

THE EFFECT OF ZAKAT PROGRAMS ON THE SOCIAL IMPACT OF MICROFINANCE INSTITUTIONS IN BANGLADESH

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Abstract: *The purpose of this paper to measure the effectiveness of the central for zakat management (CZM) efforts in utilising zakat funds for promoting microfinance among poor rural people in Bangladesh. This study assesses the effectiveness of zakat on aspects such as income, household expense and fixed asset accumulation of the poor client based on the before and after approach groups comprising to impoverished individuals and families are given equity capital and are encouraged to set on small businesses according to their liking and ensure sustainable development goals (SDGs). The group are supervised for a period in 2010 to 2018, ensure all individuals within the group can continue with their activities and ultimately, free themselves from the shackles of poverty and graduate into a sustainable livelihood and social impact. Results indicate a significant nominal and real increase in average monthly income, an increase in fixed assets and an increase in monthly average household expenditure before and after receiving zakat money. The findings from this paper shed light on the effectiveness of the zakat-based approach in alleviating poverty and ensuring sustainable economic empowerment of the poor rural people. This research is significant as it could be useful in future discussions on the potential ways to improve zakat-based MFIs and SDGs in Bangladesh. The outcomes from the discussions will be useful as a guide to policymakers in improving the zakat institution's governance system.*

Keywords: Zakat, Social impact, Poverty, Microfinance, SDGs, Bangladesh

INTRODUCTION

The purpose of the study is to estimate the effects of microfinance programs on poverty reduction in Bangladesh. The multi-faceted poverty is a severe issue in Bangladesh. A microfinance institution is considered one of the most effective and flexible tools in the fight against poverty in Bangladesh. However, still, about 35% of people live below the poverty line

in Bangladesh. The objectives of this study the role of microfinance programs in poverty reduction in Bangladesh. To evaluate the effectiveness of microfinance programs on poverty reduction; to identify the contributing factors for high dominance of poverty; to analyse the role of *Zakat* to recommend dependable poverty reduction policy that will progress the living standard of poor Bangladeshi citizen (M. I. Ali, 2013).

Problem Statement

The main part of this study is dedicated to evaluating the *Zakat*-based microfinance programs in Bangladesh. There is a scope to study the sustainability of short-term gains of poor people in Bangladesh. Therefore, this study attempted to evaluate whether the microfinance projects are imperative for poverty reduction in Bangladesh. This study also intended to suggest adopting the *Zakat* that played a significant role to reduce poverty in Bangladesh. In Bangladesh, many microfinance institutions are being operated to reduce the intensity of poverty. These institutions are constructed on diverse basic settings and having unique programs. It also widely acknowledged that these microfinance programs are not being utilised to its full potential in Bangladesh. still about 35% of people live below the poverty line.

Research Objectives

The general purpose of the study is to understand the effect of *Zakat* programs on the social impact on the social impact of microfinance programs for poverty reduction in Bangladesh. The following are the specific aims of this study:

1. To study the role of microfinance programs in poverty reduction in Bangladesh.
2. To analyse the role of *Zakat* in poverty reduction in Bangladesh.
3. To formulate a dependable and sustainable policy that will comprise social work knowledge and serve to enhance the living standard of those suffering from prolonged poverty in Bangladesh.

The remaining part of the paper is structured as follows. The next section discusses literature on zakat and microfinance. Thereafter, the methodology employed for data collection and analysis is explained in MFIs in CZM and SDGs. The remaining sections are findings, conclusion and implication of the study for research and practice, in that order.

LITERATURE REVIEWS

Principles of *Zakat*

In the religion of Islam, it has a mechanism to assist mitigating poverty, which is called *Zakat*. *Zakat* is an essential institution in the socio-economic framework of Islam. *Zakat* is an Arabic word which means “purity” and “cleanliness”, and it is an act of giving away part of one’s wealth to the poor – a contribution paid once a year on savings of at least 2.5%. In doing so, one purifies one’s wealth and soul. *Zakat* is one of the five pillars in Islam; hence, it is obligatory on every Muslim who has financial means (*nisab*). *Nisab* is measured as an amount equal to the essential needs of a person or family for one year. Basic needs refer to include any or all of the following: Food, clothing, housing, medical treatment and transportation for oneself and one’s dependents.

