

# Islamic Microfinance Industry in Yemen “Challenges and Opportunities”

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## **Abstract**

The purpose of the study is to theoretically review the Islamic micro finance industry in Yemen and to identify the challenges and opportunities for this industry. The data collected is entirely based on secondary data collected from various sources such as books, websites, official reports and others. The study covered the period from 1997 to 2013. The study revealed that there is a promising demand for Islamic microfinance and at the same time there are some challenges facing its growth and development. The researcher finally concluded the study by providing some valuable suggestions that might help in progressing of the industry.

**Keywords:** Islamic, Microfinance, Challenges, Opportunities, Industry

## 1. Introduction

The Muslim population is estimated to reach to 2.2 billion people by 2030 spread over the six continents (Population Reference Bureau, 2011). The number of poor people who earn less than US \$ 2 per day is approximately 1100 million (True Banking, 2011). It is believed that one of the main causes for having such a huge number of poor people in Muslim countries goes back to the improper way of lending followed in their counties when dealing with them. The method of the extension of credit to Muslim people is based on the interest rate (Reba) which is forbidden in Islam law. This results in depriving them from getting a chance to have the credit required for improving the standard of living of their lives and other benefits.

This religious perception about the interest rate along with other qualification requirements represent the major obstacles that hinder poor Muslim people to approach conventional commercial banks and other financial institutions for credit. This clearly indicates the need to establish a suitable credit system capable of meeting the un-banked Muslim people's needs without breaking their religious rules. Islamic finance is one of the solutions to this dilemma as it provides financial services as per the law of Islam (Shariah compliant). This Islamic finance gives an opportunity for needy Muslim poor people to apply for loans that might be used in creating new job opportunities which will eventually contribute in mitigating their poverty level. Islamic finance has another branch of finance called Islamic microfinance. Islamic microfinance is specifically designed for underprivileged people who lack access to credit and who do not want to violate the Islamic laws of borrowing. The current landscape of Islamic microfinance in the world as reported by CIBE shows that the total size of Islamic microfinance is US\$ 1 Billion which is less than 1% of Islamic finance market (US\$ 1.6 Trillion). Moreover, there are around 300 Islamic microfinance institutions (IMFIs) operating globally. The major markets for Islamic microfinance are Sudan, Yemen, Pakistan, Indonesia, Egypt, Qatar, Bahrain, Jordan, Mali, Lebanon, KSA, Syria Iraq, Afghanistan and others (M. Zubair , 2015).

Islamic microfinance has become one of the new recent hottest topics that provide alternative way for funding poor Muslim people. This type of funding depends basically on following the Islam instructions of not to charge interest rate on loans disbursed. However, Islamic micro financial institutions can charge borrowers specific amount decided in advance to cover up the operating expenses incurred by the institutions when operating. The main idea behind the interest rate forbidding lies in the theory that money cannot be treated as a commodity hence it cannot be increased alone or without involving other factors with it. The concept of Islamic microfinance industry is relatively new and still faces a lot of difficulties and challenges. The top three countries in the world that deal in Islamic financing comprise of Indonesia, Bangladesh and Afghanistan. These countries account for 80% of the global outreach of Islamic microfinance (CGAP, 2008). In Yemen, the conservative Muslim country surrounded by many economic and political problems, the poverty rate has exceeded more than 54% in 2012 and unemployment percentage reached around 45% (World Bank, 2014). Thus, it was very essential for the government of Yemen along with some foreign collaboration to establish the social fund for development (SFD) to promote the industry of Islamic and conventional microfinance in the country so that it can help in improving the difficult economic situation of the households in the country. Therefore, this study is an

attempt to theoretically review the Islamic microfinance industry in Yemen along with the obstacles and opportunities available there.

