



CHALLENGES OF MICROFINANCE AND THE
PROSPECTS OF DEVELOPING AND
INTRODUCING AN ISLAMIC MICRO-
INVESTMENT MODEL IN NIGERIA

BY

ALIYU DAHIRU MUHAMMAD

A dissertation submitted in fulfilment of the requirement
for the degree of Doctor of Philosophy in Economics

Kulliyyah of Economics and Management Science
International Islamic University
Malaysia

OCTOBER 2012

ABSTRACT

Poverty alleviation efforts dominate the agenda of developing nations. Various government and donor agencies have been applying various techniques to alleviate the menace of poverty. Recently, microfinance has been touted as an effective tool in fighting poverty. However, the institution of microfinance faces some obstacles on its way to success. These include high and fixed interest rate on loans, mismatch between the objective of fighting poverty and the service provided. This has led to the emergence of Islamic microfinance in some Muslims countries and communities. However, the practice of Islamic microfinance again raises an alarm on the mismatch between the objectives of Islamic economics and Islamic finance with that of the institutions offering Islamic microfinance. In Nigeria, there exists a sizable number of poor below the poverty line engaging in microenterprises that are in dire need of financial services to prosper, but who have no access to finance. In lieu of this, there is need for alternative model that will ensure business success with socio-economic objectives of the Muslims community. This research has developed an Islamic micro-investment model (IMIM) that can be applied by any Islamic microfinance institution which has the dual objectives of attaining profitability and promoting socio-economic welfare of the society. IMIM incorporates *waqf* and microfinance and as the former is a voluntary act, it can be seen to be an ‘ethically superior’ institution. A mixed-methods approach was used to collect the data. Findings from this study, using structural equation modeling, showed that Theory of Reasoned Action (TRA) model was useful in predicting intention to use Islamic micro-investment instruments. The hypotheses tested showed that the model fits the data well, thus, the TRA predicts the behavioural intention of Islamic micro-investors in Nigeria. The result showed that intention to use Islamic micro-investment model was impacted significantly by the attitude of the micro-investors while subjective norms were found to be insignificant. However, subjective norms were able to predict intention through attitude in the revised model. Findings from qualitative data also indicated that the Islamic micro-investment model is applicable in Nigeria and has tremendous benefits for the micro-investors in particular and the society at large.

ملخص البحث

إن جهود تخفيف الفقر مسيطرة على جدول أعمال الدول النامية. وقد استخدمت أساليب شتى من قِبل حكومات كثيرة لوضع حل لخطر الفقر. وفي الآونة الأخيرة، روجت التمويل المصغر كأداة فعال في محاربة الفقر. إلا أن مؤسسة التمويل المصغر نفسها تواجه عقبات إلى حد ما تحول دون نجاحها. وتشمل هذه كلاً من نسبة الربح العالية والمحددة في الديون المقدمة، والخلط بين هدف محاربة الفقر والخدمات المقدمة. وأدت هذه المحاولة إلى ظهور التمويل الإسلامي المصغر في بعض البلدان والمجتمعات الإسلامية. إلا أن ممارسة التمويل الإسلامي المصغر بدوره حذر من خطر الخلط بين أهداف الاقتصاد الإسلامي والتمويل الإسلامي مع أهداف المؤسسات التي تقدم التمويل الإسلامي المصغر. وفي نيجيريا مثلاً، يوجد العديد من الفقراء تحت خط الفقر يزاولون المشاريع المصغر الذي بحاجة ماسة إلى الخدمات المالية للنمو والازدهار، ولكنها تفتقر إلى ما يوصلها إلى التمويل. وتزامنا مع هذا، فإن هناك ضرورة إلى إيجاد نموذج بديل يضمن نجاح التجارة مع أهداف العوامل الاجتماعية والاقتصادية للمجتمعات الإسلامية. وقد اقترح هذا البحث نموذج استثماري إسلامي مصغر (IMIM) والذي يمكن لمؤسسات التمويل الإسلامي المصغر تطبيقه بصورة ثنائية الأهداف تحقق الربح وتعزز رفاهية الاجتماعية الاقتصادية للمجتمع. ويتضمن IMIM كلا من الوقف والتمويل المصغر، فكما أن السابق يعتبر تصرفاً تطوعياً، يمكن اعتباره كذلك أفضل مؤسسة أخلاقياً (حنيف، 2011). واستخدم المنهج المزدوج لجمع بيانات الدراسة. وقد توصلت نتائج هذه الدراسة عبر استخدام نمذجة المعادلة البنائية (SEM) إلى أن نموذج نظرية مسبب العمل TRA كان مفيداً في تنبؤ النية من استخدام أدوات الاستثمار الإسلامي المصغر. وكشفت الافتراضات المختبرة أن النموذج المقترح مطابق للبيانات، يعنى أن نظرية مسبب العمل TRA محدد تماماً لنية تصرف مستثمري التمويل في نيجيريا. كما أشارت النتائج إلى أن الميل إلى استخدام نموذج الاستثمار الإسلامي المصغر كان متأثراً بسلوك مستثمري التمويل المصغر، بينما كشفت النتائج أن القيم النسبية غير مهمة. إلا أن القيم النسبية تكمنت من تحديد النية عبر السلوك في النموذج المعدل. وأخيراً، أكدت نتائج المنهج النوعي كذلك أن نموذج الاستثمار الإسلامي المصغر يمكن تطبيقه في نيجيريا وله فوائد جمة لأصحاب الاستثمار المصغر بصفة خاصة وللمجتمع بصفة عامة.

