

MICROFINANCING IN ISLAMIC BANK

(A Practical Approach)

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ABSTRACT

The Requirements of our Society were pointed out in the 20th Century by some financial innovations. Among these innovations, most of the financial products were launched for the interests of the economically developed countries. In the same way, the need of an Islamic Society were also addressed and Serious steps has been taken for solving those problems. The concept of micro financing and Islamic banking emerged almost at the same time in 1970's from its modest beginning. Islamic Banking and Microfinance both are independently studied; however the correlation between them is not so familiar and need a lot of research. The purpose of this study is to find out the importance of Islamic financial institutions, in view of their prospects and feasibility, to merge with the Microfinance activities, in their operations. The proposed co-integrated structure would be practicable, since the objectives of Islamic banking and Microfinance are consistent with each other, i.e. equitable distribution of wealth in the society and social justice. This study will examine the products and services, offered by Islamic financial institutions, for example *Murabaha*, which may be applied in the

small business of farm animals, *Ijarah* may be applied in the Car wash and Diminishing *Musharakah* for small vehicles.

Keywords

Islamic Banking, Microfinance, Products in Islamic Bank, Murabaha, Musharakah

1. Introduction

The literature review is about the Practice of Microfinance in Islamic bank. There is a wide range of products, which can be offered in microfinance, such as small loans, savings and insurance. These concepts have been explained with special reference to Pakistan and the step by step procedure followed in Islamic Banks is being discussed. Presently, it is one the most emergent segment in the financial market all over the world. In the same way, microfinance institutions (MFIs), initiated by Professor *Muhammed Yunus* of *Grameen* Bank in Bangladesh, have flourished in both developing and developed countries. Due to disappointing results to alleviate poverty in developing countries, the microfinance initiative is considered to be an ideal innovation for development and eradicating poverty from our society. "Microcredit Summit 1997" envisaged that, by the end of 2005, 100 million poor people would be able to have access to microfinance. It's a useful way for alleviating poverty as International donors and multilateral financial institutions have adopted in the developing world.

1.1 Implementation Strategy / Application Process Flow

The Islamic Microfinance Division in Islamic Bank initially will offer four products namely: Musharika, Murabaha, Mudarabah and Ijara. The Islamic Bank will also develop specialized online software for the operations to avoid lapse of time and develop paperless operations.

Step 1.1.1: Application Forms

The Islamic Bank will develop, print and make available the financing facility application forms to all the participating branches. The applicant will fill the application form with the help of Islamic Microfinance field staff and attach the relevant documents as mentioned in the form. The completed form will be submitted with the Islamic Microfinance Division concerned branch where an officer will check the form for possible deficiencies on the spot. Complete form in all respect will be accepted and the officer will assign an identification number to the application, record in Register. Receipt will be provided to the applicant. The officer will then communicate an expected date of verification visit by the officers to the client's business and/ or residence to verify the genuineness of the provided contents / facts. The field staff will then enter the contents / data of the application to the specially developed software which would be available on line with Islamic Microfinance Division Head Office.

Step 1.1.2: Assessment

The field staff will verify the contents by visiting the business premises and / or residence of the applicant. The officers will use the already defined banking tools for verification purposes.

Following main indicators will be assessed:

- Authenticate the contents provided in the form (Addresses, Business Status, Guarantor's addresses and professions etc
- Credit Worthiness Checks
- Assess the Growth potential / current market of the proposed business
- Assess the existing skills of the applicant
- Entrepreneurial Capabilities
- Financing facility Requirement & Repayment Capacity Assessment

After ascertaining the status of the application the credit officer will paste remarks on application electronically and will submit the same to Islamic Microfinance Division at Head Office.

Step 1.1.3: Assessment at Islamic Microfinance Division, Head Office

The Islamic Microfinance Division at Head Office will re-assess the cases as per the criteria. eCIB of both client and guarantors will be checked. Any discrepancy will be communicated electronically through pasting remarks.

