



**The Effects of Islamic Microfinance on Borrowers  
Household Income and Wellbeing in Bangladesh:  
Religiosity as Moderator**

by

**Shamsuddin Ahamad**

**(1432511486)**

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## **DEDICATION**

To my first teacher, my late father, Abdur Rahman, who would have been proud of my academic achievements and to my mother, Shamsun Nahar for her continuous prayers for me.

JajakAllah Khairan.

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## LIST OF ABBREVIATIONS

ASA	Association for Social Advancement
AIM	Amanah Ikhtiar Malaysia
BRAC	Advancement Committee
BDT	Bangladeshi Taka
BMT	Baitul Maal wat Tamwil
GDP	Gross Domestic Product (GDP)
IBBL	Islami Bank Bangladesh Ltd
IGA	Income Generating Activities
IMFs	Islamic microfinance
IMFIs	Islamic microfinance institute
MABFO	Muslim Aid-UK Bangladesh Field Office
MAB	Muslim Aid Bangladesh
MDGs	Millennium Development Goals
MFIs	Microfinance Institutions
NGO	Non-Government Organization
RDS	Rural Development Scheme
SPSS	Statistical Package for the Social Science
UNDP	United Human Development Programme

Kesan Kewangan Mikro Islam Ke Atas Pendapatan dan Kesejahteraan Isirumah Peminjam di Bangladesh: Keagamaan sebagai Moderator

**ABSTRAK**

Program pembiayaan mikro telah direka untuk orang-orang miskin bagi mengakses sistem kewangan formal dengan mudah tanpa sebarang cagaran. Dari awal, program pembiayaan mikro cuba untuk disampaikan kepada rakyat miskin bertujuan untuk meningkatkan taraf hidup mereka melalui aktiviti penajaan pendapatan. Mengikut objektif ini, Skim Pembangunan Luar Bandar (RDS) dan Muslim Aid Bangladesh (MAB) membantu penduduk miskin untuk meningkatkan taraf sosio-ekonomi mereka melalui pembiayaan mikro tanpa faedah di Bangladesh. Kajian ini bertujuan untuk mengkaji kesan kewangan mikro Islam terhadap kebajikan penduduk miskin. Ke arah mencapai objektif ini, kajian ini telah menggunakan teknik deskriptif dan statistik. Untuk menilai kesan pembiayaan mikro secara Islamik kepada penduduk miskin, data kualitatif dan kuantitatif telah dikumpul daripada 192 peminjam dari daerah Chittagong, Bangladesh. Kaedah persampelan kuota telah digunakan untuk memilih responden kajian. Teknik kualitatif dan kuantitatif telah digunakan untuk menganalisis data. Dapatan kajian menunjukkan bahawa RDS dan MAB telah cuba untuk menyediakan jumlah pinjaman yang memadai dan latihan kepada pelanggan untuk menjalankan perniagaan mereka walaupun jumlah pinjaman dan latihan didapati masih tidak mencukupi. Pembolehubah bebas yang dimasukkan dalam kajian, tempoh masa pembiayaan mikro, umur dan tahap pendidikan pelanggan didapati berada dalam julat yang boleh diterima tetapi terdapat beberapa isu yang perlu dipertimbangkan mengikut keperluan pelanggan. Hasil kajian menunjukkan bahawa RDS dan MAB berkesan dalam meningkatkan pendapatan pelanggan. RDS dan MAB juga didapati telah membantu untuk meningkatkan perbelanjaan pelanggan mereka dalam aspek perbelanjaan terhadap makanan, pakaian, pendidikan anak, rawatan perubatan serta pembaikan dan penyelenggaraan. Walaupun demikian, dari segi pengumpulan aset isi rumah, RDS dan MAB masih belum berjaya menambah pengumpulan aset pelanggan seperti yang diharapkan oleh pelanggan. Berdasarkan kepada pengujian hipotesis yang dijalankan, dapatan kajian telah menunjukkan bahawa jumlah pinjaman, tempoh, pendidikan dan umur peminjam mempunyai kesan yang paling signifikan ke atas pendapatan. Dalam kes kesejahteraan secara keseluruhan, jumlah pinjaman, tempoh dan peminjam pendapatan mempunyai kesan yang paling signifikan. Kajian ini juga meramalkan bahawa keagamaan boleh bertindak sebagai moderator dalam usaha untuk meningkatkan kesan faktor-faktor kejayaan pembiayaan mikro ke atas pendapatan dan kesejahteraan. Keputusan kajian menunjukkan bahawa peranan keagamaan sebagai moderator kami telah dibuktikan kepada hubungan antara tiga faktor yang mempengaruhi (jumlah pinjaman, tempoh, dan tahap pendidikan) dan pendapatan. Sebaliknya, keputusan itu ternyata di hubungan antara dua faktor yang mempengaruhi (jumlah pinjaman dan pendapatan) dan kesejahteraan. Kesimpulannya, dapatan kajian ini menunjukkan bahawa skim pembiayaan mikro secara Islamik telah berjaya meningkatkan kebajikan keseluruhan peminjam yang menggunakan skim ini.

