

## Chapter 32

# Integrating Zakat and Microfinance: A Proposed Framework

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### **ABSTRACT**

*This chapter bridges the concepts of microfinance and Zakat, and proposes a conceptual framework as a potential strategy to solve poverty. This study employs qualitative approach. Specifically, it performs content analysis on related manuscripts, and conducts a structured interview with selected stakeholders of Zakat institutions. The study proposes that Zakat institution must have a clear definition about which Zakat fund portion should be used for the program. Authors propose the use of amil for the program and it must be given by amil voluntarily and there must be clear mechanism on which deserving categories (asnaf/mustahik) should be prioritised to be the part of the program. In practice, amil can be considered as investors (where Zakat institution distributes and becomes Islamic microfinance institution) or financial intermediary (where the amil distributes and becomes Islamic microfinance institution appointed by the authority).*

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## BACKGROUND

Inequality and poverty have been a global issue for centuries. United Nation Development Program (UNDP) estimates that in 2018, 77% of global population faces a multidimensional poverty. Most of this population reside in Sub-saharan African and South Asian countries. UNDP defines that multi-dimensional poverty is a condition where people have issues with their standard of living which includes sanitation, drinking water, education and health (UNDP, 2018). To address poverty issues, myriad of steps have been proposed and undertaken by the government, which include macroeconomic financial approach such as controlling the interest rate, to microeconomic financial approach such as incentive for business and others alike. As poverty issue persists, there is always avenue for academics and social activists to propose alternative approaches that can potentially help eradicate poverty.

Previous study reports that microfinance programs provided by conventional banks in the United States have failed to develop the business due to the higher rate that lender gave to the business (Petersen and Rajan, 1994). On the other hand, inspired by success story of Grameen Bank in Bangladesh in reducing poverty through Islamic microfinance program, Dusuki (2007) argued that Islamic banks can be a solution (source of fund) for poverty issues in Muslim-majority countries. His study offers some schemes that can be used for the program. However, there have been limited studies analysing the role of Islamic banks in microfinance programs. We note only Possumah *et al.*, (2019) who document the effect of microfinance programs implemented by Islamic banks on the inequality of Indonesian society through the year of 2000 to 2017.

On the other hand, many scholars also propose the use of Islamic social fund such as *Zakat* and *waqf* for the Islamic microfinance program (Ahmed, 2002; Kaleem *et al.*, 2010; Ismail and Possumah, 2012; Rahman and Dean, 2013). In practice, many *Zakat* institutions in Indonesia and Malaysia have started applying *Zakat* and *waqf* fund for Islamic microfinance, aptly known as *Zakat* for productive purpose (Hassan and Noor, 2015 ; Yumna and Clarke, n.d). A more recent example is Akhuwat Islamic Microfinance in Pakistan (Rafay, *et al.*, 2019), a *waqf* based Islamic microfinance in Turkey (Babacan, 2011).

*Zakat* is an Islamic medieval income distribution tool that is obligatory upon Muslim whose wealth possession reaches the *nisab* (minimum threshold). The amount of *Zakat* fund collected by *Zakat* institutions around the world is potentially huge. For instance, in Indonesia, Al Parisi (2017) mentioned that the potential of *Zakat* funds had reached IDR 286 trillion or equal to USD 20,46 billion. However, the actual *Zakat* fund collection reached only IDR 3.7 trillion in 2015, which is the equivalent of USD 265 million.

Fundamentally, *Zakat* has been distributed to support consumption purpose among the poor and needy. Following the suggestion from Islamic scholars, a recent innovation in *Zakat* distribution includes “productive” *Zakat*. Several Muslim countries like Indonesia and Malaysia have introduced and practiced *Zakat* for productive purpose, which is a financial aid program to support the poor and other *mustahik* (deserving categorized) setting up or growing their business until they reach the status of non-eligible for *Zakat* funds.

Notwithstanding the progress made, *Zakat* institutions still face some challenges. Notable issues are inefficiency and *Shari'ah*-compliance problems. Inefficiency is reported in the case of Malaysian *Zakat* institutions, particularly with respect to the distribution of *Zakat* funds which failed to reach the “real target group” (poor people in dire need of support). Ab Rahman *et al.*, (2012) opine that this issue is caused by the lack of publicity from the authorities and information about the target group in the community.

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