APPROVAL PAGE

This dissertation of Aliyu Dahiru Muhammad has been approved by the following:

Mohamed Aslam Haneef
Supervisor

Musfata Omar Mohammed
Co-Supervisor I

Muhammad Arif Zakaullah
Co-Supervisor II

Norma Md Saad
Internal Examiner

Muhammad Syukri Salleh
External Examiner

Tunku Mohar B Tunku Mohd Mokhtar
Chairman

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Aliyu Dahiru Muhammad

Signature.....

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION
OF FAIR USE OF UNPUBLISHED RESEARCH**

Copyright © 2012 Aliyu Dahiru Muhammad. All rights reserved.

**CHALLENGES OF MICROFINANCE AND THE PROSPECTS OF
DEVELOPING AND INTRODUCING AN ISLAMIC MICRO-INVESTMENT
MODEL IN NIGERIA**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Aliyu Dahiru Muhammad

.....
Signature

.....
Date

*This dissertation is dedicated
to my parents and family for continuous support,
patience and prayer.*

ACKNOWLEDGEMENTS

Thanks be to Almighty Allah for sparing my life to see the end of programme successfully. Equally, I found it necessary to thank Allah once more for giving me the ability and will to undergo the programme despite numerous challenges. Peace and blessings be upon our noble Prophet Muhammad, his family and his companions.

I am indebted to my supervisor Professor (Dr.) Mohamed Aslam Haneef, for his guidance, insights and numerous supports throughout my studies. May Allah reward him abundantly. I am equally indebted to my Co-Supervisor, Assistant Professor (Dr.) Mustafa Omar Mohammed for his moral as well as academic contributions towards accomplishing my program. Sir, I really consider you as a father and mentor as well. I pray for Allah to continuously increase you in knowledge and wisdom. Similarly my prayer goes to my able Co-supervisor, Prof. (Dr.) Muhammad Arif Zakaullah, whom his knowledge, wisdom and strong motivation impact positively on the entire thesis. He has been with me since my master's program and up to Ph.D. I thank him and pray for Allah to improve his health condition and whatever pains he suffers from his illness to make it expiation of his sins.

