Abstract: The objective of the paper is to identify challenges and opportunities in Islamic microfinance industry by reviewing the present status of Islamic microfinance in Palestine and later suggesting a multiple-stages financing model which will alleviate poverty significantly. To accomplish this purpose, we obtain secondary data from various sources. We suggest a financial framework incorporating several Islamic financial models and the sources of fund applying into different levels of poverty in Palestine. The paper concludes with some policy recommendations, which may potentially create small entrepreneurs and alleviate poverty to a certain extent.


Key Words: Islamic Microfinance, Palestine, Challenges, Prospects.

JEL: F63
Introduction

The conventional and Islamic microfinances are becoming professional industries and offering a wide range of products to the poor population all over the world. Both the concepts got the wide range of global acceptance to pull a certain segment of the population by making them enabled in generating income and changing their lives with small capital they get as a micro finance from Microfinance Institutions. The conventional microfinance was initiated in order to eradicate poverty by giving a small amount of credit to the poor by charging interest. On the contrary, Islamic microfinance was introduced to give a substitution to interest. The Muslim population is increasing rapidly in the world. According to (Haub et al. 2011), It is estimated that the Muslim population on this earth may reach to 2.2 billion by 2030. The World Bank (2012) shows the almost 896 million people live on earning less than USD 1.90 per day. The Muslim countries are facing high unemployment, poverty and low level of financial access which predominantly created a huge demand of micro-credit and reached successfully in the poor Muslim countries like Bangladesh and Indonesia. The excessive number of poverty in the Muslim countries is believed to be the improper way of financing with high interest rate to the poor people of those countries. The interest is strictly forbidden in Islamic law. The high interest rate is depriving the poor people from improving their living standard and other benefits. Thus the ultimate goal of microfinance of eradicating poverty and keeping it in the museum is becoming unsuccessful.

The Islamic financing system to the poor Muslim people living all over the world that support religious perception against the interest rate in conventional micro financing is becoming a formidable way to make the millions of poor Muslim’s economically solvent which will bring them out of the fence of high interest payment. Islamic microfinance will involve the poor Muslims in sharia compliant suitable credit system and bring the unbanked poor under the umbrella of Islamic microfinance.

According to (Nimrah Karim 2011), almost 20 percent of the people in Algeria and Jordan denied conventional microfinance and giving the excuse of the religious region. In case of Yemen and Syria the percentage rises to 40 percent. According to (Karim et al. 2008) revealed that the local practitioners and key informants suggested similar demand trends in Indonesia, Afghanistan, Pakistan, and the Palestinian territories and also Muslim majority areas of India, Sri Lanka, Brunei, Cambodia and the Philippines. Islamic microfinance shows an alternative model
for those poor people who are not currently entertained by conventional microfinance. Thus it is rather important for this thriving industry to come up with some innovative and comprehensive microfinance business model in order to provide sustainable services which will meet the financial demand of the Muslim poor. The present status of Islamic microfinance in the world is the USD 1 billion which is still less than 1 percent of Islamic finance market (USD 1.6 trillion). Moreover, around 300 microfinance institutions are operating worldwide. The major markets of Islamic microfinance includes Sudan, Yemen, Pakistan, Indonesia, Egypt, Qatar, Bahrain, Jordan, Mali, Lebanon, Syria, KSA, Iraq, Palestine, Afghanistan and others (Ahmed et al. 2015).

Religious perception towards the conventional way of lending created necessity to establish a suitable lending system which would meet the demand of Muslim people. According to (CGAP News 2008) survey demonstrated that global Islamic microfinance is contributing very little and operating merely in few countries (80% of the 380,000 clients of Islamic microfinance worldwide are in Bangladesh, Indonesia and Afghanistan); Furthermore, the practice of Islamic microfinance is very little, and it does not surpass more than .05 percent of total microfinance outreach. In case of Arab world, Microfinance Institutions (MFIs) that have been operating for 7-10 years typically only reached between 2000-7000 active borrowers through Islamic microfinance. Therefore, Islamic microfinance needs to be promoted to the poor Muslims as potential a weapon to fight against poverty. It can develop a valuable human capital base in the Muslim community and positively contribute towards the economic growth in these countries.

