it is something similar to typical west banks contracts called *Leasing*.

As I explained before, the common characteristics of all types of contracts of Islamic Banks is that Banks and clients work together in the objective of maximize benefits and, in case of failure, share losses too.

For this reason, the bank will help and intrude in the business of its client, because is interested in client's business. We can deduct that if bank helps you in your business, there will be more opportunities to be successful than if it doesn't help you.

Speculation is one of the main characteristics of traditional bank system, and one of the main reasons that west banks earn lots of benefits. The prohibition of Islamic banks of any type of speculation makes that profits are directly related with real work and activities; this point creates more richness, but less rich people, and more equity in distribution of richness.

Islamic banks have relation with social works, with communities where they can help to improve local and small business at the same time that they give the confidence that they are following Islamic principles, which is very important is Islamic communities.

Another important characteristic of Islamic bank is that debt cannot be sold: if anyone acquires any commitment, he/she has to comply until expiration/maturity of contract; this characteristic is totally opposite to traditional bank system, in which you can buy debt from other people, even other countries.

As I explained you before, Islamic banks cannot finance projects contraries to Sharia, as pork industries, guns, pornography... but neither business in which is involved child workers or overexploitation of natural resources: client can choose in which business can invest his/her money (Sansano, 2012).

The importance of Islamic finances is as huge that Financial Times, Dow Jones and Standard & Poors have created a specific stock indices in which exclude all firms which activities are to Islamic Law.

We can find the beginning of Islamic capitalism between 7th–13th centuries, in the “Golden Age of Islam”, but we have to advance more for find the beginning of the concept of Islamic Finance.

In 1930s in the Old India there were a minority of population who were Muslim and because of the growing discrimination that Hindu population apply to Muslims, they were affected in all of their lifestyle, including the economy. Muslims could not afford debts with Hindu moneylenders because they ask for huge amounts of interests (Prohibited by Sharia), so after Pakistan’s independence in this new country population supported writing laws against usury and interest, but it didn’t success, so the creation of a free-interest bank were received with a huge expectation. But this bank didn’t success because of lack of liquidity and the problems of earning profits; but as *Islamicfinance.com* explains here *“this idea was soon followed by another Islamic bank in Egypt, founded in 1963 by Ahmed El-Nagar. This bank was a success, and eventually led to the founding of the Nasser Social Bank, although it still faced the same problems as the initial bank in Pakistan.”*(Mohammed, 2015)

3.2 BASIC CONCEPTS AND TYPES OF CONTRACTS

For understanding better Islamic Finance, first we have to learn some concepts and types of contracts which are important.

Sharia

We can find lots of definitions about what “Sharia” means like:

- *“Islamic religious law that governs not only religious rituals, but aspects of day-to-day life in Islam. Sharia, literally translated, means “the way.”*(Investopedia, 2014)
- *“Muslim or Islamic law, both civil and criminal justice as well as regulating individual conduct both personal and moral.”* (Duhaime, n.d.)
- *“Islamic canonical law based on the teachings of the Koran and the traditions of the Prophet(Hadith and Sunna), prescribing both religious*

and secular duties and sometimes retributive penalties for lawbreaking. It has generally been supplemented by legislation adapted to the conditions of the day, though the manner in which it should be applied in modern states is a subject of dispute between Muslim traditionalists and reformists.” (Oxford Dictionaries, 2015)

And how is related Sharia with Islamic Finances? Sharia dictates how businesses need to be, which investments are available...; Sharia is the law which all Islamic Banks need to follow. Sharia is the ABC of all Islamic laws, and this law creates the difference between Western banks and Islamic banks.

Riba:

-We can find the definition of Riba as: *“A concept in Islamic banking that refers to charged interest. It is forbidden under Sharia, Islamic religious law, because it is thought to be exploitive. “Depending on the interpretation, riba may only refer to excessive interest; however to others, the whole concept of interest is riba, and thus is unlawful”.* (Investopedia, 2014)

-For a better understanding of the concept, we can find another definition like this one: *“In Islamic finance, riba is commonly translated as interest rate or excess. The prohibition of riba is the cornerstone of Islamic finance. Riba symbolizes both the earning of money on money via a predetermined rate on a loan and a social injustice. Although making profit is allowed in Islam, earning money on money is not, because there is no productive and/or trade activity creating additional wealth.”* (Financial Times, n.d.)

Gharar:

- We can find a definition of what Gharar means like this: *“An Arabic word meaning risk, uncertainty, or hazard. Financial products where details concerning the conditions of sale are unknown or uncertain are generally prohibited under Islamic law. Thus, all contracts should be devoid of uncertainty and speculation and parties must have perfect knowledge of the terms of exchange. In particular, the identification of the owner of the goods must be disclosed.”* (Financial Times, n.d.)

- To contrast the best information, we find another definition: *“An Islamic finance term describing a risky or hazardous sale, where details concerning the sale item are*

unknown or uncertain. *Gharar is generally prohibited under Islam, which explicitly forbids trades that are considered to have excessive risk due to uncertainty.*" (Investopedia,2014)

Qimar:

- Holly Quran speaks about Gambling (Qimar) as: *"They ask you about wine and gambling. Say, 'In them is great sin and [yet, some] benefit for people. But their sin is greater than their benefit.'"*(Quran (2:219)), and *"O you believe: wine, gambling, idols, and fortune-telling arrows are but filth of the Devil's handiwork, so shun them..."* (Quran (5:90))

- Outside we can find this definition:” *A type of prohibited arrangement in which the acquisition of property is contingent upon the occurrence of an uncertain event, as is the case in gambling*”. (Islamic Banker, n.d.)

Zarat:

-We can find the definition of Zarat as: *“Payment made annually under Islamic law on certain kinds of property and used for charitable and religious purposes, one of the Five Pillars of Islam.”* (Oxford Dictionaries, 2015)

-As a more simple definition we can find this: *“an annual tax on Muslims to aid the poor in the Muslim community”* (Collins Dictionaries, 2015)

But Zarat is more than what some dictionaries say: Zarat is a cultural act and a fiscal contribution for improving some aspects of Muslim societies or to finance some specific activities in the community.