Similarly, I acknowledge and thank the Research Management Centre, IIUM, through my supervisors for funding this research, which covers my trip for data collection and related expenses as well as honorarium for the student. My thanks also go to all my lecturers at the Kulliyah and Bayero University Kano/schools such as Prof. Dr. Ataul Huq, Assoc. Prof. Dr. Jarita Duasa, Dr. Norma Saad, Dr. Alias Mat Derus, Head of Department of Economics, Dr. Ghairuzazmi M., M. Ahmad G. Amin, Dr. Badayi, Dr. Umar Abdurrahman, Prof. Dr. Sahari and M. Ahmad Ridwan.

To my late parents, I have no enough words that would express my thanks to you. You always pray for my success when you were alive. I will never forget the love and affection that you had shown to me. That, indeed, offered you golden opportunity to mould me and enable me to obey your commands out rightly. As you have departed this world, all that I can say is for Allah to make your graves portions of your homes in paradise and re-unite us in Jannat al-Firdaus.

To my beloved wife Marawiyya Kabiru Zubair, I would like to thank you for your patience and perseverance that you have expressed during my studies. To my parents in law A. Kabiru and H. Mariya, I appreciate your support at various stages of my life. My special prayer goes to my kids Abdallah Aliyu and Fatima Aliyu, may Allah make you pious children and the comfort of my eyes always. Similarly, I would like to acknowledge the numerous financial and moral supports given to me by my beloved uncle, Alh. Garba Shehu. May Allah reward him with the best of that he has done to me. I am indebted to my elder brother A. Hamisu Dahiru, enrolling me into primary school and continued mentoring me since childhood until I was married. May Allah reward him generously. I acknowledge the contribution of Abba Shehu, Alhaji Ibrahim Muhd, Maikudi Dahiru, Bashir Dahiru, Muhd Dahiru, Hamza Dahiru. My

special prayer goes to my brothers that recently passed away i.e. Alh. Auwal Dahiru and Aminu Dahiru, may Allah forgive them and reward them with paradise.

Finally, I would like to express my gratitude and appreciations to my friends such as Isa Ado Abubakar, Yahuza H. Umar, Dr. Nuruddeen Bashir, Muhd Ibrahim (Shamsu), Abdullahi Muhd, Mukhtar Abdullahi, Abubakar Affan, Usman Muhd (Shehu), Sharfuddin Umar, Idris Uba, Yusuf Bashir, Dr. Umar Idris, Dr. Muhd Abduh, Hamza Muhd, Fouad Amin, Ismaeel I. Na`iya, Dr. Adewale Abidin, Dr Naail Muhd, Muhd Burhan, Qasim Bakari and all those that have in one way or the other contributed to my success not only educationally but in all other endeavours.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration	v
Acknowledgements.....	viii
List of Tables	xiv
List of Figures	xv
List of Abbreviation	xvi
Glossary of Terms.....	xviii
CHAPTER ONE: INTRODUCTION	1
1.1 Background Of The Study	1
1.2 Statement Of The Problem.....	6
1.3 Research Objectives	9
1.4 Research Questions	10
1.5 Hypotheses	11
1.6 Contributions Of The Study.....	11
1.7 Scope And Limitations Of The Study.....	13
1.8 Plan Of The Study.....	14
CHAPTER TWO: OVERVIEW OF NIGERIA'S MICROFINANCE INDUSTRY.....	15
2.1 Introduction.....	15
2.2 Nigeria'S Economic Growth And Poverty Reduction.....	15
2.3 Emergence Of Microfinance And Its Charateristics	18
2.3.1 Microfinance Policy in Nigeria	19
2.3.2 Development Finance Institutions and Microfinance in Nigeria.....	22
2.4 Challenges Of Microfinancing In Nigeria.....	26
2.4.1 Interest rate	26
2.4.2 Reducing Inequality in the Distribution of Wealth and Income.....	27
2.4.3 Microfinance Outreach of the Poor	28
2.4.4 Quality of Loan Portfolio	30
2.5 Needs And Prospects Of Islamic Microfinance In Nigeria.....	31
2.5.1 The Needs for Microfinance in Nigeria.....	31
2.5.2 Prospects of Islamic Microfinance in Nigeria	35
CHAPTER THREE: REVIEW OF THE RELATED LITERATURE	37
3.1 Introduction	37
3.2 Concept Of Microfinance.....	37
3.3 Conventional Theories Of Microfinance	38
3.3.1 Imperfect Information Theory	39
3.3.2 Informal Credit Market Theory	40
3.3.3 Supply Leading Finance Theory.....	40
3.3.4 Minimalist view on Microfinance	41