The Islamic Microfinance concept is comparatively new, and it is still facing challenges and difficulties. Palestine is relatively a conservative Muslim country with extreme poverty and surrounded by different political and economic problems. According to World Food Programme WFP (2014) Palestine economy went through a recession specially the Gaza faced a negative growth and had a severe effect on unemployment which went up to 43 percent. The youth unemployment in Gaza soared to 60 percent and overall unemployment in West Bank and Gaza increased to 27 percent in 2014. The Palestinian economy is basically aid driven, but aid cannot be a sustainable long-term solution for a nation to be developed. Therefore, it is important to come up with some formidable Islamic micro financing models which will make the economy dynamic by creating entrepreneurial opportunities in the SMEs and agriculture which will ultimately open a number of job opportunities.
Therefore, the objective of the paper is to identify challenges and opportunities in Islamic microfinance industry by reviewing the present status of Islamic microfinance in Palestine and subsequently, provide a sustainable multiple-stages financing model which will alleviate poverty significantly complying with the Islamic regulations.

**Literature Review**

Islam does not allow interest and any other activity, which is not permissible by the sharia or Islamic law. On the other hand, interest is supposed to be a drawback of poverty eradication. According to (Mollah & Uddin), mentioned that 98 percent of the borrowers under microfinance program are not aware of the terms and condition of loan and interest rate, and they are completely disadvantaged, on the contrary, Islam ensures social justice and equity, which guide to balance and peace in the society.

Muslims have always been struggling for years to retain their values and cultures in almost every sphere of their lives. (Frasca 2008) focused on the competitiveness of Islamic microfinance and argued that Islamic microfinance could be a potential sector for the investors who faced badly in the global credit crisis of the conventional and speculative credit system. (Akhter et al. 2009) conducted a survey on 125 institutions in 19 Muslim countries. It revealed that Islamic microfinance merely reached to 300,000 clients, Bangladesh contained one third of them alone. They further mentioned that it was very important to concentrate in crafting affordable micro financing models, training and retaining skilled loan officers and administrators, improving operational efficiency and managing overall business risks to reach more people. (Obaidullah 2008), concluded that the commercial banks and other Islamic financial Institutions are not interested in financing micro loans to the lower-income people and Small and Medium Enterprises in the society and demotivated due to the absence of collateral or credit guarantee. He further mentioned that it is important to make a linkage among various organizations, including government agencies, None Government Organizations (NGOs), None Profit Organizations (NPOs), cooperative companies, Takaful so that they can reach to the poorest of the poor of a society significantly. The linkage between the organizations will fruitfully contribute in the micro-enterprises development which will ultimately eradicate poverty significantly from the grass root levels of a society. According to (Mohammed) describe the IDLO Report (2009), Islamic microfinance got less attention and remained less developed in
the Arab world than the other countries in Asia, Africa and Latin America. In the Social and Development Summit in Kuwait city at Arab Economy in 2009, the League of Arab States declared the formation of the USD 2 billion fund run by the Arab Development bank to establish and implement microfinance programme which targeted at boosting small businesses and alleviates poverty across the Arab World.

According to (Barden 2010)A number of aid and assistant programmes are being provided in West Bank and Gaza region to support for a strong and healthy financial sector on a large scale which will contribute to financing for infrastructure projects. In case of promoting small businesses and individual a wide range of micro financing programmes has been undertaken. The financing programmes are specially shahriah based and becoming increasingly widespread in these days in Palestine.

Data Collection and Methodology

The data collected is mainly from the secondary sources from various journal papers, books, different official reports, scholar’s studies, newspapers, website, government reports and other sources. This paper puts an effort to theoretically review the microfinance industry in Palestine along with the Islamic microfinance models, challenges and opportunities. Furthermore, this paper suggests multiple- stages integrated model, which will probably be able to fit socio-economic and political condition of Palestine and alleviate poverty.