Kata kunci: Pembiayaan Mikro Islam, kesan, Pendapatan, Kesejahteraan, Skim Pembangunan Luar Bandar, Muslim Aid Bangladesh.

The Effects of Islamic Microfinance on Borrowers Household Income and Wellbeing in  
Bangladesh: Religiosity as Moderator

**ABSTRACT**

Microfinance programs have been designed for the poor people to access the formal financial system easily without any collateral. From the beginning, microfinance programs have been trying to reach the poor people to improve their living standard through income generating activities. Following this objective, the Rural Development Scheme (RDS) and Muslim Aid Bangladesh (MAB) are working with the poor vulnerable people to improve their socioeconomic status through delivering interest-free microfinance in Bangladesh. This study is therefore, aims to examine the effects of Islamic microfinance on borrowers' household welfare. Towards the achievement of its objectives, this study used descriptive and statistical techniques. To assess the effects, qualitative and quantitative data were collected from 192 borrowers from Chittagong district of Bangladesh. Quota sampling method was used to select the borrowers'. Quantitative techniques were used to analyze the data. The descriptive results revealed that the RDS and MAB have been trying to provide the handsome amount of loan and training to the clients to run their businesses though the amount of loan and training were not sufficient. Determinants, time duration with microfinance, client's age and education level were found in the acceptable range but there are some issues that need to be considered according to the clients' needs. The findings showed that the RDS and MAB effectively have increased the clients' income. The RDS and MAB also helped to raise their clients' wellbeing through improve the expenditure ability on food, clothing, child education, medical treatment, repair and maintenance. However, in terms of improving the household's asset accumulations, the RDS and MAB still could not able to change the clients' household assets as expected by the clients. Based on the hypotheses testing, the findings revealed that the amount of loan, tenure, education and age of borrowers had the most significant effects on income. In the case of overall wellbeing, the amount of loan, tenure and borrowers income shown the significant effects. This study also predicted that religiosity can act as a moderator in order to enhance the effect of microfinance success factors on income and wellbeing. The results of the study indicated that the role of religiosity as a moderator was evidenced on the relationship between three influencing factors (amount of loan, tenure, and education level) and income. On the other hand, the result was evidenced on the relationship between two influencing factors (amount of loan and income) and wellbeing. Therefore, these findings indicated that the overall welfare of the Islamic microfinance borrowers has increased after receiving and using the microfinance loan.

Key words: Islamic Microfinance, Effects, Income, Wellbeing, Rural Development Scheme, Muslim Aid Bangladesh.

## CHAPTER 1

### INTRODUCTION

#### 1.1 Background of the Study

Over the last decade, Bangladesh has achieved significantly well in terms of macroeconomic stability in general and economic growth. Market-oriented economic reforms and deregulations in the early 1990s led to a more stable macroeconomic environment compared with that in 1970s and 1980s. The Gross Domestic Product (GDP) growth rate improved steadily during the 1990s. The average annual GDP growth was 4.65 % from 1991 to 1995 and raise further to 5.5 % from 1996 through 2000 and 6% since 2008 (UNDP, 2011). Bangladesh Development Update (2013), noted that GDP growth in 2013 decelerated 6 % while World Bank data showed that 2011 and 2012 achieved 6.5 %.

However, despite the recent macroeconomic achievements, microeconomic focus on rural household poverty and wellbeing is still pervasive and endemic in Bangladesh. It has one of the most vulnerable economies, characterized by extremely high population density, low resource base, and high poverty. The disparity between the rich and poor is also growing. Poverty alleviation remains high on the development agenda as it is the key indicator of socio-economic advancement. According to the World Development Indicators Database (2014), and Bangladesh Economic Bureau (2012), population of Bangladeshi living below the poverty line stands at 31.5% in 2010 which was 92% at the time of liberation of the country

(1970), 59% in 1980, 49.8% in 1990, 41.4% in 2004, and 40.5% in 2007 described in Table 1.1.