3.3.5 Maximalist view on Microfinance.....	41
3.4 Microfinance And Poverty	42
3.4.1 Concept and Nature of Poverty	42
3.4.2 Poverty and Basic Needs	46
3.4.3 Sen`s Capability Approach to Poverty Reduction.....	50
3.5 Models Of Microfinance	51
3.6 The Demand For And Supply Of Microfinance	53
3.6.1 Demand for Microfinance	53
3.6.2 Supply of Microfinance	54
3.7 Clients Of Microfinance.....	55
3.8 Empirical Studies On Microfinance Impact.....	58
3.9 Islamic View On Poverty	60
3.10 Principles Of Islamic Microfinance	66
3.10.1 Beneficent Loans.....	73
3.10.2 Appraising Profit-sharing and Equity-participation.....	74
3.10.3 Islamic Banking and Microfinance	76
3.10.4 Nature of Islamic Microfinancing	82
3.10.5 Benefits of Islamic Microfinancing.....	84
3.10.6 Impact of Riba on the Economy.....	86
3.11 Models Of Islamic Microfinance	88
3.11.1 Islamic NGOs and Microfinance in Bangladesh.....	89
3.11.2 Islamic Microfinance in Sudan	91
3.11.3 Islamic Microfinance in Yemen.....	93
3.11.4 Islamic Microfinance in Malaysia.....	94
3.11.5 Islamic Microfinance In Indonesia.....	95

CHAPTER FOUR: THE PROPOSED MODEL AND THEORY OF REASONED ACTION97

4.1 Introduction	97
4.2 Proposed Model For The Present Study	97
4.2.1 Concept of Islamic Micro-Investment Model	98
4.2.2 Islamic Microfinance versus Islamic Micro-Investment Model..	99
4.2.3 The Needs and Prospects of Islamic Micro-Investment Model ..	100
4.2.4 Waqf-Ijara Contract	103
4.2.5 Mudarabah Contract	105
4.2.6 Musharakah Contract.....	107
4.2.7 Structure of Islamic Micro-Investment Model (IMIM).....	109
4.2.8 Economic Implications of the Model	110
4.3 Theory Of Reasoned Action (Tra): A Theoretical Framework.....	112
4.4 Justification For Employing Tra	114
4.4.1 TRA Application in Consumer Behaviour and Decision Making Studies	114
4.4.2 TRA Application in Islamic Economics and Finance	117