An Overview of Islamic Micro-finance and Islamic microfinance Practice in Palestine

Micro-credit was first introduced in 1980s in the occupied Palestinian territory for the rapid growing demand for financing from small and microenterprises, which were the backbone of production and employment in Palestinian economy (Dodeen 2013). Before the establishment of Palestinian National Authority, microfinance associations were the only source of financing. Afterwards with the monitoring of Palestinian National Authority microfinance organizations have expanded and attracted attention of donors given the role of microfinance as one of the key elements for development and the fight against poverty. As a result the number of financing institutions, registered NGOs and international organizations have increased remarkably. In 1996, West Bank and Gaza Strip were given a limited political and economic autonomy to be administered by Palestine National Authority (Arnon & Weinblatt 2001). Since then the territory
is experiencing a high degree of political instabilities, military interventions and conflicts, which have been deeply discussed all over the world but a very little attention has been given to evaluate economic and business environment. The development of the credit sector was even more neglected especially the result of negligence of the contribution and dynamism of banks and not-for-profit organization in practicing microfinance was serious, which hindered smooth economic performance. This cannot be kept as a passive element which respond to the stimuli coming from the real economy (King & Levine 1993). The Palestinian economy is largely relied on Aid. Therefore, the dependence on external donations has major implications in terms of domination and performance, since donors are mainly motivated by political and ideological aims. The main reasons for the poor performance and the fluctuation of Palestinian economy have been attributed to the Israeli policy of limiting the free movement of goods and people from and to Palestine. Basically, there is less literature on the topic of the development and functioning of microcredit industry in Palestine and thus the paper will fill that gap. Since the regions in Palestine are poorer and the banks cannot generate loan utilizing its deposit, therefore the emergence of Islamic microfinance industry can be the obvious alternative in this perspective. Although West Bank has gained a measure of economic growth assisted by donor’s aid programs and nine million members of Palestine diaspora who have sent their hard-earned money as remittance to help relatives or funds fledgling business activities. Despite this growth, wealth has not been evenly distributed to the people of West Bank. (Barden 2010) addressed that 50 percent of the West Bank Population live under the poverty line. In the village many people still live a Bedouin lifestyle, preferring tents or impoverish housing shelters.

Since transaction of interest is prohibited in Islam and for the devoted Muslims in Palestine, the financial system is guided by the principles of Shariah where riba meaning that charging exorbitant rates of interest are totally forbidden. Therefore, microfinance Department of United Nations relief and Work’s agencies, Palestine Development Fund and even the Gaza Women Loan Fund provides particularly shariah based loans at comparatively low interest rates of 5 to 10 percent and compel borrowers to attend classes in financial and business management (Barden 2010). But still this financing system does not follow Islamic norms of financing because it includes interest. Therefore, a sustainable model is highly demanded for the people of Palestine, which will support Islamic rules and regulations in micro-financing.
The trend of Palestine microfinance practice is shown in the following graphs. The data is collected from eleven Islamic microfinance institutions operating in Palestine base from the year 2008 to 2014 from the mix market website. The first graph for the gross loan portfolio highlights big fluctuations. In 2011, the portfolio became highest and all of a sudden in 2012; the portfolio shanked down sharply but in the subsequent years the trend of total portfolio started to grow. One of the reasons for the rapid fluctuation is the insurgence of Israel in Palestinian territory.

Graph: Total Loan Portfolio from the year 2008 to 2014.

![Gross Loan Portfolio in USD](image)

Source: Author’s own sketch based on Mix Market data.

The second graph demonstrates the number of active borrowers in Palestine. The chart shows high demand for Islamic microfinance in Palestine. Every year the number of active borrowers are increasing except in 2012. Although there remains a lot of challenges but there is a high demand for the micro loans. In 2014, the total number of active borrowers reached almost sixty thousand.
Principles of Islamic Micro Finance

For designing a viable Islamic financing model it is very important to integrate Islamic views and ethics in modeling. Islamic micro financing model must follow certain principles which will provide guidelines for how Islamic microfinance is different from conventional financing. (Relief 2008) has illustrated following principles.

1. There must be some risk, whether credit is used in a commercial or productive venture. That means every business venture must contain risk of either profit or loss.
2. Money cannot be a product; any financial transaction must have a material finality which means it should be directly or indirectly linked to a real tangible economic activity.
3. The product or services provided must be clear to both parties.
4. No funding will be allowed in any activities, which are prohibited in Islam.
5. Financial risk will lie on the investors only and not to any managers or agents related to the project management.

