

## ECONOMIC NEED AND IMPORTANCE OF ISLAMIC MICROFINANCE

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### ABSTRACT

Poverty is one of the biggest challenges of the 21st century. More than three billion people in the world live in poverty. Muslim societies are far behind the rest of the world in tackling poverty. In Indonesia, which has the largest Muslim population in the world, more than half of the national population - about 129 million people - is poor or earns less than \$ 2 a day. One of the main reasons for this is the limited access to financial services. In fact, the poor will not only need loans, but will also need a variety of banking services such as loans, savings, money transfers and insurance. As commercial banks specialize mainly in megacities, microfinance institutions come to the rescue. Microcredit organizations are also divided into two groups in terms of formation and operation. These are Traditional and Islamic microcredit organizations. The microcredit offered by traditional microfinance institutions contains an element of usury that is prohibited by Islamic Sharia, which prevents it from being used by the Muslim population and businesses in the country. This means that the establishment of Islamic microfinance institutions will play an important role in eradicating poverty in the country. Microfinance can be viewed in a narrow and broad sense. In the narrow sense, microfinance refers to the provision of small loans and leasing services. In a broad sense, microfinance includes a wide range of financial services, in addition to microcredit and microleasing, such as microfinance, microinsurance, money transfers, and consulting services. The provision of these services in accordance with the rules of Islamic Sharia is called Islamic microfinance. Unlike commercial banks, microfinance institutions have been established and are developing as a financial mechanism to serve low-income people. This article presents the economic necessity and importance of Islamic microfinance, as well as scientifically based proposals and recommendations for the establishment of the Islamic Microfinance Organization in Uzbekistan.

**Keywords:** Islamic Microfinance Organization, usury, Islamic financial services, zakat, waqf, murabaha, musharaka, mudaraba.

Microfinance is emerging as a powerful financial mechanism in the fight against poverty around the world. The concept of microfinance was first implemented in 1976 by Nobel laureate Professor Muhammad Yunus. Since then, it has been adopted by many, improved, and used by organizations in various countries, mainly in the developing world, as one of the main financial tools to fight against poverty and improve the rural economy. The main reason for the emergence of microfinance was to reduce the level of poverty, to create an opportunity for the population with low income to use financial services, but it was later redirected as a mechanism aimed at making a profit and was used for various purposes [2]. Until now, it is actively used not to reduce poverty, but to make financial services available to the general public. It has been

recognized internationally that Islamic microfinance is more effective in reducing poverty than traditional microfinance.

In 2020, the assets of Islamic microfinance institutions were estimated at USD 156.7 billion and this figure is projected to reach USD 304.3 billion by 2026, with an annual growth rate of 11.9% during the analysis period[3]. As a result of the introduction of this financial mechanism, it is possible to reduce poverty by creating job vacancies and increasing the financial literacy of the population, and the use of financial services by the low-income population.

Research method.

This article is written on the basis of available secondary data scientific articles, studies and websites of Islamic microfinance organizations. Grouping, comparison, scientific abstraction methods were used in writing the article.

Microfinance institutions have been proposed as a way to provide financial services to low-income households that do not have access to commercial banks. Microfinance is primarily the provision of financial services in the form of savings and loans to low-income people, as well as other forms of service provision such as insurance, social mediation, financial literacy, and entrepreneurship training.[8] It is an effective tool to combat poverty, especially in developing countries.

Brandsma and Bourgeoisie (2004) describe microfinance as:[9]

1. Focusing on low-income entrepreneurs who do not have access to commercial banks;
2. Creating simple and convenient access to small, short-term and recurring loans to borrowers using informal assessment that replaces collateral and investments;
3. Provides voluntary savings services that facilitate small deposits, convenient deposit and quick liquidation.

From the point of view of state regulation, microfinance is divided into three types:[10]

1. Informal. Not regulated or controlled by a regional authority. Institutions include self-help groups, credit unions, families (relatives), and personal lenders.
2. Partially formal. Includes registered individuals and certain financial institutions. Although they provide several financial services, these institutions do not accept deposits and do not make loans. Hence, they act as financial intermediaries but are not regulated like commercial banks.
3. Formal. These include microfinance units of commercial banks, rural banks and cooperatives. Institutions are regulated as commercial banks.

Any microfinance organizations are necessarily based on a model. That is, it refers to microfinance programs that include how capital is formed, the volume of microfinancing, income, expenses, profit, loss and other information. Below we will get acquainted with the models of microfinance organizations.

