



HALAL NEWS

THE INSTITUTE OF HALAL INVESTING NEWSLETTER

Blake Goud, IHI Executive Director
blake@investhalal.org

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NOTE FROM THE IHI EXECUTIVE DIRECTOR

During the past month, the Institute of Halal Investing has pushed forward with our application for tax-exempt status able to receive tax-deductible contributions. In addition, I have been working to develop a model for halal micro-finance (the focus of this month’s newsletter) that does not rely as heavily upon *murabaha* (cost plus sale) financing but instead adopts a model that is closer to the partnership model described in the literature on Islamic finance.

SPONSORSHIP OPPORTUNITY

The Institute of Halal Investing would like to thank those individuals and companies who provide the support that keeps our organization running. Anyone who would like to become a sponsor of the IHI should contact the Executive Director at blakegoud@investhalal.org

Finally, the IHI has added the ability to receive donations through our website (through PayPal). There is no account with PayPal needed to make a donation through our website. –BLAKE GOUD

CONTENTS

Note from the IHI Executive Director	1
Halal Microfinance	1
Upcoming Conferences	3
A Basic <i>Musharaka-Murabaha</i> model for halal microfinance	3

HALAL MICROFINANCE

The Islamic financial industry has revolved around creating Shari’ah-compliant forms of conventional financial products. However, the Islamic financial industry has almost completely ignored conventional finance and has not developed halal microfinance products. There have been a few articles

lamenting its absence and proposing structures of halal microfinance projects, but Islamic financial institutions have not yet shown an interest in adding micro-finance to their product offerings.

BOX 1: ARTICLES ON HALAL MICROFINANCE

Sajjad Chowdhry, “Creating an Islamic Microfinance Model – The Missing Dimension”, *Dinar Standard*, November 18, 2006.

Atif Raza Khan, “Poverty to Profit”, *Islamica Magazine*, Issue 12 – Summer 2005.

Dr. Ehsan H. Feroz, “The Halal Way to Social Change,” *Islamic Horizons*, January/February 2007, p. 42

For those that understand the trends within conventional micro-financing, this should not be much of a surprise. Micro-financing was ignored by mainstream financial institutions until very recently. The impetus for the popularization of conventional microfinance was the United Nations declaration of 2005 as the ‘Year of Microfinance’. This momentum was reinforced when Dr. Mohammad Yunus and his Grameen Bank were awarded the Nobel Peace Prize in 2006.

Dr. Zeti Akhtar Aziz, governor of Malaysia’s central bank, Bank Negara Malaysia, hinted at the potential for halal microfinance in a recent speech at the opening of the International Centre for Education in Islamic Finance (INCEIF) conference on February 23, 2007 in Kuala Lumpur, Malaysia¹. Dr. Zeti described how “Opportunities also need to be created for Islamic financial products to have an outreach to the small and medium-sized enterprises [as well as in] those sectors such as agriculture and manufacturing where there is limited participation by conventional finance.”

¹ Dr. Zeti Akhtar Aziz. “Welcoming Remarks at the INCEIF Inaugural Intellectual Discourse ‘Islamic Finance: Issues and Challenges of Co-existence in an Entrenched Conventional System’, February 23, 2007.

BOX 2: HODEIDAH MICROFINANCE PROGRAM

One of the few halal microfinance programs for which there are a detailed description available is the Hodeidah Microfinance Program (HMFP) in the port city of Hodeidah, Yemen, which began in 1997. The HMFP was run by the United Nations Capital Development Fund (UNCDF), which had 1770 active clients and \$350,000 in outstanding loans in June 2000. The average loan size was 38,000 Yemeni Rials (YR), which was about \$240 and, unlike most microfinance projects, only 23 percent of clients were women. The loans are given using a group-based mutual collateral (i.e., each member of the group is co-equally responsible for enforcing repayment of the total loan amount). In order to avoid agency problems associated with profit-and-loss sharing financing methods like *mudaraba*, the HMFP was based on *murabaha*, where the MFI purchased goods on behalf of clients, with a service charge included in the repayment schedule equal to 2% of the loan per month the loan is outstanding which is repaid at the conclusion of the loan period. This service charge equates to a 26.8% annual rate, about the same rate offered by conventional microfinance institutions, but is fixed at the beginning of the loan period. The UNCDF continues to offer both conventional and Islamic micro-financing, but the latter is exclusively *murabaha*-based (cost-plus sale) but “does increase transaction costs [but some clients are] willing to pay a premium to get access to a type of finance that is in line with their religious beliefs”^{2.2}. —BLAKE GOUD

^{2.1} According to Dahlia El Hawary & Wafik Grais (“The Compatibility of Islamic Financial Services & Microfinance: A Little-Explored Avenue for Expanding Outreach”), this rate is similar to a *murabaha*-based program in Bangladesh, which had compound annualized implied interest rates of 24-25%. A similar, UN Development Program-supported community-based program in the Syrian region of Jabal Al Hoss charges “high” markup fees, but have almost no transaction costs.

^{2.2} UNCDF. 2004. *Microfinance in the Arab States*, p. 84.

The idea of focusing on providing products to those who are currently outside the conventional financial system affords Islamic financial institutions an opportunity to cultivate a market with less pressure from the conventional financial institutions. One such opportunity is developing a halal microfinance program for poor Muslims who see conventional microfinance as prohibited by the ban on *riba*.