With Zarat, Muslims treats to equalize the richness in their society, reducing the differences between poor and rich people, but in opposition to communism system, Muslim recognize private property and freedom of achieve richness and freedom of business while following Muslim principles and laws, transparency and honesty.

Now I am going to explain you different types of contracts and Islamic banking products that are used in Islamic finances.

<i>Islamic Banking Contracts</i>	<i>Definition</i>	<i>Types of Contracts</i>
Wadiah	<i>“Custody. Literally: safekeeping. In Islamic banking, wadiah refers to the deposited property, the</i>	As we can observe in the previous definition of Wadiah, we can divide this term into 2 categories:

	<p><i>acceptance of sums of money for safe-keeping in a Shari'ah-compliant framework, under which it will be repaid. Islamic banks use the concept of Wadiah (and Amanah) to accept deposits from customers. A bank is deemed as a keeper and trustee of funds and becomes wholly responsible and liable for its safekeeping with a guarantee refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands repayment. The bank may at its discretion and in certain circumstances reward the customer with a payment in the form of Hibah as appreciation for keeping the funds with the bank. Also termed as Al Wadiah and Wadia. ”(IIBI, n.d.)</i></p>	<p>-In the 1st category we can see deposits from clients who do not give any interest or payment for having their funds in the bank; the bank just has care of the funds of their clients</p> <p>-In the 2nd category we have saving accounts which bank gives to clients some profitability if bank has profits that year. It is not considered an interest because there is not any guarantee than bank will pay any <i>Hibah</i>, so it is not out of Sharia.</p>
Ijarah	<p><i>“a type of lease compatible with Islamic law. Under the structure, the owner of a property gives the renter the ability to use the property in exchange for a periodic payment. The owner remains responsible for maintenance. Under an Ijarah, the terms of the agreement must be clear and known to both parties”. (Farlex Financial Dictionary, 2012)</i></p>	<p>There are two types of Ijarah:</p> <p>-1st type: Lease agreement in which bank leases to a lessee one or various properties, plants or equipments against an agreed rental, with which the bank will receive the price of the PPE with a profit.</p> <p>-2nd type: Agreement between leaser and lessee in which lessee</p>

		<p>will pay a determined amount to leaser for using the PPE during a determined period of time. In this period, all the profits which the PPE could produce will be for the lessee and at the end of the period the property will come back to the leaser. In this type of Ijarah exists some other options than IIBI explains very clever:</p> <ul style="list-style-type: none"> - <i>Ijarah Thumma Bai</i> - Lease Agreement Incorporating sale of leased asset at the end of the lease period. - <i>Ijarah Muntahiya Bil Tamleek</i> - Lease Agreement with option to own the leased asset at the end of the lease period. - <i>Ijarah Wa Iqtina</i> - Lease Agreement with option to acquire the leased asset at the end of the lease period. Often used in the context of home purchasing (IIBI, n.d.)
Musharakah	<p><u>Musharakah concept in banking:</u> Islamic banks usually finance projects according with this type of contract. IIBI explain it as "<i>Musharakah allows Islamic banks to provide financing for purchase of an asset required by a customer; the bank invests capital in the co-ownership in the</i></p>	<p>-Musharakah Permanent: is an agreement between bank and customer in which bank receives profits according its investment on the business at the same time than can suffer losses if business is not profitable. As its name say, this agreement has not ending data and can be maintained as long as</p>

	<p><i>asset with the customer, instead of providing interest-bearing loans. The bank will achieve a return on its capital contribution in the form of a share of the actual profits earned, according to a ratio agreed in advance. However, unlike a traditional creditor, the bank will also share in any losses.” (IIBI, n.d.)</i></p> <p><u>Musharakah concept between groups/organizations:</u> It is what in the western world we named <i>Joint Venture</i>; when two people or firms sign a contract in which they agree the terms of distribution of the benefits (If it is not agreed in the contract, the contract is not valid) and if there are any loss they loss according of the capital they put for the business. In this contract is specified that the partners have the right of managing if they want.</p>	<p>both parts want.</p> <p>-Musharakah Diminishing: as IIBI explains “An agreement that combines the concept of partnership as in Musharakah to invest in a joint asset and leasing. It allows equity participation by a bank and a customer in an asset and provides a method through which the bank keeps on reducing its equity in the project and ultimately transfers the ownership of the asset to the customer. This involves the customer simultaneously purchasing the bank's equity in the form of unit shares, progressively reducing it until the bank is left with no equity left an” (IIBI, n.d.). This is most known as Islamic Mortgage and is very common for financing studies or dwelling.</p>
Murabaha	<p><i>“Sale on mutually agreed profit. Technically a contract of sale in which the seller declares the purchahse cost and profit. A contract of sale between a seller and a buyer; the seller sells certain specific goods to the buyer at a cost plus an agreed profit mark-up for the seller. The</i></p>	<p>-Murabaha Muajjal: <i>“Literally it means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the bank earns a profit margin on its purchase price and allows the customer as buyer to pay the price later”.</i></p>

	<p><i>seller must disclose the cost of goods and the profit mark-up.” (IIBI, n.d.).</i></p>	<p>-Commodity murabaha: “A murabaha contract using certain specified commodities, through a metal exchange.” (IIBI, n.d.).</p>
<p>Mudarabah</p>	<p><i>“Mudaraba could be individual or joint. Islamic banks practice Mudaraba in its both forms. In case of individual Mudaraba an Islamic bank provides finance to a commercial venture run by a person or a company on the basis of profit sharing. The joint Mudaraba may be between the investors and the bank on a continuing basis. The investors keep their funds in a special fund and share the profits without even the liquidation of those financing operations that have not reached the stage of final settlement”. (IIBI, n.d.).</i></p> <p>The financier is known as ‘Rab-ul-maal’ and the entrepreneur as ‘Mudarib’.</p>	<p>- “Al Mudarabah Al Muqayyadah: Rab-ul-Maal may specify a particular business or a particular place for the mudarib, in which case he shall invest the money in that particular business or place. This is called Al Mudarabah Al Muqayyadah (restricted Mudarabah).”</p> <p>- “Al Mudarabah Al Mutlaqah: However if Rab-ul-maal gives full freedom to Mudarib to undertake whatever business he deems fit, this is called Al Mudarabah Al Mutlaqah (unrestricted Mudarabah). However Mudarib cannot, without the consent of Rab-ul-Maal, lend money to anyone. Mudarib is authorized to do anything, which is normally done in the course of business. However if they want to have an extraordinary work, which is beyond the normal routine of the traders, he cannot do so without express permission from Rab-ul-Maal. He is also not authorized to:</p> <p>a) keep another Mudarib or a partner</p>

