# Assessing the Impact of Islamic Microfinance on Poverty Alleviation in Northern Nigeria

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**ABSTRACT**

Nigeria is one of the leading economies in Africa endowed with vast oil reserves and abundant human and material resources. Despite these resources, poverty among the populace is widely spread. The National Planning Commission in Nigeria in 2012 reported that more than 75 million people are trapped by poverty. Several efforts have been put forward at various points in time by successive governments, private entrepreneurs and other development partners to overcome the menace of poverty among the populace. Recently, Islamic microfinance becomes a mechanism through which poverty is being challenged as witnessed in some Muslim countries such as Bangladesh, Malaysia and Pakistan. The purpose of this study is to examine the role of Islamic microfinance products on poverty alleviation in northern part of Nigeria. The study used recipients of Islamic loan from some selected microfinance banks in Kano and Jigawa states of Nigeria. A total of 400 samples drawn from beneficiaries of Islamic microfinance loan through simple random sampling were used. Questionnaires were used and the data generated were analyzed using Pearson correlation analysis. The findings of the study show that there is significant improvement on household income, children education and assets acquisition as a result of Islamic microfinance intervention. This study has also identified that amount of Islamic loan, age, level of education and gender as important variables for increasing household income. Microfinance regulators or policy makers (Central Bank of Nigeria) will also make use the findings of this study in designing policy framework for microfinance institutions in Nigeria

**Key Words -** *Microfinance, Poverty, Islamic product*

## 1. Introduction

The Global Monitoring Report (2009) defined extreme Poverty as the proportion of population in developing countries, who live on less than US $1.25 a day (based on purchasing power parity at 2005 constant prices). The causes of poverty include poor people's lack of resources, an extremely unequal income distribution in the world, conflict and inadequate infrastructures. The World Development Report (2001)

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indicates that out of the world's six billion people (6 billion), two billion eight hundred people (2.8 billion), almost half of the world population live on less than US $2 a day, and 1.2 billion live on less than US $1 a day. Similarly, International Fund for Agricultural Development (IFAD, 2011) reported that, 35% of the total rural population of developing countries is classified as extremely poor, down from around 54 percent in 1988, while the corresponding percentage of US $2 a day poverty line is just above 60% down from over 80% in 1988. Moreover, about 1,375 million people in developing countries (25% of the population) were living in extreme poverty (Global Monitoring Report, 2009). Moreover, IFAD (2009) reported that poverty in Africa is predominantly rural. More than 70 percent of the continent's poor population reside in rural areas and largely depend on agriculture for food and daily livelihood. The incidence of poverty in sub Saharan Africa is increasing faster than the population, where more than 218 million people live on less than US $1.25 a day. More than 60% of the population in sub Saharan Africa live on less than US $1.25 a day, and almost 90% of the population live on less than US$2 a day. This statistics indicate more than half of the population in sub Saharan Africa live in abject poverty due to lack of infrastructure and access to capital for investment in small and micro enterprises.

As for Nigeria, the incidence of poverty is increasing even faster than the population. In 1999, United Nations Human Development Index placed Nigeria among the 25 poorest nations in the world. Similarly, World Bank (1999) revealed that 70 percent of the country's total population was living below the poverty line of US$ 1 a day. Therefore, more than half of people in the country are living below the poverty line as a result of inadequate social and financial services that will reduce their levels of poverty and improve their livelihood.

Past and present governments in Nigeria have at one time or the other established several poverty alleviation policies, programs and institutions for the purpose of providing basic infrastructures, diversifying the economy, reducing the level of unemployment, achieving dynamic self-sustaining growth and increasing the living standard of the people. However, most of these programs and institutions have not yielded the expected results. The failure of these strategies was attributed to bad governance, corruption, low productivity, unemployment and inadequate funding. Others believe that, high level macro-economic distortion, globalization, high population growth rate and poor human resources development are the key factors that hinder the success of poverty alleviation programs in Nigeria (Ugor and Ukpere 2009).