6. Interest is strictly forbidden but still some mark-up can be included to cover charges incurred decided by the both parties.

7. It is not allowed to sell what one does not belong. Thus short selling is impermissible.

Islamic microfinance stands on these basic principles supported by the Quran and Sunnah. All the financial institutions must follow these principles in designing financing models for their clients. In conventional microfinance any idea can be tested and apply on the clients regardless of their harmful and negative impacts on the people but in Islamic finance the people are much prioritized.

**Existing Islamic Microfinance Practices around the Globe**

Islamic microfinance predominantly follows the instruments of Islamic finance. The widely accepted models namely Mudaraba (Profit sharing), Musharka (Partnership), Murabaha (Markup or cost plus), Ijara thuma bai (Hire purchase), Qard hasan (Interest free loan), Bay salam (forward sale), Wadiah (safe keeping) etc. are adopted by Islamic microfinance and have been successfully practicing in some Muslim countries like Bangladesh, Indonesia, Malaysia, Afghanistan and in some middle east and African countries. All the models are not always accepted by all the countries. The socio-economic, political and countries cultural trends vary from one country to another. Thus different Islamic models are adopted by different country. In some cases, the models are designed incorporating social aspects and economic condition of any particular country. But overall the main aims of all the models remain same of eradicating poverty, creating employment opportunities, spreading out of education and healthcare facilities and improvement of standard of life.

According to (Mollah & Uddin)Islamic microfinance was initiated in Sudan in 80s and the Microfinance Institutes only have Mudarabah and Quard e Hasan products. However, In Syria Microfinance was launched in 1998 and they only follow Murabaha model. (Mollah & Uddin) further address that Indonesia has large diversity of both conventional and Islamic Micro-financing. The country has 97 percent Muslim people but only 11 percent of them understand the Islamic microfinance products. Qard-e-Hasan model is very popular in Iran. These loans are free but an administrative cost is charged on the size of the loans and the ability of the borrowers to
repay. IDB has provided a model for the Deprived Families Economic Empowerment Program (DEEP) in Palestine. The family bank is established in Bahrain signing agreement between Family Bank and Grameen Trust (Mollah & Uddin). Islamic microfinance demands innovative models to serve various financial needs of the poor around the world. The conventional microfinance system contains high risk and therefore they charge high interest rate and give loans in groups. The other group members are taking loans from other MFIs which ultimately creating debt burden for the borrowers and the loans are becoming unproductive. The existing Micro financing model are not effective enough in integrating basic need of the poor and lagging behind the reasonable solution to the real problem in an effective manner. Therefore a societal integrated model is badly needed.

**Challenges of Islamic Micro Finance in Palestine**

The promotion and operation of Islamic microfinance in Palestine encounter a lot of challenges and difficulties. Palestinian monetary system is not fully free and the country is greatly affected by insurgence and Israeli occupation from time to time. The people of Palestine are religiously fundamental and consider loan in a negative way. Apart from these issues, there are some specific challenges which are causing Islamic microfinance slow to contribute in socio-economic development. These are shown under.

- Islamic microfinance is governed and administered by Shariah law, but there is unavailability of separate Shariah compliant board which could have played a vital role in promoting Islamic microfinance by providing consultative services to the IMFIs.
- Islamic microfinance incur high operating cost for maintaining offices and branches, meeting costs of salaries for the staffs and utility bills. The IMFIs are not subsidized or supported by the government.
- There are a limited number of microfinance Institutions operating in Palestine. Therefore they cannot outreach to the maximum number of the poor people.
- In Palestine, political conflict and turbulence is very common. There always tensions between Palestine and Israel government. This conflict carry a big threat to the economic development of the country. Islamic microfinance encounters huge challenges in such conflicting regions.
• Islamic microfinance requires trained and qualified staffs who can come up with innovative, creative and effective ideas of new Islamic products and services in the market. But unfortunately IMFs operating in Palestine find shortage of such trained and qualified officers for their institutions to carry forward.

• There remain a lack of initiatives to promote and spread awareness about the significance of Islamic microfinance industry especially to poor people and the economic development of a country.