		<p>b) mix his own investment in that particular Mudarabah without the consent of Rab-ul Maal.”(Islamic Banking, 2006)</p>
<p>Sukuk</p>	<p>“the issuer of a sukuk sells an investor group the certificate, who then rents it back to the issuer for a predetermined rental fee. The issuer also makes a contractual promise to buy back the bonds at a future date at par value. Sukuks must be able to link the returns and cash flows of the financing to the assets purchased, or the returns generated from an asset purchased. This is because trading in debt is prohibited under Sharia. As such, financing must only be raised for identifiable assets.” (Investopedia, 2014)</p>	<p>-“<u>Ijarah Sukuk</u> are related to leased properties and assets, they carry equal values, and are issued by the owner of the leased property or his agent. The aim of the transaction at the end is to sell the leased property through issuing Sukuk, accordingly, the holders of the certificates or Ijarah Sukuk own the asset and its charges during the rental period, each in proportionate to the certificates of Sukuk held in the leased asset.”</p> <p>- “A contractor’s or a supplier’s Sukuk can be issued by a contractor or a supplier of a good or a service. The Sukuk could be for existing commodities or those which would be offered during a contracted time in future. These sukuk carries equal values issued by a covenanter to provide or sell services described in the security, such services are to sold in a form of sukuk, so that the holders of the same shall to be the owners of such services and shall gain the proceeds from selling the same in the markets.”</p> <p>- “<u>Potential Services Sukuk</u>:</p>

		<p><i>These Sukuk carries equal values issued by a contractor (or a supplier) or an agent having saleable services to Sukuk holders and such holders shall have the right to sell the same in the stock market.” (Wakar, 2012)</i></p>
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Takaful

Insurance all around the world are a very important part of population’s life: you need car insurance for being able to drive a car, health insurance is needed in lots of countries where public health system is not able to offer enough medical assistance to population, life insurance, house insurance...

But in Islamic world, the term “insurance” is not welcome: following the Islamic Law (Sharia), the insurances have three elements which are prohibited:

- Gharar (uncertainty)
- Maisir (gaming)
- Riba

Some Islamic lawyers affirm that Muslims just have to trust in Allah and recruitment of any kind of insurance is opposite on the belief of Allah.

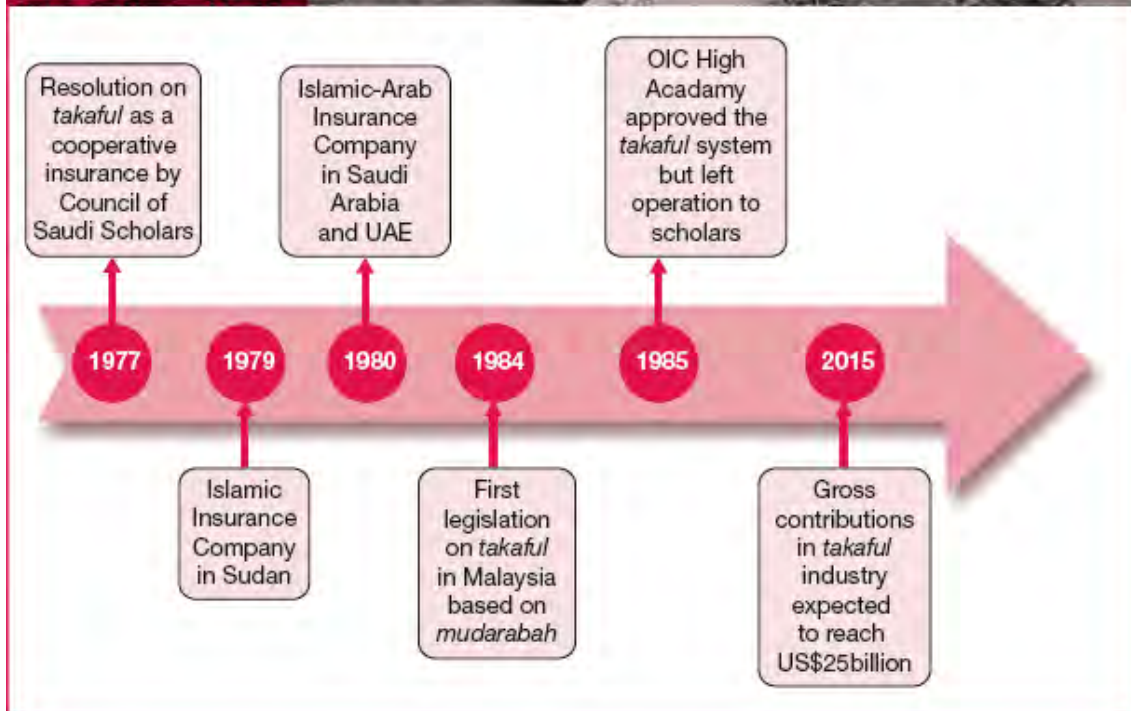
For all these reasons it was decided create a system of Islamic insurance which respects Sharia and follow the thinking than Islamic doctrine is about sharing and helping the most needed people: the *takaful*.

As it is explained here: *“takaful is founded on the cooperative principle and on the principle of separation between the funds and operations of shareholders, thus passing the ownership of the Takaful (Insurance) fund and operations to the policyholders”*. (IIBI, n.d.)