Moreover, a large number of people in Nigeria do not have access to financial services such as loans, savings, insurance and transfers. Households use financial services to build incomes, make investments in micro and small enterprises, purchase assets and improve their homes, improve access to health, pay for the education of their children and for overall household protection against vulnerability. Conventional commercial banks failed to serve these households due to the nature of their business models which are generally not suitable for managing microfinance business such as high interest rate and collateral requirements which will greatly hinder the maximization of profit of small scale entrepreneurs (Noreen, 2010).

The last decade has seen the evolution of Islamic microfinance institutions that have provided sufficient income and employment opportunities for the poor in developing countries (Bhatt and Yan Tang, 2001). In an attempt to fight against poverty, several efforts have been put forward in various countries. Such efforts are seen in Bank Rakyat Indonesia's (BRI) Unit Desa program in Indonesia, Amanah Ikhtiar Malaysia (AIM) in Malaysia. It is evident that, microfinance institutions could play a vital role in poverty alleviation based on the superior performance of these programs. The experiences of these and other prominent microfinance programs have triggered imitation efforts, in one form or the other, in many countries of the world. The performance of the programs in some countries, however, has not been encouraging. Many have been weighed down by problems which include, among others, high default rates, poor outreach performance and a seemingly unending dependence on subsidies.

## 2. Role of Islamic microfinance on Household Income, Education and Assets

Conventional microfinance institutions failed to provide affordable financial services to the poor due to high interest rate which is also prohibited by Islam. Ashraf, (2010) indicated the need for Islamic microfinance institutions due to the failure of conventional microfinance to alleviate poverty in Bangladesh. The Provision of credit and finance for the poor via microfinance is also relevant to Islamic banks. A greater religious commitment is required in order to achieve the Islamic objectives of social justice, equitable distribution of income and general economic development of a particular society. Many scholars have shown great concern on Islamic banking to be involved in microfinance programs to cater for the needs of the poor and the low income earners that usually have a limited or no access to the formal banking sector (Dasuki, 2008). Therefore, in the light of the above, there is the need for microfinance approach specifically designed according to Islamic principles in order to help the poor and the low income Muslims to have available and affordable financial services to be use in their income generation activities. The oldest Islamic banking experiments in India and Egypt were small rural cooperatives inspired by European mutuals.

The microfinance institutions have focused on the economic development, poverty eradication and enhancing a culture of thrift among poor Muslims. Hence, the issue of financing the poor through microfinance is not alien to Islamic banking; Therefore, Islamic banking microfinance initiatives should be free from any form of prohibited activities e.g. usury (riba) gambling (maisir) harmful substance (darar), and excessive ambiguity (gharar). It should be noted that, various approaches were used by microfinance institutions to ensure effectiveness and efficiency in providing financial services to the poor. Moreover, Islamic banking can also be applied using diverse set of financial instruments together with other available mechanisms such as zakah, charity and waqf; which can be combined with the microfinance activities to promote entrepreneurship among the poor in a society. Dasuki (2008) further pointed out that, there are a number of instruments used for mobilization of funds and financing the poor based on Islamic system of microfinance. The Islamic system of microfinance identifies this group being the poorest of the poor as those who are eligible for receiving zakah. It is geared towards alleviating poverty through its institutions along with sadaqah. Most conventional microfinance providers charge higher interest rates because their returns on investment in microenterprise are very high, while interest rate, high or low, is rejected by large sections of the Muslims society as riba; which is prohibited by the Islamic Sharia. Mohammed and Hassan (2008) claimed that, theoretically, the main point of departure for Islamic microfinance from conventional system comes from the concept of joint liability. Conventional microfinance violates Islamic principles by charging interest rate, and this became the matter of concern for Muslims due to prohibition of interest (riba) because Islamic teachings do not allow a fixed return on capital. Therefore, the main benefit of microfinance in Muslim society is the empowerment of Muslim women, while the ability of microfinance institutions to provide financial service to rural women in gender segregated society is commendable (Obaidullah, 2008). The Islamic microfinance institutions offer micro credit using variety of Sharia compliant products with qard al hasan, murabaha; bay- bithaman ajil, ijara and bay-salam, being the most common products. In addition,