Table 1.1: Population and poverty rate in Bangladesh

Year	Total Number of Population (Millions)	Incidence of Poverty	
		Poverty rate (%)	Total Population (Millions)
1970	85	92	78.2
1980	100	59	59
1990	120	49.8	59.76
2004	130	41.4	53.82
2007	158.57	40.5	64.22
2010	156.6	31.5	49.32

Sources: World Development Indicators database, 2014.

According to the UNDP Human Development Report (2011), 40% of Bangladesh population are poor in terms of income and poverty level. Thus, one-third of the total people of Bangladesh is living under poverty line and a significant proportion of them live in extreme poverty. In a recent article, Rumana Rakhi (2016), quoted the former caretaker government of Bangladesh that “the country’s two million people are still extremely poor”.

Therefore, it is often argued that the formal financial sector has failed to serve the poor to reduce poverty (Chowdhury, 2000). The main issues contributing to the reluctance of formal financial sectors to serve the poor are high risk (i.e., having no valuable assets for collateral and no previous transaction record) and high transaction cost (Nghiem, 2007). The failure of the formal sector to provide affordable credit to the poor is often viewed as one of the main factors that reinforce the vicious circle of economic, social and demographic structures that ultimately cause poverty (Chowdhury, 2000).

In this concern, to reduce the poverty, microfinance (*microcredit and microfinance are hereby used interchangeably*) program is generally proposed as a practical and attractive method for providing the poor accessibility to credit (Bhuiyan and Hassan, 2013). Microfinance programs can provide the poor with reasonable services by alternative approaches such as group lending, peer monitoring, compulsory saving, and progressive lending, which enables them to reduce both transaction costs and default risk. By providing financial services for the poor, microfinance can contribute to poverty reduction by breaking the circle of poverty (Nghiem, 2007). According to the Microcredit Summit (2004), microfinance is a “program that extends small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families”. The World Bank has recognized microfinance program as an approach to address income inequalities and poverty. The microfinance program has been proven to be successful in many countries in addressing the problems of poverty. The United Nation has also set out their prime Millennium Development Goals (MDGs) for the eradication of extreme poverty and hunger by 2015.

Since the 1980s, one of Bangladesh’s major weapons in the fight against poverty has been the microcredit programs which are targeted to poor and vulnerable households (Webb et al, 2002). Microfinance came as revolutionary rescue approaches to the accessibility of the poor to credit without assets for collateral, enough financial records and credit history to increase their productivity in the self-employed economic activities for reducing vulnerability and poverty. The experience of Grameen Bank in Bangladesh and other similar programs shows that microcredit is effective in helping poor people to use their own efforts and creativity to meet their

basic needs thus it has proven to be an effective and powerful tool for poverty reduction (Yunus, 2004, Morduch and Haley 2002).

According to the Credit and Development Forum (CDF) annual report (2014), more than seven hundred Microfinance-Non-Government Organization (MF-NGO) are presenting working in Bangladesh to reduce poverty, unfortunately, poverty is still a central illness to the progress of the country and it is not reducing as expected. However, to reduce the overall poverty level in Bangladesh, the concept of microcredit is still insufficient in many aspects though the microcredit came as a revolutionary approach to eradicating poverty in the poor society (Amin et. al, 2003). Microcredit has also some limitations. One of the serious limitations of these microfinance institutions is interest rate (Obaidullah, 2008, Parveen, 2009, Rahman and Ahmad, 2010, Morshid and Abdullah, 2013). The microfinance institutions including Grameen Bank charged interest rates between 20 and 35 percent which is very high for the poor borrowers (Rahman, 1999). The poor people are not able to pay such interest, which gradually leads them to remain poor and they fall in the vicious cycle of poverty. Most of the NGOs operating their institution with a commercial mentality for profit making.

Furthermore, conventional microfinance is stopping the practice of the spiritual, moral and ethical dimensions of human socioeconomic development, which is precious in sustainable human development (Alam, 2009). These MFIs maintain non-Islamic characteristics and mostly secular in nature (Ahmed, 2002). Subsequently, most of the poor people living in developing countries are practicing Muslims, this limit belief in using the conventional microfinance system. Furthermore, Muslims need financial schemes that are *shariah*-compliant. As Islam provides the complete code of life, the religion covers poverty reduction as one of the

premier agendas. Islam considers that poverty induces other indecent acts; therefore, poverty should be treated with much care.