We can find the timeline of takaful insurance model here (Hassan, Kayed and Oseni, 2013)

FIGURE 8.2

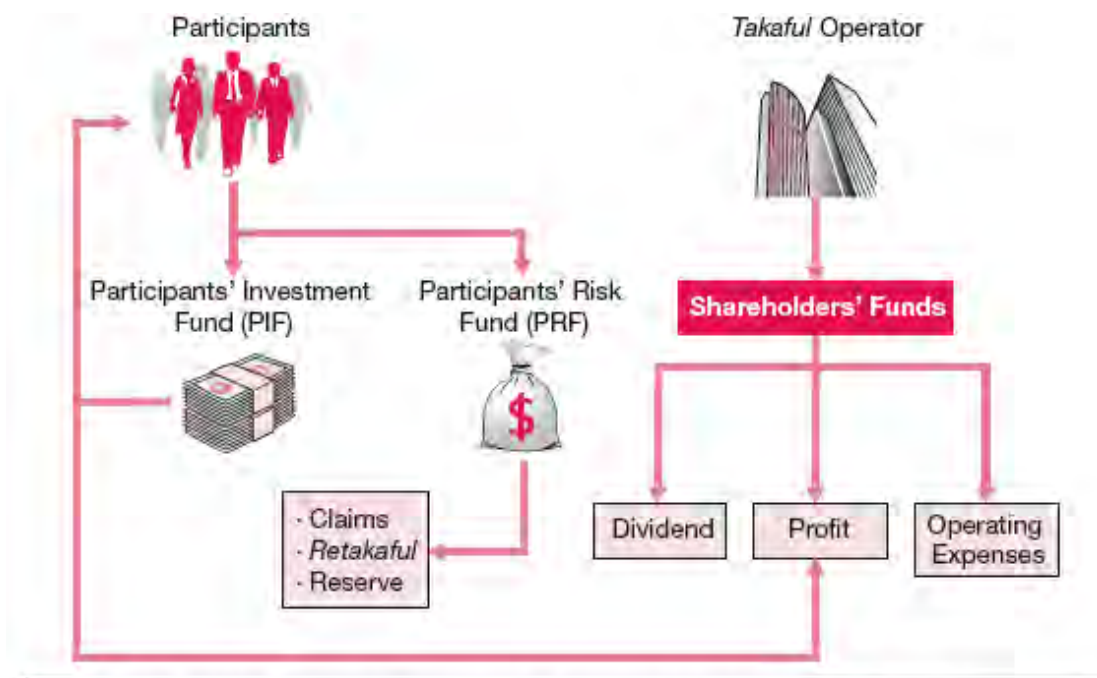
TIMELINE OF THE DEVELOPMENT OF TAKAFUL



We can distinct between two different types of *takaful*: *Mudarabah* model and *Wakalah* model.

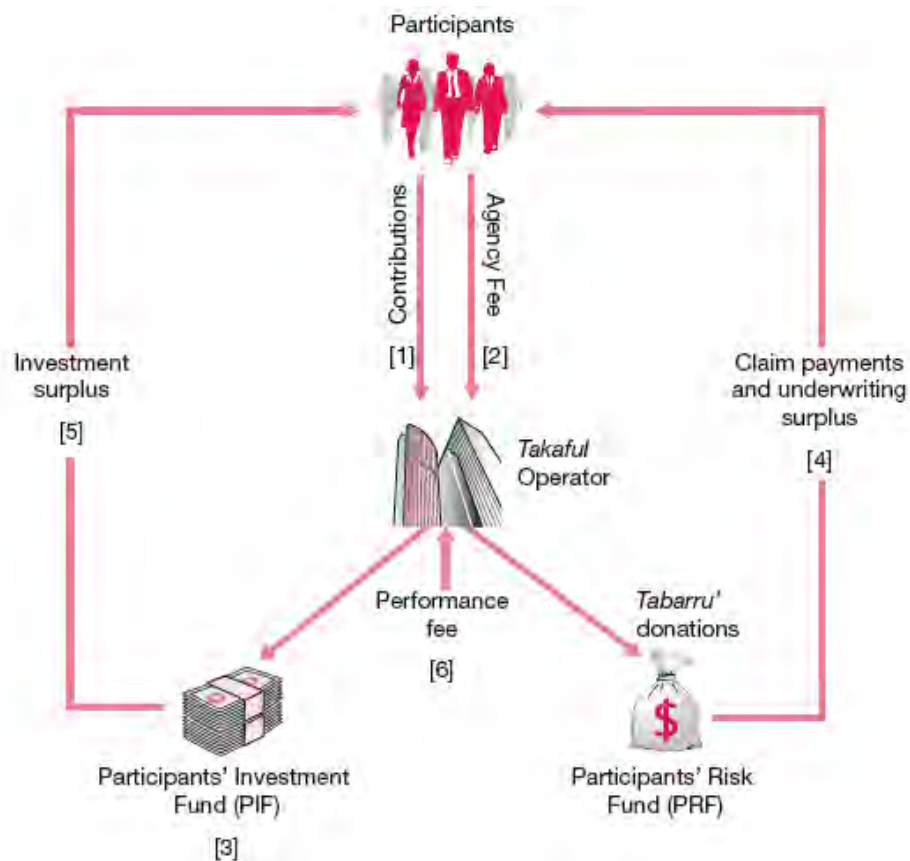
Mudarabah Model: “An Islamic insurance model based on a trust partnership between the *takaful* operator who is appointed to manage the *takaful* business by the participants who act as the financiers, investors, or fund contributors.” (Hassan, Kayed and Oseni, 2013)

The following image explains how model works:



Source: IFSB. (2009). *Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings* (p. 30). Kuala Lumpur: IFSB.

Wakalah model: "the surplus of policyholders' investments – net of the management fee or expenses - goes to the policyholders. The shareholders charge the wakalah fee from contributions and this covers most of the expenses of the business. The fee is fixed annually in advance in consultation with the company's Shari'ah Supervisory Board. The management fee is related to performance." (IIBI, n.d.)



3.3 REGULATION AND INTERNATIONAL ORGANIZATIONS

At the beginning of Islamic finances, they were not strictly regulated by one principal organism or laws, so for that reason each country treated to promote and, in some cases, impose, Islamic finance model as law.

Some countries as North Sudan have created a legislative framework according with Sharia; other countries as Indonesia, Malaysia, Brunei or Pakistan have created a normative mark following Sharia but, instead of eliminating traditional banking laws, they have created their norms parallel.

Other type of regulation is given by Sharia Supervisory Boards (SSBs) (Karim, Tarazi and Reille, 2008) which in some countries (Kuwait, Lebanon, Jordan, Thailand) have been standardized and regulated, controlling the composition and the norms of dismissal and designation of their members (Graiss, Waifk and Pellegrini, 2006). But there are no knowledge about the controlling of the norms of Sharia and the jurisdiction of this.