## **2. Methodology**

### *2.1 Statement of the Problem*

The religious perception of Muslim people in Yemen and other world countries towards the conventional way of lending has created a necessity to establish a suitable lending approach capable of meeting the demand of Muslim people for credit without breaking the law of their religion. Thus, this study is an attempt to theoretically review the Islamic microfinance industry in Yemen along with its challenges and opportunities.

### *2.2 Objectives of the Study*

- To theoretically review the current status of Islamic microfinance in Yemen
- To identify the challenges and opportunities facing the Islamic microfinance industry in Yemen

### *2.3 Importance of the Study*

- The study would add a new literature to the existing one
- The study shall be of good help to policy makers and other parties interested in this topic

### *2.4 Data Collection*

The data collected is mainly based on secondary data collected from different official reports, papers, studies, websites, government reports and other sources.

## **3. Literature Review**

In a recent conducted study by (YMN, 2013), it was revealed that there is a promising market for Islamic microfinance in Yemen as 99% of people are Muslims who refrain from conventional way of lending. Further in another study by (SFD, 2011), it was reported that, though, some Islamic Micro financial institutions provide Islamic products, some people still look at it with suspicion.

## **4. Emergence of Islamic Microfinance Industry in Yemen**

The concept of Islamic microfinance in Yemen goes back to 1997 when the United Nation (UN) in cooperation with government of Yemen decided to start a program that contributes to poverty reduction in the country. This program included different phases; one of them was related to the development of microfinance industry in the country, the government established the social fund for development (SFD) as especial body for this purpose. The SFD, later on, created a specialized cell named as the small and micro enterprises development unit (SMED). This unit began the first program of Islamic microfinance in Hodeida province after receiving the required funds and grants from SFD. The Murabaha approach ( cost plus ) was the main lending methodology , which was based on group lending system , however, due to some difficulties , the program suffered from high operating costs and contract servicing performance. Presently, there are around 14 micro financial institutions operating in the market, 60% of them provide Islamic products and services, remaining supply both conventional and Islamic products and services (YMN, 2013). These institutions have different entities; They vary from banks to foundations to programs to companies. The market structure is comprised of three micro financial banks, two foundations, one company,

five programs and other different forms. The industry growth rate in 2011 was 6% however to the political crises and unrest situation, the growth percentage declined to – 4.3% (SEEP, 2012).

### **5. Principles of Islamic Microfinance**

For a financial institution to operate as per the Shariah law, it should follow certain principles; these principles provide the guides to how Islamic micro finance is different from other traditional financing. These principles have been illustrated by (Islamic relief, 2008). As follows:

- 1- There must be some risk whether credit is used in a commercial or productive venture.
- 2- Any financial transaction has to have a “material finality “which means it should be directly or indirectly linked to a real tangible economic activity.
- 3- The product or service provided must be clear to both parties involved in the transaction.
- 4- There should be no funding of sinful activities (as can be called in Arabic “Haram”).
- 5- Financial risk must lie with lender of fund not with manager or agent of it.
- 6- Interest rate is forbidden however some mark-up might be added to cover the charges incurred
- 7- It is not allowed to sell what one doesn't own.

### **6. Types of Products and Services Provided by Islamic Micro Financial Institutions (IMFIs)**

Islamic micro financial institutions (IMFIs) provide various types of products and services to the low income people in the market, some of the main products can be listed as below:

Murabahah (markup or cost plus), Mudharabah (Profit sharing), Musharaka (Partnership), Ijarah thuma bai (Hire purchase), Qard hasan (interest free loan), Muzar'ah (farming contract), Musaqat, Bay salam (forward sale), Wadiah (safe keeping), bai bithamn Ajil (deferred payment sale), wakalah (Agency), Hibah (gift).