Islamic microfinance institutions provide other services such as micro-savings; transfers and micro insurance (takaful) specifically designed to help the poor household to engage in various kinds of business activities. Research evidences have shown that the poor should have access to such services before the real impact on poverty reduction can be seen. Therefore, to do away with poverty, time and repeated use of financial services need to be combined with other services. Moreover, basic needs such as food, shelter and employment are often more urgently needed than financial service and should be appropriately funded by the government or donor agencies. Microfinance should not be seen as a substitute for investments in basic education, health and infrastructure (Obaidullah, 2008). In other words, microfinance can only be useful in poverty reduction only if adequate infrastructures and other social services are available in both rural and urban communities. Similarly, Islamic microfinance institutions offer financing under the concept of trade and partnership. Charity based funds are also created in the Muslims world to help the poorest of the poor through interest free loans and monetary aid for consumption purposes. The need is to institutionalize the Islamic concept of charity as per modern day's requirements (Kaleem, 2009). Similarly, charity based funds such as waqaf and zakah could serve as a poverty alleviation tools that will help the poor household to invest the amount of money received from the fund into a particular business or micro enterprise. The Islamic approach to poverty alleviation is more inclusive than the conventional one; it provides for the basic conditions of sustainable and successful system of microfinance with sympathy for the poorest of the poor. The instruments used in Islamic microfinance include the participators profit and loss sharing instrument such as mudarabah and musharakah, as well as sales based modes such as murabaha, and lease based modes such as Ijara and the benevolent loans or qardal hasan. Moreover, Dogarawa (2009) urges that, Islamic microfinance provides financial services and products to those whose low economic standing excludes them from Sharia compliant financial institutions. As an alternative to riba; the profit and loss sharing arrangement are held as an ideal mode of financing Islamic microfinance. The Islamic approach to poverty alleviation through microfinance underscore the need for dual approach; including zakah and waqf based charity programmes for the poor. Thus, Islamic microfinance institutions are expected to play not only the role of providing financial services and products to the unbankable members of the society, but also help shape the attitude of their clients towards hard work and commitment so that they can be free from poverty. Smole, (2011) indicated that implementing Islamic microfinance in Bosnia and Herzegovina will greatly help in improving the living standard of people by reducing unemployment. Rahman and Ahmed (2010) conducted an empirical study on the impact of Islamic Bank of Bangladesh on the rural poor's livelihood in Bangladesh. The study focused on the impact of Rural Development Scheme (RDS) which is Sharia based microfinance program used to alleviate poverty among rural communities. The study has explored the true picture of poverty alleviation through micro investment in the livelihood of the RDS clients. The outcome of the study indicated that:

1. The average client's income level has increased by more than 33 percent. This shows the impact of microfinance product on the client's household income level.

2. The household expenditure of RDS clients shows that highest expenditure was observed for food, medication and house maintenance.

3. Growth in total household assets. Therefore, these findings have clearly revealed the strong impact of Islamic microfinance in poverty alleviation in rural communities.

Moreover, Ahmad & Mubarak (2013) revealed that despite the limitation of RDS, it can also serve as an alternative microfinance program to the conventional microfinance institutions and NGOs in Bangladesh. Rural Development Scheme will greatly help in creating employment opportunities for the clients by giving loans in forms of Mudarabah, Musharakah and Murabaha could accelerate the poverty alleviation programs. Abdulrahman (2010) described how Islam has the potential of providing various schemes and product services that can be advanced and adapted for the purpose of microfinance. Comparatively, qardul hasan, murabaha and Ijara schemes are relatively easy to manage and will finance the capital needs (qardul hasan), equipments (murabaha) and leased equipments (Ijara) for potential micro entrepreneurs and the poor. Participatory schemes such as mudarabah and musharakah, on the other hand, have great unfulfilled potentials for microfinance purposes as these schemes can satisfy the risk of sharing needs of the micro entrepreneurs. Ahmed (2002) conducted an analytical study of Islamic microfinance institutions in Bangladesh and the results of the study show that there is a great potentiality of Islamic microfinance institutions to take care of the needs of the poor. Islamic microfinance has more potential to expand both in the liability side and the assets side. On the liability side, Islamic microfinance institutions can tap some alternative sources of funds such as zakah, sadaka and waqf. These institutions can be integrated into microfinance program to effectively alleviate absolute poverty. Moreover, Islamic microfinance institutions can use variety of financial instruments; modes of financing may be used for various activities. However, the study concluded that Islamic microfinance institutions have not yet tapped some sources of funds, nor have they used variety of financial instruments in their operations. Yasin (2011) conducted an empirical study on the impact of Islamic microfinance on household education in Tanzania. The findings of the study indicate that Islamic microfinance has a positive impact of household children education.