Dependents include spouse, children who are unable to earn their living and parents who are in need. In many modern societies, *nisab* is considered equivalent to a governmentally determined poverty threshold. Islam has a code of life which includes, among other things, the economic side of life. Consequently, religion has a scheme of mitigating poverty. *Zakat* is one of the fundamental philosophies of the Islamic economy, based on social welfare and fair distribution of wealth. It is the rights of the poor who do not have enough to take care of their basic needs, the needy whose basic needs are met, but their income does not take care of other essential needs, for those whose sole job is to collect and distribute. The *Zakat* funds, for freeing a Muslim person from slavery (whether a slave in the old times, or a convict of war in our times), for those who are indebted and cannot pay their debts, for the wayfarer (*ibn as-sabil*) who is stranded in a foreign property and cannot get enough money to go back to his homeland. Even though he might be productive as long as they are cut off from their wealth, Bangladesh is a Muslim country and therefore, cannot deny the importance of *Zakat* for poverty reduction. Hence, this study established the difference of household income between the only microfinance recipients and both microfinance and *Zakat* recipients in Bangladesh.

This model offers a combined model of two organisations: Islamic charities the institution of *Zakat* with the institution of Islamic microfinance. The integrated institution is utilised a common source of funds: Islamic charities and *Zakat* as well as the commercial source of funds. By using respective sources of funds, the institution could provide both social services and commercial for both economically active and extremely poor (Yumna *et al.*, 2011). The commercial services offer various financial facilities such as savings products, funding schemes and fee-based product for the economically active poor of the population. Meanwhile, social services are designed to improve the comfort of the extremely poor and to increase their capacities and capabilities in conducting productive activities (Kasri, R 2014; Wulandari, P. 2019). After having satisfactory skills and efficiency, it is expected that some of the extremely poor can start a new microenterprise and escalate to the wealthier group of the poor.

Poverty has been a severe problem and challenge for developing countries. Some of the Muslim countries have implemented the system of *Zakat* officially, and while in others, it is a private matter, and they have ignored the collection and distribution. However, the fact is that none of the Muslim countries has enforced *Zakat* in letter and spirit. It is believed that if the system is enforced in letter and spirit, then extreme poverty can be eliminated (Shirazi & Fouad Bin Amin, 2018). *Zakat* has a positive and significant influence on human development in five states in the short and long run. *Zakat* in Malaysia can be used as a tool of fiscal policy that is decided in the states of Malaysia to stimulate human development and economic growth in the long run (Suprayitno, Aslam, 2017).

According to Sudirman (2016), *Zakat* has a significant role in reducing poverty, Bank of *Zakat* or microfinance. eL-Zawa has successfully implemented this kind of microfinance. *Zakat* system which ensures proper utilisation of this *Zakat* fund thoroughly pursuing income-generating activities (IGAs) is more effective than microcredit (Debnath, 2015). The household-count ratio, the mean income gap, the poverty gap ratio and Sen's index measures suggest an improvement in income distribution after *Zakat* is distributed. It means that the positive contribution of *Zakat* in reducing poverty (Ahmad Fahme Mohd Ali *et al.*, 2015). The *Hasana* project was to improve the living standard of the poor households in terms of income and expenditure by providing *Zakat* facilities (Sohag, Mahmud, Alam, & Samargandi, 2015).

Encouraging women to participate in economic activities, a large pool of hard-working and determined can be encouraged to better themselves and improve the lives of the members of their households — the efficiency of *Zakat*-based style in alleviating poverty and ensuring sustainable economic empowerment of the poor rural women (Anis & Kassim, 2016). In Malaysia, their *Zakat* funds are being handled by a responsible, competent body, and the poverty rate is relatively much lower than those in Indonesia and Bangladesh. People in Indonesia are eager to give *Zakat*, but the problem lies within the less than ideal situation with the administration. Unfortunately, the system of *Zakat* in Bangladesh leaves much room for improvement. There are no government initiatives to collect *Zakat* funds. Due to the corruption and non-existence of an administrative body, *Zakat* able people are reluctant to give. Consequently, the barakah, as promised by God, is not manifesting to those countries (Ali & Hatta, 2014).