### **7. Current landscape of conventional and Islamic Microfinance in Yemen**

Program	Active number of clients			Outstanding loan portfolio Million YR	PAR (%)	Cumulative Numbers		
	Borrowers		Savers			No. of loans	Loan amounts million YR	
	Total	Women						
1	<b>Al-Amal Micro finance Bank</b>	34373	51	57894	1904	0.53	84216	5457
2	<b>National MF Foundation</b>	14896	93	24354	594	4.81	116414	5463
3	<b>Aden MF foundation</b>	10043	90	12531	593	0	54892	2787
4	<b>MF Development program (Nama)</b>	8805	45	1872	539	5.69	64830	5298
5	<b>Altadhamon Bank</b>	8787	37	0	1433	1.10	31549	6658
6	<b>Alkuraimi Islamic Micro finance Bank</b>	5847	3	148619	1854	0.4	9226	4119
7	<b>Sana'a MF –Azal</b>	4672	58	2688	341	5.79	41538	1868
8	<b>Small enterprise development fund (SEDF)</b>	3739	19	0	1481	5	18919	114735
9	<b>Hadhramaut Microfinance Program</b>	2720	39	3534	261	6.98	14492	1134
10	<b>Aletehad Microfinance Program</b>	2487	90	1800	360	0	44592	1800
11	<b>Al-Awa'el MF Company</b>	1820	81	0	50	19.78	58799	2018
12	<b>Social Institution for Sustainable Development</b>	1466	66	0	180	2.71	17529	1723
13	<b>Other activities &amp; IGPs</b>						67495	1690
	<b>Total</b>	99726		253292	9590		624491	54750

Source: prepared by the researcher with the help of the 2013 Social Fund for Development annual report (SFD).

The above table shows the current status of Islamic and traditional microfinance in micro finance industry of Yemen. It shows the total number of poor borrowers in Yemen reached 99,726 and 253,292 savers as per the latest report published by the social fund for development in December 2013. Similarly the total amount of the microfinance portfolio is YR 9,590 billion. Likewise the cumulative number of loans is 624,49 Loans with cumulative amount of YR 54,750 billion. The report further notes that Al-Amal Micro finance Bank is the most active one among all other operators in the market with 34,374 active borrowers, 51% of them are women and 49% men. The total savers are 57,894. Finally the table shows that the Al-awael MF Company has the highest portfolio at risk scoring 19.78%.

It is believed that, the financial literacy about the Islamic microfinance is very low, people hardly know Murabaha approach as it is the main product available in Yemen market, other products and services are rarely used. In spite of this, recent study conducted by the Yemen microfinance network (2013) reported that 60% of Yemeni micro financial institutions provide Islamic products in the market and there is a huge demand for Islamic microfinance, remaining 40% provide both conventional and Islamic financial products.

### **8. Challenges Facing the Islamic Microfinance Industry in Yemen**

Islamic Microfinance industry in Yemen is still in its infancy, both conventional and Islamic micro finance face a lot of difficulties and challenges in the market. However due the religious view and complex culture that exists in Yemen society, it is believed that, the traditional microfinance faces more challenges than the Islamic one. In the below lines, the main obstacles facing the development of the Islamic microfinance industry are listed as the followings.

- ❖ There are no proper ways and techniques for spreading awareness about the significance of the Islamic microfinance industry to low income people in particular and the country in general.
- ❖ People generally do not prefer to use their own jewelries and properties as guarantees because they have the fear of losing them if they are given for collateral purpose.
- ❖ The limited source for funds for micro financial institutions restricts the outreach of IMFIs to reach the rural people in far areas, as most of the IMFIs are funded by the social fund for development only.
- ❖ The negative role played by the commercial and Islamic banks in not down scaling their operations to the level of the poor households.
- ❖ The new threats from the extremists to conventional micro financial institutions that provide both Islamic and conventional products and services lead to shutting down the whole institution.
- ❖ The very poor infrastructure in the country such as electricity, transportation facilities, safety, foreign currency stability and other create another challenge for IMFIs to sustain in the market and reach low income people in the remote areas.
- ❖ The over indebtedness of the clients challenge is one of the biggest challenges to IMFIs, this force the micro financial institutions to design policy capable of reducing this type of risk.