## 3. Methodology

The research focuses on the impact of Islamic microfinance being provided in Nigeria for the low income earners towards alleviating their poverty through various instruments by public, non-governmental and private organizations. Therefore, the research attempts to determine the impact of the instruments being used in alleviating the poverty of this portion of population. Survey approach was employed as it represents one of the most common types of quantitative research. The survey technique allows researcher to collect quantitative data which can be analyzed quantitatively using descriptive and inferential statistics. Moreover, the data collected using a survey can be used to suggest possible reasons for particular relationship between variables and to produce models of these relationships, survey strategy helps the researcher to have more control over the research process, and when sampling is used it's possible to obtain findings that represent the entire population (Saunders, et al 2009).

### 3.1 Impact Assessment Criteria

Hulme (1999) reports that impact assessment studies have become increasingly popular especially with international development partners. This study uses household unit of impact assessment in order to identify the impact of Islamic microfinance on poverty alleviation of a particular household. Economic indicators such as changes in the household income, level and patterns of household expenditure, consumption and assets level of clients or borrowers of micro credit have been used as criteria for measuring the impact of MFIs intervention on poverty alleviation. Similarly, social indicators comprise of health care level of household after microfinance intervention as well as the education level of children in a particular household have been employed in assessing the impact of microfinance on poverty eradication. Similar studies conducted in Kenya, Ghana, Peru and Ethiopia used these indicators and produces a useful findings.

### 3.2 Study Population

This refers to the population that the research will work with. The population for the research composes of ideal and the study population. The former contains all the beneficiaries of Islamic microfinance product, while the later (study population) comprises of participants of the current research study that have been drawn from the ideal population. The importance of the sorting out of the target population of a study cannot be underestimated, and is thus normal based on the essence of our research.

**3.3 Sample Size**

In survey design, determining sample size and dealing with non response bias is essential, and a common goal of survey research is to collect data representative of a population. The sample for the research work has been drawn from the ideal population and the research might have 5% margin error, thus 400 samples were used for the study using the formulae;

$N = 1/(e)^2$

Where; N= sample size

e= error (0.05)

Saunders (2009) claimed that 5% margin error is sufficient enough to run any statistical test. One method of determining sample size is to specify margins of error for the items that are regarded as most important to the survey (Cochran, 1977). The sample has covered small scale entrepreneurs comprising of traders and skill acquisitions such as tailors that constitute the customers of microfinance banks. This category constitutes individuals with small scale business that can access the microfinance schemes being in operation.

**3.4 Sampling Technique**

The importance of sampling should not be underscored as it determines to whom the results of the research will be applicable. Therefore, there is a need for full consideration of the sampling strategy to be used and be able to select the most appropriate. The researcher has employed simple random sampling technique. The basic idea behind simple random sampling is that each person in the population has an equal chance of being selected, accurate and easily accessible and covers larger geographical area (Saunders, 2009).

**3.5 Data Source and Instrument**

Primary source of data was employed in the study due to non availability of reliable and accurate secondary data in African countries like Nigeria. The instrument used in generating data from the respondents in the research was self developed questionnaire. Every step has been designed carefully because the final results will be genuine and academically sound. Although questionnaires may be cheap to administer compared to other data collection methods, it is a bit expensive in terms of design, time and interpretation. Consistent studies conducted in Ghana, Kenya, Ethiopia and Pakistan using instrument explained above were found to be very useful. Pilot study was conducted using convenience sample of 50 household beneficiaries of microfinance. The table below shows the mean and standard deviation of the research question contained in the inventory.