According to Ali (2013), Housing status of microfinance beneficiaries had improved during their membership periods. Employment opportunities, education, women's empowerment and healthcare facilities were the most influencing factors in determining the level of poverty. The income of those benefiting from both microfinance and *zakat* was more than those only benefiting from microfinance. It can relieve budget categories targeted for poverty alleviation for other budgetary needs. Increase the taxation potential through the improvement of productivity, employment and output. The government can use the method and timing of *zakat* collections as an important economic policy tool (M. Kabir & Juanyed, 2007).

Microfinance for Successful Poverty Alleviation Strategy

Microfinance is a necessary intervention to reduce poverty. Microfinance offers essential financial facilities for poor people. The Consultative Group to Assist the Poor (CGAP) explains the microfinance system as the supply of loans, funds and other essential financial services for the poor. Providing financial services for the poor is abandoned by formal microfinance institutions as this group of people is essential to high risk due to their powerlessness to meet the standard and requirements of formal financial institutions (Saad et al., 2014). Hassanain, K. M. (2015) argue that the lack of access to financial facilities restrains the ability of poor people to attain assets, start a business, increase their welfare and finance their emergency needs. Improving access to financial facilities through microfinance to some scope is believed to solve these problems.

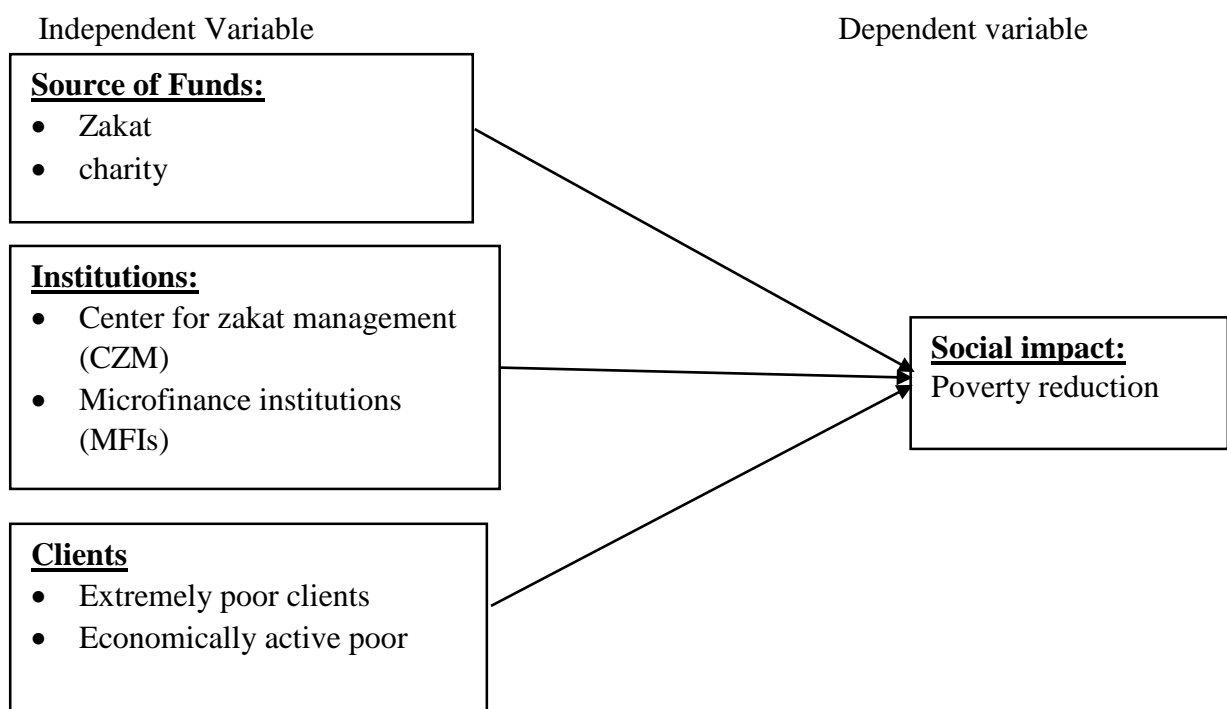
Yumna, A., & Clarke, M. (2011) notes that the Islamic microfinance approach to poverty alleviation ideally involves comprehensive approaches, including increasing income levels with pro-poor programs, achieving an equitable distribution of income and providing equal opportunities for all social segments. Microfinance, with its social and financial objective, can support the achievement of those approaches. The role of microfinance institution (MFIs) in poverty alleviation has been drawn by in three pathways by decreasing insurance cost through holding the more efficient asset improving income generation through providing production credit and saving for asset accumulation, and liability, and smoothing consumption by providing consumption credit (Arsyanti, L. D., & Kassim, S. 2016). Substantially, the microfinance system will contribute to the poverty alleviation agenda through supporting micro-saving, micro-entrepreneurs, micro-credit, and constraint the training of informal money lenders. However, microfinance system can be used as a strategy for distributing *Zakat* and Islamic charities for better outcomes in poverty alleviation. This study will be conducted on *zakat-based* MFIs efficiency specifically on disbursement, cost and time