In the era of high-growth Islamic financing, Islamic microfinance is the best-fit alternative to conventional microfinance, which offers the same benefits based on *Shariah* (Rahman, 2010). Among more than seven hundred MFIs' at present operating in Bangladesh, the UK-based Microfinance programme of "Muslim Aid-UK, Bangladesh" is the first Islamic Microfinance program in Bangladesh which is working for poor people to reduce the poverty by small and micro investment in agricultural and rural sector based on *Shariah* (MAB Annual Report, 2010). Though hundreds of NGOs are operating in the country with a view to alleviate poverty but downtrodden are still in the vicious circle of poverty and they have a little hope of getting out of the cycle. In this situation, it is more important to understand how Islamic microfinance affects the progress towards income, consumption and living standard of the poor borrowers. Therefore, the present research will focus on Islamic Microfinance which can help the poor people to improve their living standard.

This chapter is, therefore, organized as follows: first, Section 1.1; explains briefly the background of the study. Then in Section 1.2; presents the problem statement of the study, in Section 1.3; objectives of the study, in Section 1.4; significance and finally, in Section 1.5; summary of this chapter.

## **1.2 Problem Statement**

Bangladesh is a pioneer and home of conceptualizing microfinance program. More than seven hundred Non-Government Organizations (NGOs) are operating microfinance program to reduce the poverty from the rural areas of Bangladesh. To

reduce the overall poverty in Bangladesh, the concept of microfinance is still insufficient in many aspects though the microfinance came as a revolutionary approach (Amin et. al, 2003). Evidence shows that conventional microfinance institutions do not fulfill the borrower's demand. All the conventional microfinance institutes (MFIs) operating in Bangladesh including Grameen Bank, Bangladesh Rural Advancement Committee (BRAC), Association for Social Advancement (ASA), and Proshikkhan Shikkha Karmo etc. provide an interest-based loan. These conventional microfinance institutions charged an exorbitantly high-interest rate. Their charges range from 20 to 35 percent interest rates which is considered very high for the poor borrowers (Rahman, 1999). The poor people are not able to pay such exorbitant interest, which gradually leads them to remain poor and they fall in the vicious cycle of poverty. Most of the NGOs operate with a commercial mentality for profit making. Moreover, conventional MFIs also have non-Islamic characteristics and many of them have social development programs that are mostly secular in nature (Ahmed, 2002). In Bangladesh, 90 percent of the people are Muslims and they need financial schemes that are *shariah*-compliant.

To fulfill the demand of poor people of Bangladesh and to escape from the above issues of conventional MFIs, Interest-free Islamic microfinance (IMFs) came forward in 1993. Based on profit and loss sharing, Islamic microfinance program provides loan to the poor men and women. The UK-based NGO “Muslim Aid Bangladesh” (MAB) first started the Islamic Microfinance program in 1993 (MAB Annual Report, 2010). In 1995, Islami Bank Bangladesh Ltd. (IBBL) started widely microfinance program with the name of Rural Development Scheme (RDS) which is now the largest Islamic microfinance program in Bangladesh (IBBL-RDS website). Both of the institutions working for the poor people to reduce the poverty by small

and micro investment to the agricultural and rural sector based on *Shariah*. They have successfully implemented different *Shariah*-compliant financial products and models to finance the low-income entrepreneurs (Zouari and Nabi, 2013).

However, despite the progress of the Islamic financial services industry, Islamic microfinance institutions are still far lag behind their conventional counterparts in Bangladesh. They have an extremely limited presence (Obaidullah and Khan, 2008, Bhuiyan et al, 2011, Obaidullah and Khan, 2011). In Bangladesh, Islamic microfinance institutions are serving only 1% of total microfinance in Bangladesh when more than 20 million active borrowers are reached by Grameen Bank, BRAC, and ASA, all of which are providing conventional products (Khaled, 2011). Moreover, comparing to the MAB Annual Reports between 2010 and 2014, the total number of borrowers decreased from 69,082 in 2010 to 40,440 in 2014. Thus, this evidence deduced that the impact of Islamic microfinance on the poor people in Bangladesh are not yet felt. This situation motivated this study to make an attempt to investigate the issue.

The literature shows that most of the studies conducted to uncover the performance of Bangladeshi Islamic microfinance institutions from different views. For instance, Perveen (2009), Alam (2009), Hoque et al (2011), Bhuiya et. al (2011) studied on Rural Development Scheme (RDS) of Islami Bank Bangladesh Ltd (IBBL) to see the sustainability and outreach. Sustainability and outreach are the institutionalists approach. Institutionalists believe that microfinance institutions performance should be assessed in terms of the institution's success in achieving self-sustainability and breadth of outreach (Olivares-Polanco, 2005). However, sustainability and outreach does not address the effects of Islamic Microfinance on Borrowers.