• The fund for spreading and developing Islamic microfinance in Palestine territory is not enough. Sometimes the funds are coming as Aid or food or Medicare items to the people who are victims of the insurgence. These Aid funds serve immediate purpose only for time being but they become crippled economically. Thus Aid funds cannot bring long term sustainable economic solution, but only injection of money into any profit making projects can have long term effect on their lives. Therefore funds for innovative, entrepreneurial and income generating project is badly needed for Palestine.

• Poor infrastructure in the country like communication and transportation, electricity, foreign currency stability, social security etc. create another challenge for IMFIs to continue and grow.

• Keeping jewelries and property as mortgage is not liked by the general people in Palestine. Therefore, collateral free loan is another challenge for the IMFIs.

• Absence of well-structured and well equipped monitoring body with modern rules and regulations to absorb the socio-economic and political condition in Palestine is another big challenge to develop Islamic microfinance institutions in the country.

**Prospects for Micro Finance Industry in Palestine**

Islamic microfinance waves plenty of opportunities to turn the table to socio-economic prosperity. The disparity of wealth, poverty, hunger and begging is not accepted in Islam. It speaks about the equity and extension of helping hands socially and economically. Aid is not enough to bring sustainable growth for a nation. A nation requires effective and well-designed financial policy to throw the poverty in the museum. Despite having so many challenges,
promising demand for Islamic microfinance is lurking to emerge along with a vision to alleviate poverty to a remarkable extent in Palestine.

- Palestine gets enough sympathy from the international donors and developed countries in the face of Aid programs and Zakat. These aid funds can be effectively utilized in the Islamic micro financing schemes. According to (Yunus 2007) philanthropy got one life but never comes back, but business got much means to live. Therefore, society friendly business model can eradicate poverty by generating income utilizing the aid funds.
- The corporate business world has a very important role to play in making the world a better place to live by making the poor people enable in generating income starting with SMEs by giving away funds as corporate social responsibility. This will ultimately integrate poor people in the production cycle by increasing their ability to purchase by making them economically solvent through Islamic micro financing.
- Palestine economy is mainly agriculture dependent. Islamic microfinance can play a very vital role in investing agrarian production and fishing industries.
- Issuance of rules and regulations and establishment of separate promoting and monitoring department from the government side will support Islamic microfinance develop very rapidly in Palestine.
- Huge number of unemployment of young people in Palestine opens a gateway of Islamic microfinance. The frustrated young people can be a source of motivation in Islamic microfinance. By providing small loans and proper training to these unemployed may bring remarkable success in Islamic microfinance.

**Multiple- Stages Model for Islamic Micro Finance in Palestine**

Islamic microfinance can play a vital role in advancing socio-economic development of the poor and small entrepreneurs without charging interest. The micro entrepreneurs can greatly be motivated by the ethical attributes of Islamic microfinance. Therefore, it is very important to develop a suitable model of Islamic microfinance, which will respect the political, social and religious sentiment of a particular country like Palestine and work effectively to move out of poverty. For the proposed multiple-stages financing framework, we have divided the borrowers
into three segments namely, the poor people, the poorer people and the poorest people\(^1\). The three segments are incorporated with different Islamic financing models in accordance with the principles and features of those models. The most important thing in the framework is the fund. There will be a central fund monitored and administered by the board. The board members will be selected by both the IMFIs and the government. The fund will be accumulated by three sources of fund or three windows called Zakat window, Corporate Social Responsibility Window (CSR) and International Aid or donation window. Afterward the fund will be endorsed from the three windows to the IMFIs fulfilling certain conditions. The IMFIs responsibility would be to identify and evaluate the three segments of the poor people to whom they will hand over micro investments. The segments of the poor can be assessed according to the income, retaining of land or farm land or the amount of property they own and the number of children or family member they have. The monitoring board will establish a training and development unit which will train both the investors and the borrowers. They will be given training about the proper utilization of the fund and how they will be able to design new SMEs businesses. How they are going to manage their fund and how they will be able to run their business in profit. The training unit will also help them in consultation from time to time. The IMFIs will prepare package products from the window funds integrating pertaining Islamic investment models to different segments of poor. The IMFIs will form a recovery plan by creating a Risk Fund which will be accumulated by the repayment and deposit share of the clients. The poorest segment will only give an administrative fee, which will directly go to the risk fund. The recovery plan will be backed by the risk fund. The percentage of repayment and deposit will be different for the poor and poorer. The poor will repay installments; determined both by the IMFIs and the borrowers, of the loan and give a certain percentage as provisional deposit and the rest of the profit after paying installment and deposit will be solely taken by him. The provisional deposit will work as collateral but subsequently this deposit will help him manage his own business without taking any more loan. In case of poorer segment, certain percentage will be estimated as repayment both by the borrowers and IMFIs. There will also be a provisional deposit and rest of the profit will be taken by the clients. The poorest segment will be given concession or relaxation in