efficiency using ratio analysis and then correlate the analysis with poverty reduction and achieved SDGs.

METHODOLOGY

Drawing on the unique aspects of Islamic finance principles for poverty alleviation, there is a scope for Islamic microfinance institutions (MFIs) to have great success in the dual goals of financial sustainability and comprehensive outreach to the most in need by utilising *Zakat* and Islamic charities as an additional source of funds. It is used in Ibn Khaldun economic theory based on Thawhidic paradigm. Data source is secondary data analysis, data collection is annual report in 2010 to 2018 of Central for Zakat Management (CZM) and data analysis is descriptive analysis method.

Figure 1: Integrated Model



Source: Development by authors

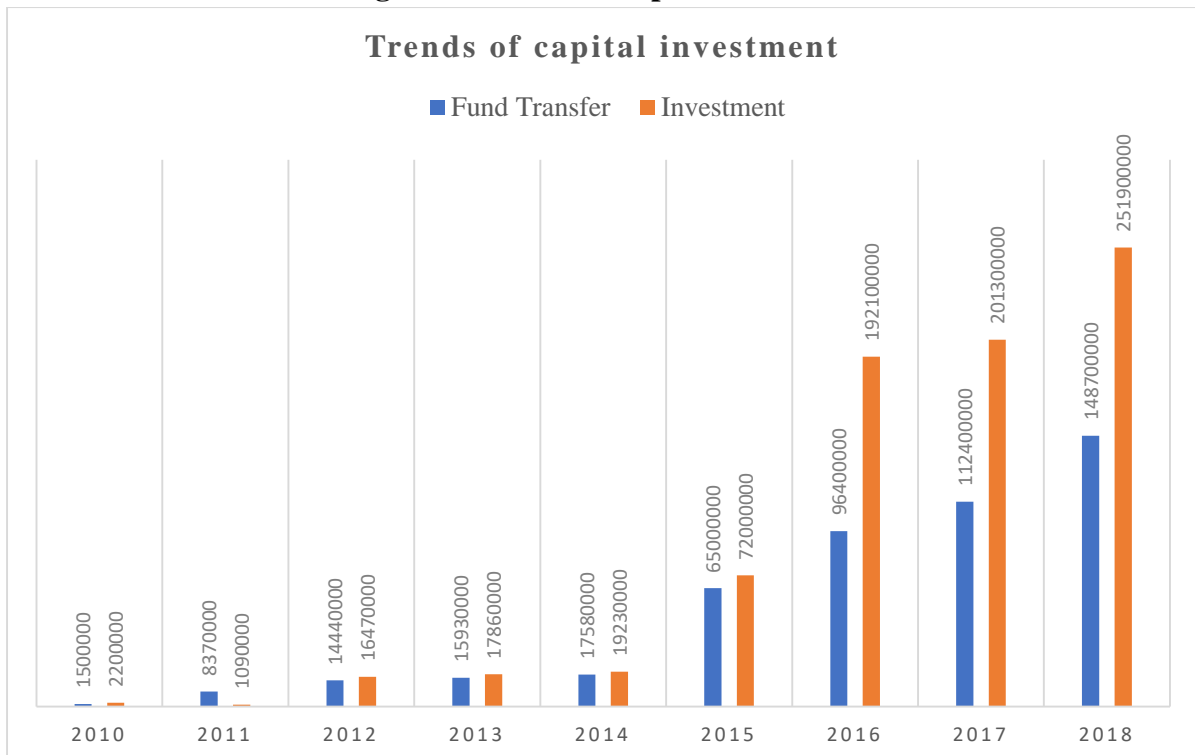
DESCRIPTIVE ANALYSIS

Center for Zakat Management (CZM)

Center for Zakat Management (CZM), a faith-based welfare organisation, it worked for the pro-poor people in Bangladesh. CZM is the pioneer of institutionalisation of *Zakat* for the development of disadvantaged people of the society. Since its beginning in 2008, CZM has been implementing several programs in order to make sustainable development of disadvantaged people. CZM is worked for mobilising *Zakat* and aware the *Zakat* payers for abiding the rules of Allah SWT. The organisation provides the management service to correctly distribute the *Zakat* in development and find out the result by payment approach (Mohammad Osmani *et al.*, 2014; Kausar *et al.*, 2016). For livelihood and human development, CZM has applied a program named *Jeebika*, Corporate Initiatives of Poverty Alleviation (CIPA).

(Annual Report-CZM, 2017) *Jeebika* Program is the livelihood development program applying in 32 districts across Bangladesh and supported more than 1,25,000 people for changing the livelihood and come out from the cocoons of poverty. The prominent corporate of the country sponsors *Jeebika* program and come forward to eliminating poverty from the end. *Jeebika* is a