Engaging this underserved market with a new form of micro-financing provides the testing ground for a halal microfinance product, but it need not be limited to this market. If the

structure allows the halal micro-finance institution (hMFI) to be self-sustaining, funded by the profits shared with its clients and capital provided by deposits, it will attract attention from the conventional MFIs, and be able to significantly increase its visibility and adoption.

The cost of funds and the cost of lending to the poor, and therefore the interest rates charged by MFIs, surprises many people. For example, a Grameen Foundation market survey of micro-financing in the Dominican Republic² found interest rates ranging from 18% to 60% with most MFIs charging between 30-36%. If a new micro-financing paradigm is developed that provides the hMFI an adequate return without high interest rates (by Western standards; they are significantly lower than moneylenders’ rates), the industry will demonstrate that Islamic banking is distinct and beneficial. —BLAKE GOUD

BOX 3: HARVARD CONFERENCE ON ISLAMIC MICROFINANCE

Harvard Islamic Finance Project
<http://ifptest.law.harvard.edu/>

April 12, 2007

Development of Islamic Finance in Pakistan
Speaker: Dr. Shamshad Akhtar, Governor, State Bank of Pakistan
3:30 – 5:00 p.m. (No prior registration required, no fee)

April 14, 2007

“Financing the Poor: Towards an Islamic Micro-Finance”
8:30 a.m. – 5:30 p.m. (Prior registration required, no fee)

Once more details are released about the list of panelists and position papers, I will post them on my blog:
<http://investhalal.blogspot.org/>

Halal News is released monthly and is written and edited by Blake Goud, the Executive Director of the Institute of Halal Investing (IHI). The IHI is a non-profit think tank based in Portland, Oregon, U.S., which is devoted to demystifying Islamic finance and supporting developments within the industry to increase its appeal to both Muslims and non-Muslims. To subscribe to *Halal News*, please email info@investhalal.org

² Grameen Foundation USA. *Market Survey of Microfinance for Grameen Replication in the Dominican Republic*, November-December 2002, p. 27.

A BASIC DIMINISHING *MUSHARAKA* MODEL FOR HALAL MICRO-FINANCE

The basic transactions involved in this halal micro-financing product would diminishing *musharaka*, a partnership where the one party provides the funds and the other oversees the venture and gradually buys out the financing agent's share of the venture. A halal microfinance institution (hMFI) would provide investment in a business venture with several partners per finance group. Members of the group would use their funds to start micro-businesses. Upon the finance agreement, the hMFI would agree upon a formula for splitting profits with the group, as well as a weekly (or monthly) repayment schedule for the invested funds.

At the end of each week (month), the hMFI would ascertain the amount of profit earned by the group (with each member responsible for accurate reporting by all other members), split the profit according to the pre-specified ratio and receive its share and the repayment amount agreed upon. The repayment & profit-sharing would continue until the group owns their entire venture. The amount of financing available to the group would increase as it develops a financing relationship with the hMFI allowing group members to grow their businesses and increase their incomes over time in a halal way, reducing poverty as the program becomes more developed. It would also allow the hMFI to earn a return and expand to help others. –BLAKE GOUD

UPCOMING CONFERENCES

MARCH 4 – 5, 2007

World Islamic Finance & Investment Conference
Kuwait

MARCH 15, 2007

*Islamic Financial Services Board (IFSB) Workshop
On Clearing & Settlement Systems*
Hong Kong

MARCH 20 – 21, 2007

Islamic Finance & Capital Market Conference
Kuala Lumpur, Malaysia

**IFSB GLOBAL ISLAMIC FINANCE FORUM
(GIFF) 2007**

MARCH 26, 2007

*IFSB Inaugural Lecture on Financial Policy &
Stability*

MARCH 27, 2007

*4th International Seminar on Challenges Facing the
Islamic Financial Services Industry*

*Interactive Session: 'Recent Developments in the
Islamic Financial Services Industry: Are They
Adding Value To or Diluting the Industry?'*

MARCH 28 – 29, 2007

*3rd Seminar on Legal Issues in the Islamic Financial
Services Industry*
Kuala Lumpur, Malaysia

A more extensive calendar of conferences and seminars is available online on our website.

	Symbol	Close (2/28/07)	1 Month	QTD
Dow Jones Islamic Market World Index	DJIM	2,077.90	0.1%	0.2%
Dow Jones Islamic Market U.S. Index	IMUS	2,132.16	-0.6%	0.3%
Dow Jones Islamic Market Europe Index	DJIEU	2,852.29	-0.1%	-0.9%
Dow Jones Islamic Market Asia/Pacific Index	DJIAP	1,397.85	2.4%	1.2%
	YTD	1 Year	3 Year	5 Year
Dow Jones Islamic Market World Index	0.2%	11.0%	33.0%	41.2%
Dow Jones Islamic Market U.S. Index	0.3%	7.8%	22.2%	23.9%
Dow Jones Islamic Market Europe Index	-0.9%	19.1%	48.0%	66.4%
Dow Jones Islamic Market Asia/Pacific Index	1.2%	10.5%	42.0%	68.1%

Source: Dow Jones Islamic Market Indexes *Monthly Index Performance* (As of February 28, 2007)

NOTE: These are provided for reference. The DJ Islamic Market World Index is frequently used benchmark for halal mutual funds.