\(^1\)Palestinian Central Bureau of Statistics reveals that according to consumption patterns, the relative poverty line and the deep poverty line (for example household consists of 2 adults and 3 children) in Palestine in 2011 were 2,293 NIS, and 1,832 NIS respectively. The poverty rate among Palestinian individuals was 25.8 (17.8% in the West Bank, and 38.8% in Gaza Strip). 12.9% of the individuals in Palestine were suffering from deep poverty in 2011 according to consumption patterns (7.8% in the West Bank, and 21.1% in Gaza Strip). While 27.4% of youth (15-29) years are under the poverty rate (19.2% in the West Bank and 40.9% in Gaza Strip.
repayment of the loan. They will only be obliged to pay nominal administrative fees. Basically, the Zakat fund will be provided to them as Quard-e-Hasan and Hiba. The following multiple-stages model will give a clear idea about the whole system of financing.

Multiple-stages Model
Source: Author’s proposed model.
Since Islamic microfinance is collateral free, therefore, the loans will be given in groups. The active and matured family members, friends and relatives together will consist small groups of 5 to 8 members. They jointly plan a business project and propose it to the IMFI. If the officers of IMFI understand the business project viable and enough to make them financially sound in the future, they will take initiatives to process the loan.

**Recommendation and Conclusion**

The famous speech of (Yunus 2007) is that the poverty is not created by the poor rather it is created by the system which is influenced by institutions and policies. The main purpose of our study is to eradicate poverty and to link with the famous Nobel Prize winner’s view it can be said that if a suitable financial framework is designed and established in a war affected country like Palestine, the economy and the fate of those poor will turn towards the development in the near future. The success of an effective financial strategy for the development of Islamic microfinance basically demands concerted efforts by the stakeholders involved like the poor, the investors, NGOs, (None Profit Organizations) NPOs, government agencies such as Ministry of Finance, the monetary authority and he capital market authority. Therefore, my recommendation will be both at micro and macro level. The fund controlling, monitoring and management members will be selected from the both government and private sector and they will be accountable for the actions in handling the fund. The government of Palestine will take initiatives to create awareness to promote Islamic microcredit. Both the IMFI and government will take steps to issue suitable, modern and situation demanded rules and regulation to support and promote Islamic microfinance. The successful and profitable businesses require to be motivated to contribute in poverty alleviation by supplying fund as CSR. This way the big businesses will patronize small entrepreneurs. The international donors will make understood that the fund they are supplying as aid has been utilizing in proper manner in socio-economic development and poverty reduction. The government will take proper steps to raise Zakat fund. Trained and qualified staffs should be employed in this industry to develop IMFI rapidly. The borrowers need to be involved in training and development programs from time to time to carry out their business projects successfully. The IMFI will find markets for the produced items by the borrowers. In this regard IMFI can play an intermediary role to reach the products to the consumers in the domestic market as well as in the international market. More research and development work need to be
continued to measure efficiency and productivity of the loans and recommend policies to both Governments and IMFI which will be financed by the both parties. Develop infrastructure and support systems for the borrowers.

If the above recommendations are taken into consideration and prompt measures are taken into action, the challenges of Islamic Micro finance can be mitigated. Proper management of the overall system can ensure healthy Islamic microfinance in Palestine. Again referring the famous quotation of (Yunus 2007), “Run the engine and the engine will run the system automatically.” For decades, the concentration of the world in Palestine was only war, conflicts, devastation and casualty but hardly any attention was paid to the poor people waiting to change their destiny by empowering themselves financially. Now it is time to come up with some innovative, effective and worthy ideas to hand over them opportunities of developing their socio-economic condition by Islamic finance.
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