combined program that includes not only livelihood development but also, microfinance, healthcare, education and humanitarian support during a disaster. In Bangladesh, more than seven trades training is provided through five centres. For providing humanitarian assistance, the *Insaniat* Program is worked directly. On different problems such as Medical emergency, Loan payment, microfinance, educational support, food support, Relief and rehabilitation support, *Insaniat* program supported more than 35,000 people in 2018.

Figure 2: Trends of capital investment



Source: annual report 2018 in CZM.

Overall, CZM is such an organisation that defines the Zakat for the tool for poverty alleviation. CZM, since its start in 2008, has worked entirely for the sake of mobilising Zakat and creates a new arena of development by properly utilising Zakat. CZM has been hurrying its activities day by day with proving its excellence Zakat mobilisation and development. All program is continued by figure 2.

Figure 3: SDGs and CZMs Program

SDGs	CZM's Program	Volume of work
Goal-1: No poverty	Jeebika Program	25 projects
Goal-2: No hunger	Jeebika Program	25 project
Goal-3: Good health and well being	Jeebika Program and Ferdousi	31 primary healthcare centers
Goal-4: Quality Education	Jeebika Program and Gulbagicha, Genius Program	25 project, 121 education center, Scholarship to all public university, engineering college and medical college
Goal-6: clean water and sanitation	Jeebika Program and Ferdousi	25 project, and 31 healthcare centers
Goal-11: Sustainable Cities and Community	Jeebika Program, Gulbagicha Program, Naipunna Bikash	25 project, 40 center in Dhaka city, 5 centers for youth development
Goal-12: Responsible Consumption and production	Jeebika program	25 projects
Goal-13: Climate action	Jeebika program and Insaniat Program	25 projects and this year support more than 12000 people
Goal-17: Partnership for the goal	Jeebika Program, Ferdousi Program and Gulbagicha Program	Have more than 20 corporate partners, 7 local partners