- ❖ The non-availability of Shariah advisor who can frequently provide some consultations to the IMFIs to make sure that the products and services are in line with the Islam law.
- ❖ Shortage in the trained and qualified staff who can meet the requirements of IMFIs and shortage in innovation and creativity for new Islamic products and services in the market.
- ❖ There are still some people in the society who look to Islamic microfinance with suspicious, they say both Islamic microfinance and traditional microfinance charge poor clients high interest or high Murabaha cost.
- ❖ There is a very high operating cost in the Islamic micro financial institutions and this leads to increasing the cost of loans on poor people which ultimately lead them to cancel the loan and depend on their relatives or friends.
- ❖ Limited number of microfinance institutions which provide Islamic products and services in the market
- ❖ Limited outreach of Islamic micro financial institutions to the unbanked people due to the structure of their branches especially in rural areas.
- ❖ Very poor promotion and advertisement about Islamic microfinance among people.
- ❖ High operating cost and collateral demanded restrict the poor people to apply for credit. Study shows that some IMFIs operating cost reach to 50% per year.
- ❖ Finally, there is no separate law for Islamic micro financial institutions that can regulate the activities in the market.

### **9. Opportunities for Islamic Microfinance Industry in Yemen**

There is a promising demand for Islamic microfinance in Yemen; This demand needs to be attained through some steps such as the establishment of separate law to regulate Islamic microfinance in the country, partnership with commercial and Islamic financial institutions ,diversification of products and services so that the scale of Islamic microfinance industry can be expanded. Further, opportunities might be found in finding other sources for fund and establishing especial agencies for promotion of IMFIs.

### **10. Suggestions to Improvement of Islamic Micro Finance Industry**

Islamic micro financial institutions must find some alternative ways for funding their institutions and expanding their scale in the market.

- ❖ The necessity to establish a special law for regulating of microfinance activities in the market
- ❖ The operation cost and other charges in the micro financial institutions must be reduced to the lowest level so that poor people can be encouraged to apply for credit to help their standard of living.
- ❖ The traditional collateral system to be reduced to the minimum and the group lending guarantee to be maximized.
- ❖ Awareness and promotion about microfinance to be increased to a large extent so that maximum people can benefit from the microfinance products and services.
- ❖ Government should provide proper infrastructure and other related facilities so that poor people in rural areas can be reached.

- ❖ Islamic micro financial institutions must have a direct line of consultation and cooperation with international organization that have rich experience in this field to benefit from them and work more effectively.
- ❖ For shortage in the qualified staff, IMFIs can have some agreements with training companies to train their personnel and provide them with required skills.
- ❖ The concept of Islamic microfinance can be increased more by the introduction of mobile banking to the market
- ❖ There is a need of focusing more on the rural areas where majority of poor people of the country exist.
- ❖ There should be a continuous innovation and creativity for products and services supplied by IMFIs to the market.
- ❖ Government should keep provide some support and grants to the new Islamic micro financial institutions in the market till they sustain.

## 11. Conclusion

The concept of Islamic microfinance is relatively new in the Yemen market. Yemen is one of the very conservative Muslim countries where people refrain from the traditional financing. Islamic microfinance work as an alternative solution to low income people who are not permitted to borrow from the commercial banks and other financial institutions due to the restrictions imposed by the Islamic law. There are around 14 microfinance institutions that supply various Islamic products and services to the market. As per the recent study of Yemen microfinance network (YMN), it has been reported that around 60% of these institutions provide pure Islamic microfinance products and services; remaining 40% supply a mixture of Islamic and conventional microfinance products and services. In spite of this impressive rate, still, micro financial institutions face with a lot of difficulties and challenges that limit their outreach and scale of operation. Often , Islamic micro financial institutions & conventional institutions face with similar challenges if not all ,finally, It is believed the Islamic microfinance market has a very promising future as 99% of people in the country is Muslim and most of them wish to have products and services as per the Shariah law.

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