CHAPTER FIVE: RESEARCH METHODS119

5.1 Introduction	119
5.2 Research Design.....	119
5.3 Research Approach	120
5.4 Study Area.....	121

5.5 Sources And Type Of Data	122
5.6 Population Of The Study.....	123
5.7 Sample Size And Sampling Technique.....	123
5.8 Instruments.....	125
5.8.1 Questionnaire.....	125
5.8.2 Interview.....	126
5.9 Data Collection Procedure	127
5.10 Data Analysis Techniques.....	128
5.10.1 Reliability And Validity Analysis.....	128
5.10.2 Structural Equation Modeling.....	131
5.10.2.1 Measurement.....	133
5.10.2.2 Model Evaluation.....	134
5.10.2.3 Potential Model Modification.....	136
5.11.1 Qualitative Data Method.....	137
CHAPTER SIX: DATA PRESENTATION AND ANALYSIS	139
6.1 Introduction.....	139
6.2 Data Screening.....	139
6.2.1 Missing Data, Illogical And Inconsistent Responses	139
6.3 Demographic Information Of The Respondents	141
6.4 Research Findings.....	144
6.5.1 Measurement Models (Cfa).....	145
6.4.1.1 Measurement Model: Behavioural Intention.....	145
6.4.1.2 Measurement Model: Attitude.....	146
6.4.1.3 Measurement Model: Subjective Norm.....	147
6.4.1.4 Measurement Model: Behavioural Belief.....	148
6.4.1.5 Measurement Model: Normative Belief.....	149
6.5 Model Specification.....	151
6.6 Qualitative Data Analysis.....	158
6.7 Summary.....	168
CHAPTER SEVEN: DISCUSSIONS, IMPLICATIONS AND CONCLUSIONS	170
7.1 Introduction.....	170
7.2 Discussions.....	170
7.7.1 Profile Of The Respondents	170
7.7.2 Tra Findings.....	173
7.7.3 Qualitative Findings	177
7.7.4 Summary Of The Major Research Findings.....	182
7.3 Implications Of The Study.....	184
7.7.5 Theoretical Implication.....	184
7.7.6 Practical Implication.....	185
7.7.7 Implications For Researchers	185
7.7.8 Recommendations	186
7.4 Conclusions.....	187
BIBLIOGRAPHY	189
APPENDIX I	206

DEFINITION OF OPERATIONAL VARIABLES.....	206
APPENDIX II.....	207
SPECIALIZED MARKETS IN KANO STATES	207
APPENDIX III	209
OUTREACH OF ISLAMIC MICROFINANCE BY COUNTRY	209
APPENDIX IV	210
SURVEY QUESTIONNAIRE	210
APPENDIX V	214
INTERVIEW QUESTIONS	214
APPENDIX VI	215
PROFILE OF EXPERTS INTERVIEWED	215
APPENDIX VII.....	216
THEMES GENERATED.....	216
APPENDIX VIII.....	218
TRANSCRIPTIONS FOR THE INTERVIEW.....	218

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
2.1	Poverty Profile of Nigeria	16
3.1	Models of Microfinance.	52
3.2	Instruments of Financing in Islamic Microfinance	71
5.1	KMO and Bartlett`s Test	129
5.2	Factor Analysis Test	130
6.1	Demographic Information of the Respondents	142
6.2	Results of the fit indices for constructs	150
6.3	Model Fit Indices and its cut-off value	151
6.4	Revised Model Fit Summary	155
6.5	Estimates Based on Maximum Likelihood	156
7.1	Summary of Qualitative Result	183

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
3.1	Types of microfinance beneficiaries	57
4.1	Waqf-Ijarah Contract	104
4.2	Mudarabah Contract	106
4.3	Musharakah Contract	108
4.4	Islamic Micro-Investment Model (IMIM)	109
4.5	Theory of Reasoned Action	112
6.1	Confirmatory Factor Analysis (CFA) for behavioural intention	146
6.2	Confirmatory Factor Analysis (CFA) for Attitude	147
6.3	Confirmatory Factor Analyses for Subjective Norm	148
6.4	Confirmatory factor Analysis for Behavioural Belief	149
6.5	Confirmatory factor Analysis for Normative Belief	150
6.6	Baseline Model (Hypothesised Model)	153
6.7	Revised Model	154

LIST OF ABBREVIATION

ADB	Asian Development Bank
AIM	Amanah Ikhtiar Malaysia
BOI	Bank of Industry Limited
CBN	Central Bank of Nigeria
CBOS	Central Bank of Sudan
CGAP	Consultative Group to Assist Poor
CM	Conventional Microfinance
CU	Credit Unions
DFIs	Development Finance Institutions
FEAP	Family Economic Advancement <i>programme</i>
FMBN	Federal Mortgage Bank of Nigeria
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HDI	Human Development Index
HDR	Human Development Report
HMPY	Hodeidah Microfinance Programme Yemen
IDB	Islamic Development Bank
IFIs	Islamic Financial Institutions
IMFIs	Islamic Microfinance Institutions
IMIM	Islamic Micro-Investment Model
LDCs	Less Developed Countries
LTCM	Long Term Capital Management
MDG	Millennium Development Goals
MF	Microfinance
MFB	Microfinance Bank
MFIs	Microfinance Institutions
MPI	Multidimensional Poverty Index
NACB	Nigerian Agricultural and Cooperative Bank
NACRDB	Nigerian Agricultural, Cooperative and Rural Development Bank
NBCI	Nigerian Bank for Commerce and Industry
NGOs	Non-Governmental organizations
NIDB	Nigerian Industrial Development Bank
NPC	National Population Commission
OIC	Organization of Islamic Conference
PBN	People's Bank of Nigeria
PBUH	Peace be Upon Him
ROSCA	Rotating Saving cooperative Association
SESRIC	Statistical, Economic and Social Research and Training Center for Islamic Countries
SHG	Self Help Group
SIB	Sudanese Islamic Bank