1. Grameen Bank Model. In this concept, individuals come together to form small groups and form a microcredit organization. A model that popularized this methodology and has been successful in many countries in different settings is the Grameen Bank model, which was established in Bangladesh. The model mainly involves careful targeting of funds to the poor, including women's groups. The model requires staff to work intensively to motivate and supervise groups of borrowers. Groups usually consist of five members who guarantee each other's loans. There are a number of variants of the model; however, the key feature of the model

is pooled and tiered financing, which is used as a means of mitigating the risk of collateral default[4].

2. The second model is the rural banking model and mainly widespread in Latin America and Africa. The model involves an agency that organizes rural banks with thirty to fifty members are formed from the capital of individual members. Individual loans issued by the microfinance organization are repaid weekly for four months, during which the village bank returns the principal with interest/profit to the implementing organization. The client who has paid the loan in full has the right to receive further loans, and the amount of the loan depends on the amount of savings of the members of the village bank. Funds accumulated in the village bank are also used for financing. When the rural bank reaches a sufficient level of internal capital, it becomes a self-sustaining institution after becoming independent (usually within three years). This model has been successfully implemented in Jabal al-Khos, Syria, in a Sharia-compliant manner. A new experiment conducted by FINCA in Afghanistan also proved the successful implementation of this model[4].

3. The third type of microfinance organization model is a credit union. This microfinance organization is based on mutual financing. Members of the association pool their money and buy cooperative shares. As a result, members of the association are able to provide each other with loans, demand deposit accounts and other financial products and services. Any income generated is used to finance projects and services that benefit the community and its members.

4. The fourth model that emerged in India is based on self-help groups. Each group consists of about ten to fifteen members of similar income. Groups basically pool the savings of their members and use them for lending. Groups also seek external funding sources to supplement internal resources. The terms of lending differ depending on the democratic decisions of the group members.

It can be noted that while most of the models described above use traditional interest-based microfinance, there are also Islamic microfinance institutions that strive to comply with Shari'ah.[5].

## RESULTS

Microfinance organizations operating on the basis of Islamic Sharia rules are called Islamic microfinance organizations. Islamic Microfinance involves providing financial services to clients using Islamic principles such as brotherhood, solidarity and partnership. In addition, business is financed on the basis of partnership between institutions and clients [6].

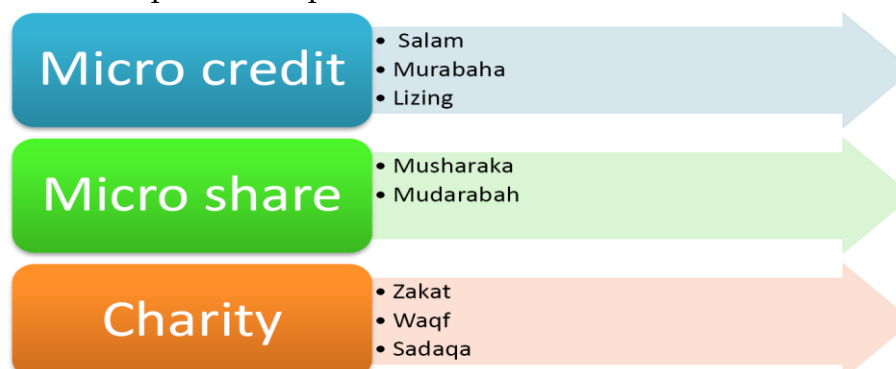


Figure 1. Structure of Islamic Microfinance.

Islamic microfinance organizations are divided into two groups: commercial and non-commercial. The business form includes microcredit and micro share (business based on partnership). Non-commercial forms include Waqf funds. All types of microfinance organizations must strictly adhere to the following 3 main principles. These are the following:

Riba (interest) in any form is prohibited. In simple terms, it means to borrow money without doing any work. Loans of any kind are an example of this.

Gharar. Insufficient awareness of information. In this case, the seller and the buyer must have equal information about the goods. The main purpose of prohibiting this by the Shari'ah is to prevent one party from gaining an unfair advantage over the other. Gharar doesn't generate anything extra at all, but earns money by losing or hurting someone. For example, hit selling a car as if it was not damaged, selling a bag of potatoes with damaged potatoes after picking good ones on top, and selling the product to a buyer who does not know the market price for several times the price.