At same time of the creation of regulators and policy, some International Organizations has been created with the objective of standardized and create accounting terms according with Islamic finances. Some organizations as the Malaysian Islamic Financial Services Board (IFSB) develop norms and principles for Islamic Financial products, at

the same time than dictate guidelines for the risks and capital adequacy; The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) advocates financial information for all Financial institutions which wants to follow Islamic laws; The Islamic Development Bank (IDB) is one of the most important Islamic banks and their main objective is through Islamic financial products and microcredit finish with poverty and promote the development of Islamic countries.

4. ISLAMIC MICROFINANCE

As I explained before, microfinance programs are very important at time of deal with poverty all around the world, and Muslim population is a huge part of it; but Muslim population is not a big fan of financial products because there are just a few group of banks which respects Islamic law (Sharia) and not all of them can help poor people in the development of their small business. For that reason it was created the concept of Islamic Microfinance.

4.1 DEMANDS IN COUNTRIES

As I explained in the first point of this project, the concept of “microfinance” was created by Muhammad Yunus in Bangladesh (Country with 90% of Muslim population (Kartika Viatges, 2015)) and was extended to countries like Pakistan and Indonesia, in where nowadays there is the biggest amount of microcredit in the world. But these traditional microfinance instruments cannot satisfy an important part of Muslim population’s needs, because for them following Sharia is more important than anything and they (for their beliefs) cannot accept a traditional microcredit.

Apart of this segment of population, there are some financial common clients who prefer Islamic financial products than traditional ones. In the following table we can observe the presence of Islamic microfinance in Islamic countries, in which we can observe the huge amount of microcredit and clients who are profiting this products.

Table 1. Outreach of Islamic Microfinance, by Country

Region	# of Included Institutions	% Female (Avg.)	Total # of Clients	Total Outstanding Loan Portfolio (US\$)	Avg. Loan Balance (US\$)
Afghanistan	4	22	53,011	10,347,29	162
Bahrain	1	n/a	323	96,565	299
Bangladesh	2	90	111,837	34,490,490	280
Indonesia*	105	60	74,698	122,480,000	1,640
Jordan	1	80	1,481	1,619,909	1,094
Lebanon	1	50	26,000	22,500,000	865
Mali	1	12	2,812	273,298	97
Pakistan	1	40	6,069	746,904	123
West Bank and Gaza**	1	100	132	145,485	1,102
Saudi Arabia	1	86	7,000	586,667	84
Somalia	1	n/a	50	35,200	704
Sudan	3	65	9,561	1,891,819	171
Syria	1	45	2,298	1,838,047	800
Yemen	3	58	7,031	840,240	146
TOTAL	126	59	302,303	197,891,882	541

* Micro and rural banks only.

**There were seven MFIs in the West Bank and Gaza that offered, with the help of training and funding facilities offered by the Islamic Development Bank, a total of 578 Islamic loans between 2005 and 2006. Data on only one of these seven are displayed in the table because the remaining six MFIs were disbursing Islamic loans with average loan sizes higher than 250 percent of the region's gross domestic product per capita.

With studies of CGAP (Grais, Waifk and Pellegrini, 2006) in 2007 Bangladesh was the country with biggest amount of clients of Islamic microcredit as we can observe in Table 1, but it represents just 1% of all microfinance products in the country.

As we can observe in the table, the major amount of clients profiting Islamic microcredit are in Bangladesh, Afghanistan and Indonesia (80% of all clients in the world), and in the other countries it is settled as an important type of financing.

Other data that we have to take account is the percentage of women taking profit of this type of financing. As we know, women are the main beneficiaries of microcredit and in Islamic microcredit it would not be an exception (59% women), increasing 80% in Bangladesh, Saudi Arabia and Jordan.

4.2 ADVANTAGES AND DISADVANTAGES COMPARING WITH CURRENT MICROFINANCE

As I explained before, Islamic Microfinance products can be productive for both banks and customers: Banks can arrive to a new market niche and Customers can have an alternative of traditional financing model, staying true to their principles and religious beliefs. Let's analyze some advantages of Islamic Microfinance over Traditional Microfinance:

- Banks can offer their products and financing more projects offering Islamic products than just offering traditional microfinance products, which can arrive to more clients and, in conclusion, increase their benefits.

- Islamic customers can find a way of financing their businesses without violate any Islamic law
- Islamic microfinance products are less risky than traditional microfinance products due to as we explained before, Islamic contracts make than banks and customers share benefits and risks.

But if we analyze advantages, we have to analyze the disadvantages of Islamic microfinance against traditional microfinance:

- It is an immature concept and has a lack of regulation and norms, as we saw before
- The Islamic world is largely unknown to the Western countries and their inhabitants are not very prone to Islamic products, let alone Islamic financial products (as we can see in the following survey I realized).

4.3 KIVA CASE

Another important agent about I did not explain is the Non-Governmental Organizations in Islamic Microfinance world. This nonprofit organizations offer microcredit to small entrepreneurs without earning any profit, reinvesting their benefits in more credits for people to take off their entrepreneurial dreams.

A one clear example is *Kiva*, a Non-Governmental which main objective is beat poverty lending loans to people for develop their projects.

Kiva use to act as an intermediary between lenders and organizations which want to help all these people. Kiva works with NGOs, MFI, Schools, profit organizations and whoever who wants to help and have the main mission of battle with poverty.

Other option of financing that they propose is that a current person can be lender since \$25 and can finance the project which he/she wants, selecting over thousands of projects. Kiva's first warning to helpers is that all loans must be at 0% interest and Kiva will help them covering their expenses for giving loans (Kiva, 2015).

As a NGO, Kiva offers the chance of helping with Gift cards, Donations and other assistance without repayment search.

And how I explained before, Kiva as 0% interest lender is a very attractive organization for Muslim people who want to start a business but are afraid of financing methods are against Sharia or Kuran: for that reason, Kiva offer Islamic Microfinance products.