### 3.6 Data Collection Technique

The researcher has personally administered the instrument (questionnaire) with the help of research assistant and the customer relation officers of particular microfinance institution. The instrument was translated into Hausa language (local language of the study area) to enable the respondents to understand the questions easily. The rationale behind the use of questionnaire is that it is a data collection technique in which each person is asked to respond to the same set of questions in a predetermined order (Saunders et al, 2009). Nor (2009) also identifies that liker scale questionnaires are used to determine the relative intensity of different items.

### 3.7 Pre Analysis of Instrument

Pilot study was conducted using convenience sample of 50 household clients or beneficiaries of Islamic microfinance. The purpose of the pilot study is to assess the reliability and validity of the scales. The reliability analysis shows an internal consistency of .98 while the validity result indicates a factor loading of .70.

### 3.8 Data Analysis Procedure

This is a process of transforming and modeling data aimed at making it more meaningful in order to answer the research questions thereby involving them in the decision making that affects their livelihood. The study uses SPSS 18 software in running the analysis and relevant statistical tests have been used to answer each of the research questions.

## 4. RESULT AND DISCUSSION

This study used social and economic indicators such as household income, children education and household asset. Improvements on these indicators indicate a significant impact of Islamic microfinance on poverty.

### 4.1 Impact of Islamic Microfinance on household income

This variable was used to assess the impact of Islamic microfinance on client's household income. Table 3.1 indicates the result for Pearson correlation analysis for the effectiveness of Islamic microfinance loan on household income.

Table 3.1

Pearson Correlation Analysis between Islamic Microfinance and Household Income

| | | Household Income | Islamic Microfinance |
|---|---|---|---|
| Household Income | Pearson Correlation | 1 | .224** |
| | Sig. (2-tailed) | | .000 |
| | N | 342 | 342 |
| Islamic Microfinance | Pearson Correlation | .224** | 1 |
| | Sig. (2-tailed) | .000 | |
| | N | 342 | 342 |

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| Islamic Microfinance | Pearson Correlation | .224** | 1 |
| | Sig. (2-tailed) | .000 | |
| | N | 342 | 342 |

**. Correlation is significant at the 0.01 level (2-tailed).

The findings show that there is a positive correlation between Islamic microfinance and household income with a correlation coefficient ($r = .224$, $p < .01$, 2-tailed) indicating a positive impact of Islamic microfinance on household income. The reason for this significant relationship can be attributed to the nature and quality of Islamic products being provided by the microfinance institutions.

### 4.2 Impact of Islamic Microfinance on Household Education

This variable was used to assess the impact of Islamic microfinance on client's children education. Table 3.2 indicates the result for Pearson correlation analysis showing the effectiveness of Islamic microfinance loan on household children education.

Table 3.2

Pearson Correlation Analysis between Islamic Microfinance and Household Education

| | | Islamic Microfinance | Household Education |
|---|---|---|---|
| Islamic Microfinance | Pearson Correlation | 1 | .135* |
| | Sig. (2-tailed) | | .012 |
| | N | 342 | 342 |
| Household Education | Pearson Correlation | .135* | 1 |
| | Sig. (2-tailed) | .012 | |
| | N | 342 | 342 |

*. Correlation is significant at the 0.05 level (2-tailed).

The above table shows the correlation analysis between Islamic Microfinance and Household children education. The findings reveal that there is a positive and significant correlation between Islamic microfinance intervention and household education (r= .135, p<.001, 2-tailed) indicating that there is significant improvement in children education of Islamic microfinance clients.

### 4.3 Impact of Islamic Microfinance on Household Assets

This variable was used to assess the impact of Islamic microfinance on client's assets holding. Table 3.3 indicates the result for Pearson correlation analysis showing the effectiveness of Islamic microfinance loan on household asset.

Table 3.