Source: <http://czm-bd.org>

Although many studies have been conducted in advancing microfinance and SDG (figure: 3) practice, many institutions still have faced many obstacles in providing services for the poor (Miah, A.A.2019; Nashir et al., 2019). Setting the optimal interest rate to achieve sustainability is the most challenging task for MFIs and SDGs (figure:2). According to Mohiuddin (2017), Microfinance institutions charge interest rate higher than commercial, financial institutions. They argue, the high rate is reasonable to cover the high operational cost, and it is still lower than informal money lenders (Yumna, A., & Clarke, M. 2011; Rasid et al., 2018). However, overcharging interest rate will cause microcredit unaffordable for the poor and will be lowering the repayment rate. The evidence shows that, when the interest rate exceeds by 60% per annum, the MFI will not generate profit because of lack of microcredit demand.

It is shown that the clients of microfinance need more than financial products; they require non-financial services to support their businesses and daily lives (Wulandari et al., 2016). According to Saad et al., (2014), Microfinance clients are often constrained by poor health and illiteracy, which limit their capacity in utilising the financial services available. Some scholars argue that an integrated model of microfinance that offers both financial and non-financial services is needed for poverty alleviation agenda(figure:2). However, providing non-financial services requires extra cost, and this could jeopardise the financial sustainability agenda. Several MFIs provide non-financial services by relying on the grants of the donor funds, which are not readily available to all MFIs.

Understanding the limitations of the current practice of microfinance, there is an opportunity to create a powerful microfinance practice, which not only serves the upper level

of the poor but also provides both financial and non-financial services without disturbing a financial sustainability agenda (Yumna, A., & Clarke, M. 2011; Shaikh et al., 2017). It is argued that Islamic finance is embedded with several characteristics that can reduce the limitation of microfinance (figure:1). According to Wulandari et al., (2016), Both microfinance and Islamic finance share the same basic concepts in how they create financial services for the poor. Both microfinance and Islamic finance encourage entrepreneurship, promote risk-sharing and encourage the poor to take part in poverty reduction activity (Siddiqi 2008; Obaidullah 2008; Yumna, A., & Clarke, M. 2011). Furthermore, the availability of Zakat and Islamic charities in the Islamic world can enhance the capital base of microfinance and to improve the wellbeing of indigent clients (Yumna, A., & Clarke, M. 2011; Khasandy et al., 2019).

The application of Islamic finance on microfinance practices has several advantages that can increase the viability and sustainability of MFIs. They might take the benefits by implementing Islamic scheme of transactions, targeting on the family rather than focusing only on women clients, using religion as social capital as well as obtaining another source of financing from Islamic charities.

CONCLUSION AND RECOMENDATION

Microfinance initiative has evolved over the past four decades as important poverty reduction mechanisms. There is strong evidence, however, to suggest that increasing their financial sustainability often constrains their ability to reach the poorest of the poor. This paper considered how Islamic religious beliefs around social inequality can provide a constitutive force for poverty reduction. Specifically, this paper considered how Islamic principles of finance and charitable obligations (including *Zakat*) could be integrated into the operations of a microfinance institution in order to enhance the financial sustainability of the organisation but more importantly to enhance poverty alleviation outcomes achieved by the organisation. By integrating Islamic financial principles and microfinance activities with Islamic charity, this paper has shown it is possible to pursue the dual objective of increasing outreach and enhancing sustainability and try to solve the debate between *institutions* and *welfarist* view in microfinance initiative. In this regard, this paper adds to the small but increasingly relevant literature calling for the more explicit recognition of the value of religion, religious belief, and religious organisations within the development.

The study only focuses on *zakat* institutions in Bangladesh. Future researchers may have interest in exploring and comparing the efficiency and practices of *zakat-based* MFIs in other countries especially in the South East Asian region. This will be an interesting study and may contribute some ideas in improving the local *zakat* management practices. This is in line with the objective to establish the South East Asia *Zakat* Council in order to improve *zakat* management and *Zakat* based MFIs in this region.

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