Kiva offers products which I explained before (Mudarabah, Musharakah, Murabaha, Ijarah) and other new products like (Bradfort, 2012):

-Qard Hassan: Interest free loans, usually to students or the very poor

-Musawama: The seller and buyer arrive at an agreed price for a commodity

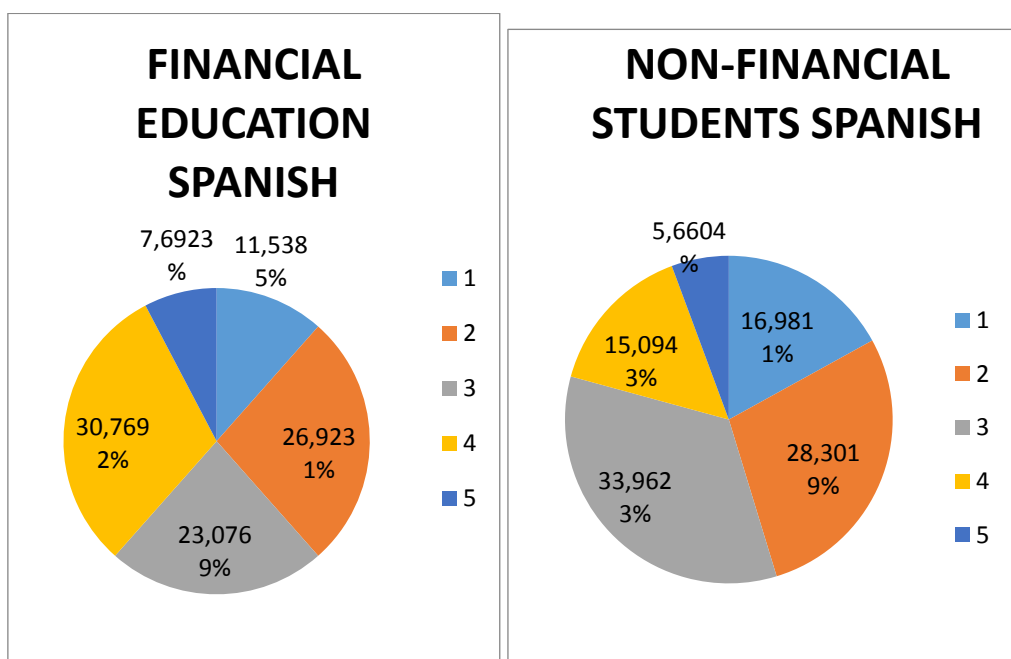
-Salam: An advance purchase of goods delivered on a future date set by the buyer and seller.

5. SURVEY ABOUT KNOWLEDGE OF ISLAMIC BANKING

I perform a survey with Spanish and Non-Spanish people about their financial knowledge, entrepreneurial spirit and their knowledge about Islamic finance. The sample about Non-Spanish people is Erasmus students from Bahçesehir University of Istanbul who were studying with me during the last 9 months.

Entrepreneur Spirit

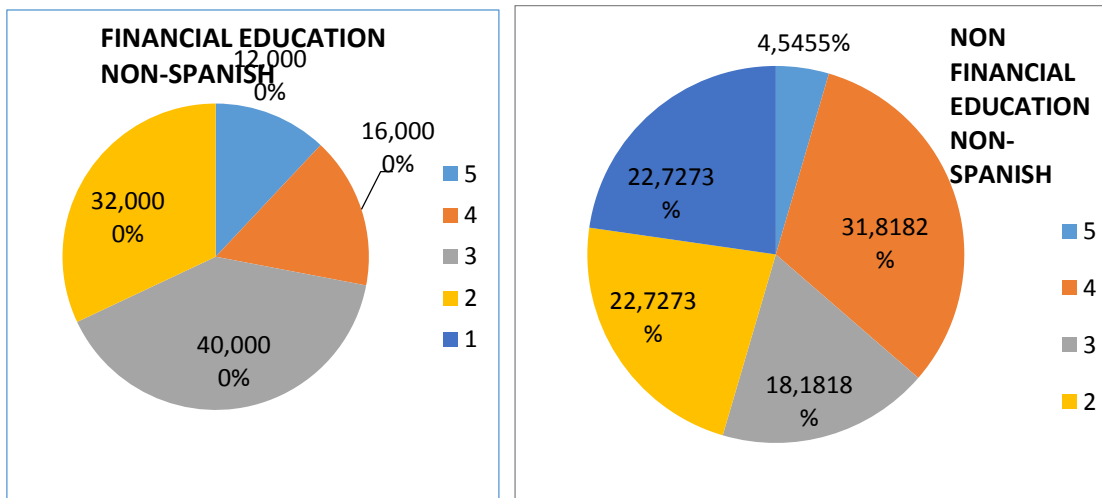
The first question in the survey is “Have you ever had the idea of starting your own business?”, assuming than 5 is “absolutely yes” and 1 is “absolutely no”, these are the results.



Comparing results between population who have had any financial education and people who have not, we can observe that people with a basis in finance have more entrepreneur spirit than people who don't have this basis.

Asking to two Spanish people, one with financial education and other one without, about which could be the reason that there is a low entrepreneur spirit, their answers were that it is more risky to start a business than working for someone; however, the

man with financial education admit that is more profitable being your own boss than working for someone, opinion that the one without financial education does not share.

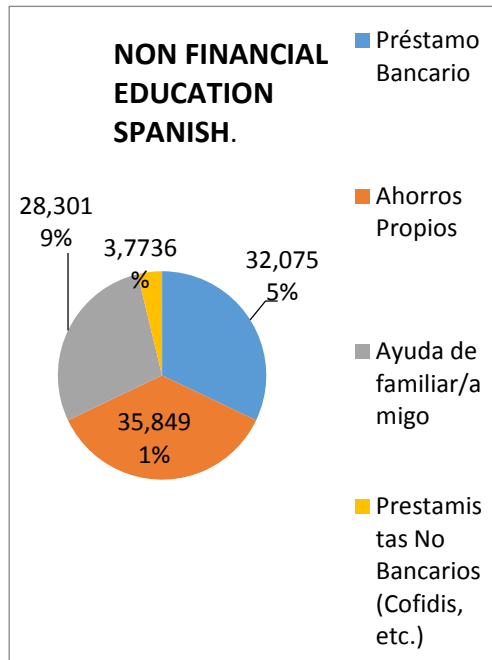
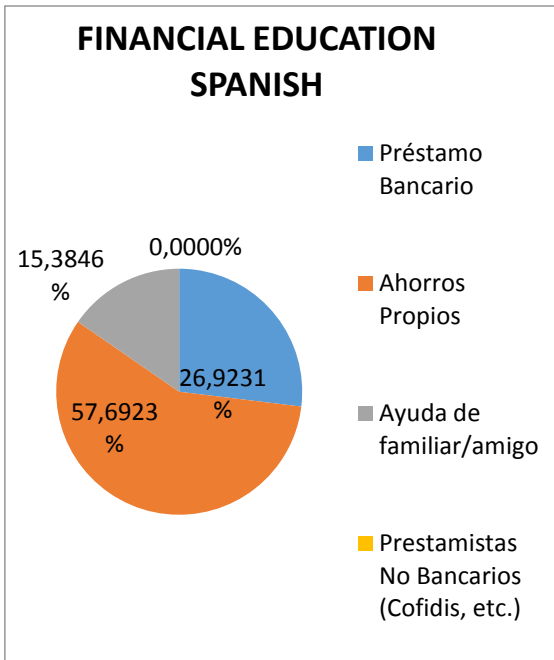