SMEs	Small and Medium Enterprises
SPV	Special Purpose Vehicle
UDEB	Urban Development and Education Bank
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Project
USAID	U.S Agency for International Development

GLOSSARY OF TERMS

Word	Glossary of Terms
<i>ADASHI</i> <i>/ESUSU/ETOTO</i>	Terms use to describe cooperative savings in the three major Nigerian languages as Hausa, Yoruba and Igbo respectively
<i>Adl</i>	Social justice promoted in Islam in all aspects of life
<i>Allah</i>	God, the Creator of universe and deserved to be worshipped
<i>Aql</i>	Intellect or reasoning that gives human being superiority over other creatures
<i>Ar-rahn</i>	Pawning contract
<i>Bay muajjal</i>	Sale on credit where delivery is immediate but payment is deferred
<i>Hadith</i>	Sayings, deeds and endorsements of the Prophet Muhammad (peace be upon him) narrated by his companions
<i>Halal</i>	Things or activities permitted by the Shari'ah
<i>Haram</i>	Things or activities that is prohibited by the Shari'ah
<i>Ihsan</i>	Benevolence
<i>Ijara</i>	Leasing
<i>Ijara wa iqtina`</i>	Leasing which ends with ownership of the user
<i>Ijara thumma al-bay`</i>	Hire purchase
<i>Maqasid al-Shari'a</i>	Higher Objectives of Islamic Shari'ah
<i>Mudarabah</i>	A contract between two parties, capital owner and an investment manager. The manager provides skills while the capital owner provides capital and the return to be shared based on pre-agreed ratio. In case of loss the capital owner losses his capital while the manager losses his efforts.
<i>Murabahah</i>	Sale at specified profit margin. It also means sales contract whereby the seller buys an item for a customer and sells to him with mark-up, the payment period however, is done within an

	agreed time-frame in either installment or lump sum.
<i>Musharaka</i>	Partnership contract where each party contributes capital for the investment and agrees to share profit and loss on a pre-agreed ratio.
<i>Nafs</i>	Human soul
<i>Nasl</i>	Progeny
<i>Qard hasan</i>	Benevolence loans or interest free loans.
<i>Qur`an</i>	The word of Allah in verbatim, revealed to Prophet Muhammad S.A.W as a guide to all aspects of life of Muslims.
<i>Riba</i>	Interest/usury which is prohibited in Islam
<i>S.A.W</i>	Sallahu alaihi wasallam i.e. peace be upon him
<i>Sadakah/Sadaqa</i>	An act of charity
<i>Shari`ah</i>	Guidance for Muslim in their spiritual and worldly affairs
<i>Tabarru`</i>	Voluntary charitable contract.
<i>Tabung hajj</i>	Special saving scheme initiated in Malaysia to enable potentials pilgrimages to plan and perform their pilgrim.
<i>Takaful</i>	Islamic Insurance, which is free from uncertainty and other prohibitions and which is based on sharing and mitigates risk among members who agree to participate through their contributions.
<i>Talakawas</i>	Masses
<i>Waqf</i>	Trust for charitable act in Islam which ties the property and allows the use of usufructs for perpetuity purpose of the original property
<i>Waqf-Ijara Contract</i>	A combination of waqf and ijara instruments to support poor and micro-enterprises development
<i>Zakat</i>	Poor due obliged to be paid by Muslim individuals and corporations who possess certain amount of wealth and income

