Is the Sudanese "Laboratory Model" of Islamic Microfinance of Relevance to other African States? – Ethiopia as an Exemplar.

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Lessons from the Sudanese Islamic MF Approach.....

☐ I believe that after more than 4 decades Islamic finance was neither clearly understood in theory, nor in the historical experience, that is why it is not fully utilized, especially for poverty-reduction.

☐ The Sudanese Islamic MF model, being the only full-fledged MF approach worldwide, shows that affordable and sustainable Shariah-compliance financial services can prove to be transformative for MF.

☐ This experience which managed to provide new conventions, via business-like MF that embodied social dimension, can provide a lesson to others world-wide.
The first Full-Fledge Central Bank-Supported Islamic MF (licensing, wholesale lending, MFIs equity sharing, HR up-grading, IT programs, sponsorship of pioneer project),

The fast growing outreach and MF institutions

Has a National MF Strategy including all stakeholders

Assign % of banking portfolio (12%) assigned for MF,

Has a comprehensive National Institutional Support HCMF, SCMF, MFUs, MF Planning Units etc.,

The first to introduce Islamic Micro insurance (Takaful),

The first to have a governmental-owned Wholesale Guarantee Agency & a wholesaling for MFIs via the Restricted Mudarabah Contract
The Sudanese Islamic MF model is described by the World Bank's Consultative Group to Assist the Poor (CGAP) as: "A laboratory for Islamic MF delivery where developments could shed light on effective Islamic MF practices".

The IMF Article of Consultation, 2013 stated that: “the results of (MF) push have been impressive .......In terms of active clients, Sudan and Bangladesh are easily the global leaders in Islamic MF, with Sudan likely to take top spot given current growth rates”

The IDB appraised the outcome of the US$ 60-Mill. MF Partnership with the CBOS & declared its replication in other member states.

The model can also be partially replicated in other African states of Muslim minorities, including Ethiopia.
The Status of Islamic Microfinance in Africa.

- Muslim population in Africa 53% (582 mill. out of 1097 mill.). 16 states (out of 47 states) in SSA have 50% & more Muslim ratio (Ethiopia 89.2 million, 50% are Muslims).

- Nearly 70% of population in SSA falls below US$ 2 a day poverty line, and only 24% (half of the global average) of the adult population having bank A/C at a formal financial institution (CGAP).

- Little is written about Islamic finance in SSA, there seems to be a large un–met Islamic MF demand given the large No. of Muslims, weak financial inclusion, & limited Islamic MF providers.
In 2012 only US$16.9 billion out of the total Islamic banking assets of US$1273.6 billion in SSA. Currently, "just four of the 255 financial service providers offering Sharia-compliant MF products are in SSA. As of end-2012, only 17 Islamic MFIs are operating in SSA.

There is a potential of Islamic MFIs in SSA. Botswana, Kenya, Gambia, Guinea, Liberia, Niger, Nigeria, South Africa, Mauritius, Senegal and Tanzania have Islamic banking activities. There is also scope for Islamic banking in Zambia, Uganda, Malawi, Ghana & Ethiopia, as all except Zambia have relatively large Muslim populations.
Why Islamic Microfinance in Africa?

- Islamic MF is a very flexible tool, whose models can be replicated, and the potential demand for tailored MF services is still largely unmet in countries of Muslim majority.
- Islamic MF is suitable for African Muslim women in organized women’s groups who become peer guarantors.
- “The unfamiliar Musharaka mode of finance is just a simplified, fixed duration limited contribution conventional partnership. If the Islamic system managed to modify the conventional partnership, why cannot the interest-based banking system apply whatever sort of partnership, based on conventional mode” (Badr El Din A. Ibrahim).
- Musharaka avoids the double burden of loan repayment and loss of livelihood in the case of total failure of the project. Musharaka also resembles venture capital.
Because of the similarity between the Islamic sharing formula and venture capital and “if the Islamic Musharaka is taken as one form of venture capital, rather than an ideological concept, it will have a great deal of universal application, as a supplement to interest for financing microenterprises (Badr El Din A. Ibrahim)