Now let's analyze the sample of Non-Spanish population dividing them at the same mode as the Spanish sample; we can observe that, in this case, there is more population without financial education who is more confident to be an entrepreneur than people with a financial basis; however, we can observe that there are at least 50% of non-financials who never or difficult begin an entrepreneurial adventure, while people with financial education have no clever their thoughts.

In a personal interview that I had with 2 Erasmus students (one finance student and the other does not, which answers were 3 and 2) they explained me how risky is start a firm by your own, but the finance student was not as afraid as the non-finance student, whose opinion was that is a high risk and less profitable than working for other people.

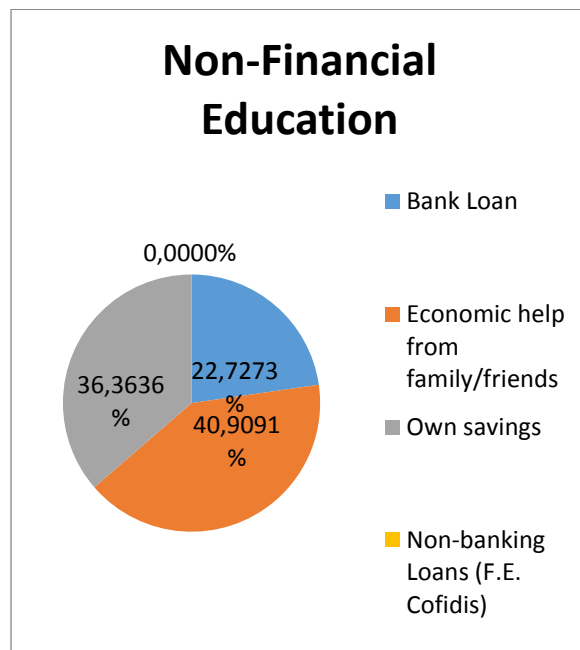
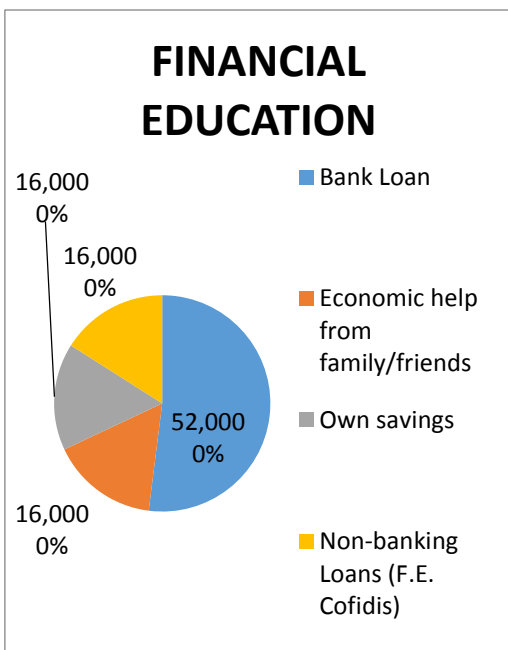
External Financing

For the question "In case you need external financing to launch the company, which of these options would choose, if all had at your disposal?" let's observe which were the most common answers.



As we can observe in these two samples of Spanish population, people with a financial basis are more afraid of asking for loans with just ¼ of the answers and giving more confidence in own savings; but with the sample of people without financial education we can observe that they are more confident in banks but for both the chosen one is their own savings for starting a business.

Asking the same two guys who I asked before, both answers were “own savings”, explaining that loans are more difficult to return if your business fail and you can earn more money if you do not depend from external agents.



On the non-Spanish population sample, we can observe a huge difference comparing

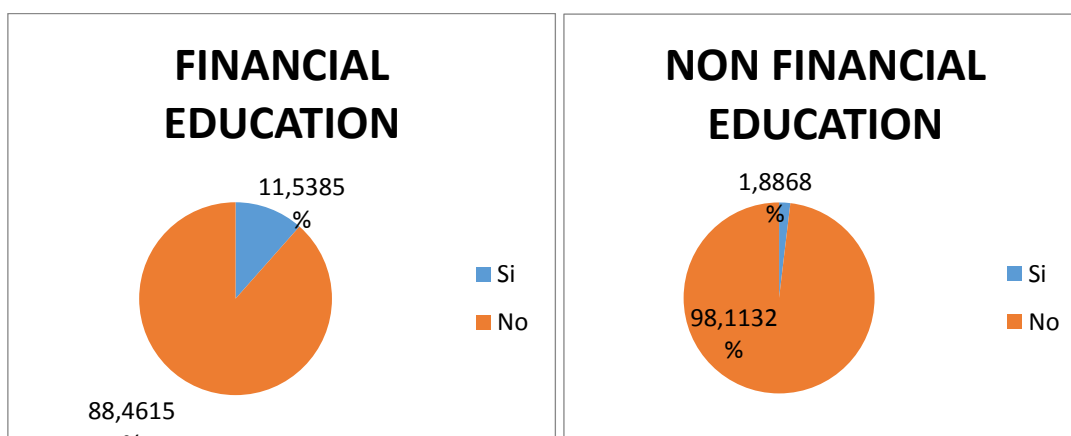
with Spanish sample: people with financial education have a big confidence in banks and more than 50% choose bank loans as first option of financing; on the other hand, in the other sample, we can observe that non financial people prefer to ask money for their family and friends or autofinancing their activities instead of ask for loans in banks.