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Poverty has been recognized as a one of the major challenges facing human being on the globe and efforts at global, national and local levels have been geared towards minimizing the menace. Halving the poverty by 2015 is the most important of the Millennium Development Goals of United Nations established in the year 2000. After a decade of the declaration of fighting the poverty, results have varied among member states. Out of the 87 countries with available data, 49 are on track to achieve the poverty goal. About 47 percent of the people in low and middle income countries have either attained or are on track to do so. Yet, 41 percent live in countries that are either off track or seriously off track. The remaining 12 percent live in the 60 countries where data is insufficient (World Bank, 2010, p.2). One of the ways considered to be useful in fighting poverty is microfinance mechanism as it provides access to financial services that could help in poverty reduction by both promoting opportunities and facilitating empowerment (Hamada, 2010, p.1).

Having assumed microfinance as a relevant tool for poverty reduction, many microfinance institutions (MFIs) emerged and by 1980s and 1990s, their number around the world proliferated. Moved by the insignificant performance of other sectors, practitioners, policy makers and international organizations advocated microfinance as the tool for reducing poverty. As at 2007, there were more than 7000 micro-lending organizations issuing loans to more than 25 million poor individuals across the globe, women constitute the greater beneficiaries. The United Nations

Capital Development Fund (UNCDF) declared 2005 as the year of micro credit. The Grameen Bank model in Bangladesh, which is deemed successful in issuing loans to poor people through group collateral-was replicated throughout the world (El-Karanshawy, 2007).

However, the coverage of microfinance services to the poor as at 2006 was only 38 percent in Asia, 8.5 percent in Africa and Middle East, 11.6 percent in Latin America and the Caribbean and 1.7 percent in Europe. Asia being the most populous continent in the world has many microfinance programmes but because of the proportions¹ of the poor there are still millions of poor potentials borrowers waiting to be reached. Similarly in other regions, the borrowers are only the minority compared to the potential clients (Latifee, 2006).

Microfinance is provided by specialized banks created for this purpose and some commercial banks, and NGOs, which are popularly called Microfinance Institutions (MFIs). A typical microfinance activity has the following key characteristics as described by Sadeq (2007). First, MF is normally provided to the rural poor. Second, for MF, the poor households are mobilized into groups whose membership ranges from 5-30. Third, MF does not require formal financial collateral. Fourth, small loans amounting to USD25-75 are provided usually for one year and are recoverable on weekly installments. Fifth, loans are offered normally for small businesses, food processing, cottage industries, transport, livestock, etc. Sixth, the loans are based on interest, which is usually about 30 percent per annum.

Microfinance is argued to create a virtuous cycle to break the vicious cycle of poverty. The infusion of credit creates self-employment for the borrower, increases

¹ For instance according to Asian Development Bank (2010) in 18 economies of the Asia and Pacific region, including the five most populous, 10 percent of the population lives on less than USD1.25 a day. The respective poverty figures for the 5 countries are: China 16 percent, Pakistan 23 percent, Indonesia 29 percent, India 43 percent and Bangladesh 50 percent.

consumption/savings. The additional credits increase further income and so on. Thus, a borrower is expected to graduate from poverty. Many impact studies (Alamgir, 1998a; Hassan and Renteria, 1997; Hossain, 1998; BIDS, 1990) ²show that microcredit enables recipient households to achieve a better standard of living, improved housing, higher human development status, greater assets and have shifted away from moneylenders. It is equally argued that, microfinance funds disbursement to the poor shows a significant improvement in social indicators, such as children`s school enrolment, fertility rates, and the use of clean drinking water (Hassan and Alamgir, 2002, p.129).