Maisir- Unfounded entrepreneurial luck is understood as profit or loss without any action. An example of this is gambling, which is the accidental acquisition of wealth without hard work at the expense of someone else. Catalyst in a football match, Boriga Baraka TV show.

In addition to the above, Islamic microfinance organizations can issue microloans only in ways permitted by Sharia (halal). Prohibited activities include: raising pigs, selling tobacco, selling alcoholic beverages or their transportation, storage, human trafficking, computer games, and other similar activities that are dangerous for society.

The introduction and development of Islamic financial services remains an urgent issue for Uzbekistan, where the majority of the population is made up of Muslims [7]. The law "On non-bank credit organizations and microfinancing activities" (ORQ-765, 20.04.2022) was adopted. The signing of this law is one of the major steps taken for the development of the sector. In Article 4 of this law, Islamic financing services are defined as Islamic services. Financial services provided by the Central Bank of the Republic of Uzbekistan in accordance with the rules of international organizations that define the standards of financing are indicated[1]. It is also important to develop the forms based on it.

Akhuwat Islamic microfinance organization was founded in Pakistan in 2001. By now, this organization has 800 branches, 301 educational institutions, and 4.8 million users.[14]

Widespread introduction of Islamic microfinance organizations provides the following opportunities for the country:

1. to ensure the maximum participation of free funds available to the population and business representatives in the development of the economy; (If deposit option is given)
2. development and diversification of financial services for the low-income population in the country;
3. create many new jobs;
4. increase the activity of the population in the financial market by increasing the financial literacy of the population;
5. Coordinate and upgrade infrastructure in the country by establishing a new microfinance industry providing Islamic financial services;
6. contribute to the implementation of the state program to combat poverty;
7. creating a personnel training program in a new direction.

## DISCUSSION

Islamic microfinance provides services based on Sharia and divides profits and losses with the entrepreneur. The question arises, why does Uzbekistan need Islamic microfinance?

Islamic microfinance has the advantage of attracting more funds, i.e. collecting deposits, from the majority of the Muslim population. It is possible to invest free funds of the population in its production by attracting this factor. From this, the entrepreneur, the bank, and others will be equally interested. Is it possible to keep cash in the hands of the population and ensure the situation in the economy? And this will serve to change self-management inflation. We do not have the right to receive deposits to non-banking organizations, this right should be reconsidered. The law "On non-bank credit and microfinancing activities" (ORQ-765, dated 04/20/2022) was adopted.[1] The signing of this law is one of the big steps taken for the development of the industry. can provide Islamic banking services.

Inadequate production of microloans by commercial banks does not ensure the ability to receive microloans, services of microcredit organizations and pawnshops are in a bad state of development of high interest rate production. Islamic microfinance, unlike interest-bearing loans, provides financing through profit or loss sharing and is widely available to consumers. That is, the entrepreneur and the microfinance organization operate on the basis of partnership. If the business makes a profit, if it makes a profit, it bears the loss in the amount of the share it invested in the business.

Profit and loss sharing among partners provides additional income to low-income or no-income entrepreneurs. It also plays an important role for the economic and social development of the society and serves to support poverty. One of the important and effective methods is Islamic microfinance for poor people of the society. [11]

Need a more convenient way for people to make their living, Islamic microfinance can be the best way. The Islamic microcredit system does not support any cause, but helps and encourages the income of the population. Because the organization participates in this project as a partner. This helps the poor to maintain micro-savings, micro-investments and micro-insurance. per day, the well-being of the population in the community will increase.

A general assessment of the data collected by the scientific research shows that microfinance refers to the provision of quality products to the poor and underprivileged, with low income controlling the use of products that are economically available. It takes a level of service such as credit, venture capital, money transfers, insurance, money transfers. Helping the poor can help increase poverty by saving household income and assets in the economy.

It presents the principles of using Islamic microfinance based on Sharia. Its advantage over traditional microfinance is that it includes services such as zakat and sadaqah, which are determined by the control of riba and gharar, the responsibility of returning to the extremely poor population. The results show that Islamic microfinance is more effective in supporting poverty and determines the welfare of the society compared to the traditional one.

Summary. Islamic microfinance organization has passed the stage of establishment and formation and proved to be more effective in fighting against poverty than traditional organizations. The introduction of Islamic microfinance organizations primarily serves to combat poverty and create jobs. The establishment of an Islamic microfinance institution will

be an important factor for the bright future of Uzbekistan, as well as a foundation for the establishment of an Islamic window and Islamic banks.

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