In the interview I did with erasmus students, the finance student's choice were loans, arguing that is more difficult to save enough money by yourself for starting a business and it would be more profitable if you got money from loans; however, the other student did not share the same opinion: his choice is "own savings", because he argued that is very difficult nowadays asking for loans and being accepted by banks, and in case of being accepted, give back the money with interest would be very dangerous if your business failed.

Knowledge of Islamic Finance

In the last part of the survey I asked about the knowledge of Islamic Finance and the confidence in Islamic financial products. Let's analyze the different answers which have had the question "Have you ever listen the concept "Islamic Finance"?".

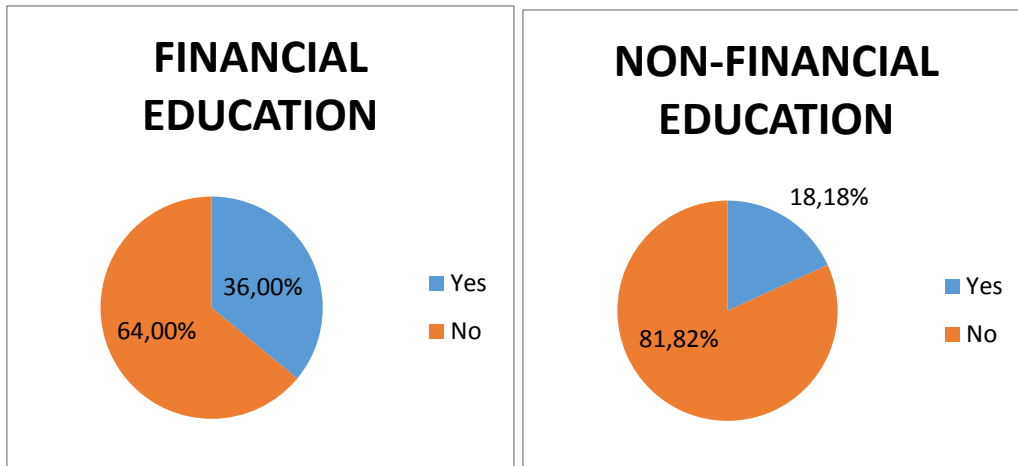
Spanish Sample



As we can observe in the Spanish sample, there are not too much knowledge about the concept "Islamic Finance", with just 1/10 of the population with a basis in finance has ever heard about it, and just 2% of people without any financial education.

In the interview, both answers were "No" but they argued different reasons: The finance student thought that the main problem of the ignorance of Islamic Finance is in our society, in the media because is not shown and taught in the school; the other student's opinion was that he was not enough attracted for learn that concept.

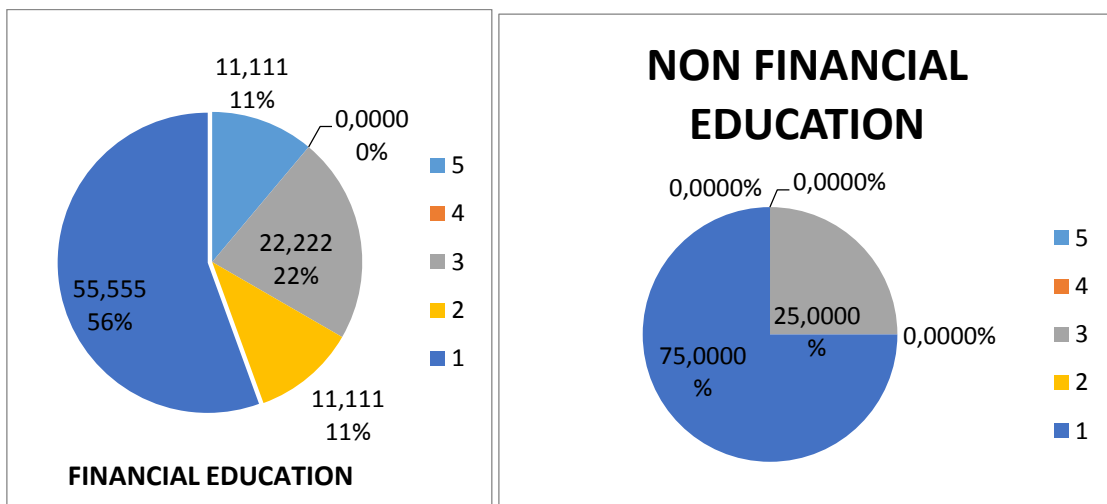
Non-Spanish Sample



But outside Spain we can observe that this concept is more known, with more than 35% of positive answers in finance-basis students and almost 20% from people without financial basis.

In the interview to Erasmus students, both answered me they did not know that concept and the main reason was because they were not attracted enough for learning it.

Observing these answers I made a last question for all who answered positively about their confidence in Islamic Financial products, being 5 maximum confidence and 1 no confidence: In the Spanish sample all answers were 1 so I exclude including the graphics.



As we can observe, there are not too much confidence in Islamic Financial products or financing through Islamic Finance, with just 11% of absolute confidence for finance students and non-positive answer for non-financial students.

6. CONCLUSION AND DISCUSSION

As we saw, Islamic finances and microfinance has numerous differences against traditional banking model: different banking products, different requirements for asking for a loan and different customers who can get profit from these “new” and “unknown” models of banking. But as we have seen also, these concepts need to be implanted in our society, need to be known for the population who has lost their confidence in the actual banking system for giving them the information that there is another way for deposit their money or financing their business projects.

In the survey that I realized and I explained before we can observe the ignorance that Western world has about Islamic finances and banks, even the students of bachelor and masters related with finances; this is a huge problem that I think we have to start solving because if we want that population without financial literacy recover their confidence in banks, we need to give them an alternative, and for giving that, people with a financial education has to know about different ways of banking.

And in this point there are just one Master in Spain in Universidad Rey Juan Carlos (Madrid) which offers an education of Islamic Economic and Finances (García N., 2015), but there are not any subject in bachelors related with Islamic finances, even in this university, and I think it should be implanted for give to finance’s students the knowledge about this model of banking.

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