Despite the fact that microfinance gains popularity as an presumably effective tool for fighting poverty, Kono and Takahashi (2010) have investigated the extent of microfinance success or failure. The authors argued that there is no solid evidence to support its positive impacts on the poor. This is due to the fact that most of the impact studies largely come up with naïve estimate which suffers from selection biases leading to overestimation of the impact of microcredit. Other factors that hinder the positive impacts of microfinance are the inherent nature of the microcredit scheme which charges fixed and high interest rate due to high administrative cost (IRTI, 2007, p.16).

Recently, few efforts by the Islamic Microfinance Institutions (IMFIs) initiatives are emerging in the microfinance industry, providing interest-free Islamic products, mostly in Muslim countries. They offer different products and serve as an alternative to the conventional model.

However, the outreach of Islamic microfinance is very limited. A recent statistics shows that an estimated 72 percent of people living in Muslim dominated

² Cited in Hassan and Alamgir (2002)

countries do not use formal financial services even when they are made available. This is due to the fear of conventional products that violate Islamic principles as found in the Shariah (Karim, N. Tarazi M. & Reille X., 2008).

Moreover, the existing reality shows that the practice of some Islamic financial institutions including microfinance tend to converge with the conventional one thereby leading to what Hasan (2010) referred to as “Structure-objective mismatch” of Islamic finance. According to the author, ordinary Muslims who hope to benefit from Islamic financing remain unattended. For instance, the dominant murabaha contracts in both Islamic Microfinance Institutions and other IFIs have the consequence of debt promotion rather than real economy (Hasan, 2010, p.7). Karim, Tarazi and Reille (2008) also find that murabaha sale carried 34 percent and of the MFIs operating in Northern Sudan accounted for 62.3 percent of the outstanding portfolio of Indonesian Islamic rural banks.³

In the case of Nigeria, microfinance industry has been characterized by both formal and informal institutions that are more or less operate on conventional framework. Central Bank of Nigeria’s (CBN) study (2001) has identified 160 registered MFIs in Nigeria with aggregate savings worth ₦99.4 million (USD835,293.98)⁴ and outstanding credit of ₦649.6 million (USD545,882.27), which indicate huge business transactions in the sector (Anyanwu, 2004).

The institutional structures for the provision of micro credit vary in Nigeria. These include government or public sector-oriented, NGO supported, traditional or a mixture of two or more. There are those that exist along the lines of the Informal Model and involve revolving credit and savings associations, which are based on long

³ Refer to appendix V for outreach statistics of Islamic microfinance in some Muslim countries

⁴ The dollar equivalence to Naira (₦) is calculated by the researcher at the respective period, using online money converter (www.xe.com/fec/charges.cgi/2011/ and www.economist.com).

experience. Microfinance is also extended to clients through formal financial institutions that are popularly known as the Formal Model. Examples of these include the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) and the Nigerian Industrial Development Bank (NIDB). Such institutions usually know very little about the poor who need micro credit but in order to fulfill statutory requirements by the political and financial authorities, such units have to be maintained.⁵

One of the challenges of the existing microfinance in Nigeria is for the MFIs to reach a larger number of the poor in the country who are mostly in the real sector hence most of microfinance funds go to the commercial sector at the detriment of real sector activities, especially agricultural and manufacturing production which form the foundation for sustainable growth and development. In fact, as at 2004, only about 14.1 and 3.5 per cent of total Microfinance Institutions' funding goes to these sectors, respectively, while about 78.4 percent goes to commerce (Anyanwu, 2004).

The CBN survey on microfinance showed that their client base was about 600,000 in 2001, and there were indications that they may not exceed 1.5 million in 2003. As at 2004, microfinance institutions in Nigeria serve less than 1 million people out of 40 million potential borrowers that need the service (CBN, 2005).⁶ Moreover, the total micro credit facilities in Nigeria, account for only 0.2 percent of GDP and less than one percent of total credit to the economy. The effect of inappropriate approach towards addressing the situation would further accentuate poverty and slow down growth and development.

⁵ See a paper on Policy challenges for microfinance design and practice in Nigeria published by African Institute for Applied Economics, accessed on 27/12/2007 at www.microfinancegateway.com

⁶Cited in Anyanwu (2004)