Further, the effort to find literature that may reveal whether Islamic microfinance improves the borrower's socioeconomic condition has not met success perfectly. Generally, income is the important socioeconomic indicator for the borrower's improvement. Zeller (2001) perceives that "access to financial services can have two main effects on household outcome. One of them is, it can increase the income". The important primary aim of microfinance program is also increase the income of their borrowers. Most of the existing studies such as Uddin (2008), Jinan (2008), Ahmed (2002), Rahman and Ahmad (2010), Bhuiya (2013), Halimuzzaman et al (2014), Jahan and Rashid (2015) investigated the impact of RDS on borrower's income. The comprehensive survey of literature exposed that income was assessed from different views and it was assessed on RDS only. As income lead the borrower's socioeconomic wellbeing, thus extensive research is necessary to assess income on MAB microfinance program beside the RDS.

Consequently, as income lead the borrower's wellbeing, the existing literature does not provide any pieces of evidence on this. These have motivated this study to investigate the borrowers overall wellbeing organizing the socioeconomic aspects in the variable.

Studies such as Uddin (2008), Halimuzzaman (2014) assessed the performances based on descriptive nature and they did not examine the factors of performances. Rahman and Ahmad (2010), Bhuiya (2013), Jahan and Rashid (2015) used some influencing factors such as the amount of loan, land size, a distance of branch, family size, human capital, age, education. In addition, by realizing the positive influence of reviewed factors, literature reveal that there are also negative effects documented. This contradictory evidence encouraged this study to investigate

the factors in the context of Bangladesh. Particularly, in Bangladesh, Islamic microfinance study demand to identify the factors of success of the program properly.

Moreover, Ullah (2011), Hamdan (2012) and Rulindo & Pramanik (2013) confirm in their Indonesian, Malaysian and Pakistan microfinance studies that clients having longer tenure with Islamic microfinancing have a greater possibility of having better business and having a higher income as well as living in better economic condition. In Bangladesh context, tenure with microfinance was assessed by Jahan and Rashid (2015) on RDS and did not find any effects on income. On the other hand, Rahman and Ahamad (2010) found a positive influence on the same institution. This contradictory result made a demand to investigate this issue for further study. Besides, effects of training provided by microfinance on borrowers did not found in the Islamic microfinance literature in Bangladesh.

Religiosity is also the important element for improving the borrower's welfare of Islamic microfinance. Researchers argued that religiosity can act as collateral. Islamic microfinance institutions motivate their borrowers to develop their religiosity through moral and ethical development. For this purpose, they provide religious education for borrowers. So, religious motivation and education may moderate the borrower's improvement. Moreover, Rulindo and Pramanik (2013) recognizes, "The higher spiritual people are wealthier as they have greater possibilities to live over the poverty line especially when the status is measured by household income as a benchmark of the poverty line". Thus, this study precisely wants to prove this theoretical understanding by using religiosity as a moderator variable.

However, in Bangladesh context, all the studies examined the Islamic microfinance performances of Rural Development Scheme (RDS) of Islami Bank Bangladesh Limited (IBBL). RDS is an associated program of a commercial bank in

Bangladesh where other reported Islamic microfinance provider institutions did not get attention. So, besides the RDS, the assessment of NGO based Islamic microfinance provider institutions is essential to see the border performances of this field.

Therefore, to solve the problems mentioned above, this study used selected variables in order to fill the above research gaps. To achieve this, the following specific research questions are posed:

Q.1: What is the effect of Islamic microfinance on borrowers' household income?

Q.2: What is the effect of Islamic microfinance on borrowers' household wellbeing?

Q.3: Which are the factors that affected to the income and borrowers wellbeing?

Q.4: What are the moderating effects of religiosity on the relationship between influencing factors and borrower's income?

Q.5: What are the moderating effects of religiosity on the relationship between influencing factors and borrower's wellbeing?

However, To fill the gap and for getting an answer to above questions and also increasing the performance of the Islamic microfinance industry it is a very important task since it can help more poor people gain both access to financial services and benefits from these services. As in many other development interventions, there is a lack of rigorous assessments of the effects of Islamic microfinance on borrowers' household welfare. An inclusive examination of the effects of Islamic microfinance is necessary because it can help to improve the performance of this sector.