"the Islamic prohibition of fixed interest lending, which is also reflected in Jewish and Christian traditions, has led to the evolution of a number of financial innovations from which everyone can learn” (Malcolm Harper)

"While prohibitions of interest have historically been centrally held tenets of several religions (Judaism and Christianity), Islam is unique in the relative persistence of its adherents’ attitude towards interest-bearing credit”(Asli Demirci-Kunt et al)
Moreover, the rate of return from Musharaka is greater than that of interest for both the Bank & the client……

<table>
<thead>
<tr>
<th>Description</th>
<th>Conventional bank</th>
<th>Islamic bank</th>
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<tbody>
<tr>
<td>Capital</td>
<td>US$ 100</td>
<td>US 100, equally shared</td>
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<tr>
<td>Interest</td>
<td>36% interest /year</td>
<td>(Musharaka) Sharing formula</td>
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<tr>
<td>Rate of return on capital</td>
<td></td>
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<tr>
<td>Rate of Return on capital (RoR)/Yr.</td>
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<tr>
<td>RoR Client.</td>
<td>14%</td>
<td>Rate of Return on capital (RoR)/Yr.</td>
</tr>
<tr>
<td>RoR Bank.</td>
<td>36%</td>
<td></td>
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<tr>
<td>Net Profit 50% of capital (US$ 50)</td>
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<td></td>
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<tr>
<td>Profit Distribution:</td>
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<td>(1) 20% for clients’ management</td>
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<td>(2) 5% for the Bank’s following up</td>
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<tr>
<td>(3) shares’ profit equally</td>
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<tr>
<td>distributed (50%–50%)</td>
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Prospects of Islamic Microfinance in Ethiopia

- Islamic MF intermediation in Ethiopia might be a necessity, not only because there is a sizable No. of Muslims in Ethiopia, but also Islamic finance is one way to diversify the limited MF products.

- 90% of a sample respondents are in favor of an Islamic Bank but, 66% is of the opinion of a separate Islamic bank, 12% prefer Islamic branches of cooperative institutions. Islamic branches of conventional banks and Islamic branches of MFIs are preferred by only 6% (the study of Jimma Muslim Society by S. Sankaramuthu Kumar et al, 2008)
Islamic MF can tap Muslim deposits in Ethiopia, 37.7% responded that they were not interested to use formal institutions for “because of their religious beliefs”.

NBE allows commercial banks to create interest-free banking separate Islamic windows.

The Commercial Bank of Ethiopia, the largest government-owned bank, has recently established a specialized Interest-free banking department & preparing to have Islamic finance windows.

Some MFIs in Ethiopia (for example Afar and Somali Ethiopia MFIs) are practicing Islamic MF, as these MFIs are working in Muslim minority areas.
In Ethiopia some lending by MF providers nowadays is made on the basis of lease and hire purchases. Both lending formulae resembles Islamic leasing (Ijara and Ijara wa-Iqtina).

Leasing was formally recognized in Ethiopia:

- In the Contract Law, the Civil Code and Commercial Code of Ethiopia between during the 1950s and 1960s.
- The Proclamation 103/1998 promote capital goods leasing business as an alternative financing system: financial leasing, operational leasing and hire purchase leasing.

Challenges of this Proclamation: 1/the focus on the rent-base leasing, 2/NBE is not a regulator of lease financing and 3/ no government moveable asset registry.

In Ethiopia irrespective of the type of the bank, leasing is one lending formula that can be developed as hybrid model.
Conclusion

- Despite meager studies there seems to be a large un-met demand for Islamic MF products, and very little number of Islamic MF providers in Africa. Islamic MF in Africa, we believe, will reach the millions of clients who are not reached by conventional financial institutions today.

- Islamic MF intermediation in Ethiopia is a necessity, not only because of sizable No. of Muslims, but also to diversify the limited MF products.

- Irrespective of the bank, Islamic or conventional, leasing as practiced by MFIs in Ethiopia today, can be a hybrid model for MF without the need to own resources.