Step 1.1.4: Approval Decision

Divisional Credit Approval Committee will be constituted under the chairmanship of Head Islamic Microfinance Division (IMFD). The committee will comprise of Head IMFD (Chairman), In-Charge Processing & Approval and Concerned Regional Manager. A quorum of two members including the chairman would be required for approval. The committee will decide the proposals and the IMFD will inform the concerned branch accordingly.

Step 1.1.5: Approvals / Declines

All approved cases will be communicated by IMFD to branches through sending electronic sanction letters. In case of decline of cases the regret letter will also be sent electronically.

Step 1.1.6: Purchase of Goods

- **How to book Murabaha**

1. Customer shall be informed to prepare list of purchases and decide a day of purchases.
2. On day of purchases cash shall be withdrawn by the field staff by debiting AAMF and he will accompany with customer to the market.
3. Purchases shall be made as per customer requirements and delivery shall be made to customer.
4. Carriage / transportation cost can also be paid out of AAMF.
5. Before leaving the customer, field staff will sell the products to customer with cost plus profit using following formula.

Cost = Purchase price + Carriage / Transportation Cost

Profit = (Cost * 18/100 * 3/12) + (Cost * 18/100 * 33/12 * 1/2)

On return to branch, field staff will deposit any cash left over due to less purchases in Advance against Murabaha Finance head and book the finance using following entries.

Credit	Debit
Cash	Cost Amount of Murabaha
Advance against Murabaha	Profit Account

- **How to book Musharaka**

1. Musharaka agreement shall be signed
2. In case of Musharaka all items are to be purchased, following the procedure of purchased given in Murabaha, however codes to be used for drawing advance shall be Advance against Musharaka.
3. All items purchased shall be handed over to the customer and acknowledgment shall be obtained.
4. Entries shall be made as under

Credit	Debit
Customer Musharaka Finance Account	Advance against Musharaka
	Income on Musharaka

- **How to book Ijara**

1. After receiving approval from Head Office, field staff will inform the customer.
2. Machine / equipment to be given under Ijara shall be decided.
3. Day of purchase shall be decided and arrangement with sell shall be made to ensure that machinery / equipment is available.
4. Cash shall be withdrawn by the field staff on day of purchases and field staff will go with customer for purchases.
5. Machinery / equipment shall be purchased and shall be handed over to the customer.
6. Ijara agreement and payment schedule shall be signed by the customer and machinery shall be handed over to him.

7. Transportation cost can be paid to the customer but will be added to cost of machinery.
8. Accounting entries

Credit	Debit
Cash	Advance against Ijarah
Advance against Ijarah	Assets Under Ijarah

Depreciation entry shall be passed at GL level on all portfolio with 30% Annual Depreciation. The rate may be changed by IMFD from time to time.

Credit	Debit
Accumulated Depreciation	Depreciation Account
Depreciation Account	Income on Expense Account
Rental Under Ijara	Customer Account
Assets Under Ijara A/c	Asset Possessed(If Repossessed)

- **How to book Mudarabah**

1. Mudarabah Agreement shall be signed.
2. Payment shall be made to customer by crediting his account with following entry.

Credit	Debit
Customer A/c	Mudharaba Finance A/c

3. Income from customer shall be credited to his account on monthly basis and following entry shall be passed.

Credit	Debit
Income on Mudharaba	Customer Account(Profit)

Step 1.1.7: Recovery

The financing facility provided will be recovered in equal monthly installments along with the profit and will be credited to / deposited in the designated Branches of The bank of Khyber. Recovery will be undertaken by Islamic Microfinance Division at Head Office, in case of default by borrowers, the government shall provide full support of the concerned departments to Islamic Microfinance Division of Bank of Khyber as a policy e.g. Revenue Department for recovery through Land Revenue Act (LRA), respective administration in case of dishonoring of cheques etc.

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