Pearson Correlation Analysis between Islamic Microfinance and Household Assets

| | | Islamic Microfinance | Assets |
|---|---|---|---|
| Islamic Microfinance | Pearson Correlation | 1 | .546** |
| | Sig. (2-tailed) | | .000 |
| | N | 342 | 342 |
| Assets | Pearson Correlation | .546** | 1 |
| | Sig. (2-tailed) | .000 | |
| | N | 342 | 342 |

**. Correlation is significant at the 0.01 level (2-tailed).

The findings indicates that there is a positive and significant correlation between Islamic microfinance intervention and household asset (r= .546, p<.001, 2-tailed) indicating that there is significant improvement in household asset of Islamic microfinance clients. These findings are consistence with Rahman (2010).

### 4.4 Econometric Evidence

The table indicates the estimates of parameters in the model with amount of Islamic loan, age, level of education, gender, types of business, duration in MFI, business training acquired and duration in business as independent variables and household income as the dependent variable.

Table 4.7
Islamic Loan Regression Model Summary

| Model | B | Std. Error | Beta | T | Sig. |
|---|---|---|---|---|---|
| (Constant) | .145 | .113 | | 1.278 | .202 |
| Age | .162 | .037 | .174 | 4.357 | .000 |
| Highest Educ. Attainment | .110 | .023 | .206 | 4.765 | .000 |
| Gender | -.124 | .054 | -.085 | -2.271 | .024 |
| Type of business | -.026 | .031 | -.031 | -.839 | .402 |
| Business training acquired | -.006 | .029 | -.008 | -.208 | .835 |
| Duration in Business | .030 | .036 | .032 | .819 | .413 |
| Date joined MFI | .060 | .035 | .059 | 1.745 | .082 |
| Amount of Islamic loan | .639 | .039 | .622 | 16.512 | .000 |

Therefore, the model equation is presented as follows:

$$Y = \beta + b1X1 + b2X2 + b3X3 \ldots\ldots bnXn$$

$$\begin{aligned} \mathit{Household\ income} \\ &= .145 + .639\ (\mathit{islamic\ loan}) + .162\ (\mathit{age}) + .110\ (\mathit{level\ of\ edu}) \\ &- .124\ (\mathit{gender}) + .026\ (\mathit{types\ of\ bus}) + .060\ (\mathit{duration\ in\ MFI}) \\ &- .006\ (\mathit{bus\ training}) - .030\ (\mathit{duration\ in\ business}) \end{aligned}$$

The model shows household income as dependent variable while independent variables constitute amount of Islamic loan, age, level of education and gender are the significant predictors of income under Islamic loan regression model. This shows that amount of Islamic loan and age of the respondent are the major predictors of household income of Islamic microfinance recipients with the highest Beta value (B=0.639& B=0.162) indicating that they are important variables in determining household income. Similarly, gender and level of clients education are also found to be significant predictors of household income (B=0.-124& B=0.110).

## 5.1 Conclusion

The study has examined the role of Islamic microfinance on poverty alleviation. Samples were drawn from the recipient's of Islamic loan from some selected microfinance institutions in Northern Nigeria. The review of literature shows that microfinance institutions have provided useful credit facilities to the poor and the vulnerable households. The findings of the study show that Islamic microfinance can be regarded as powerful and effective tool in poverty alleviation because the results show that there is significant improvement on the client's household income, children education and healthcare status as a result of Islamic microfinance intervention. Similarly, this study identified that amount of Islamic loan, age; education and gender are significant predictors of household income. Thus, for Islamic microfinance program to be more effective and successful these variables should be taken into due consideration especially in policy formulation. Moreover, microfinance regulators and policy makers (Central Bank of Nigeria) will also make use of the findings of this study in designing policy framework for an effective delivery of financial services to the poor majority. Awareness of Islamic microfinance is one of the major obstacle which occurred due to low level of functional education in the region. There is the need for mass campaign and mobilization about the existence and impact of Islamic microfinance. Despite the limitations, the study makes significant contribution in the literature of microfinance impact assessment in general and Nigeria in particular.

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