

## **The Effect of Conventional and Islamic Microfinance on Poverty Alleviation in Bangladesh**

تأثير التمويل المصرف التقليدي والإسلامي على الحد من الفقر في بنغلاديش

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**Abstract:** *Our study evaluated and examined the availability of credit services and outreach as well as propose better effect microfinance services in Bangladesh. The establishment of MFIs in Bangladesh is the result of multiple initiatives by successive government authorities. More recently, microfinance has become a system to address the challenge of poverty, and the past decade has seen a remarkable contribution from MFIs in different parts of the world. Our study used a sample of 400 Islamic and conventional microfinance clients through a simple random sampling technique. In analysing the descriptive data statistics, Pearson Moment correlations, Multiple Regression Analysis (MRA) and parametric tests such as independent t-test and ANOVA were used. The study concluded that the credit facilities are available and accessible in the microfinance institutions irrespective of gender, type of business engaged by the client and the community he/she belongs.*

**Keywords:** *Microfinance institutions; Conventional microfinance; Islamic microfinance; Poverty Alleviation.*

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## الملخص:

شهد العقد الماضي مساهمة اجتماعية واقتصادية إيجابية لمؤسسات التمويل الأصغر في العديد من أنحاء العام، وفي هذا الصدد قامت دراستنا بتحليل دور التمويل الأصغر في الحد من الفقر في بنغلاديش مع الأخذ بعين الاعتبار تأثير الجنس وطبيعة العمل، بالاعتماد على دراسة تحليلية شملت 400 عميل استفادوا من هذا النوع من التمويل سواء الاسلامي أو التقليدي، حيث كان اختيار العينة عشوائي.

توصلت الدراسة إلى أن التمويل الأصغر يساهم في تقليل حدة الفقر عن طريق تحسين مؤشرات التعليم وتحقيق الأمن للغذائي بغض النظر عن الجنس وطبيعة الأعمال الممارسة.

**الكلمات المفتاحية:** مؤسسات التمويل المصغر، التمويل الأصغر التقليدي، التمويل الأصغر الإسلامي، الحد من الفقر.

## I . INTRODUCTION

In Bangladesh, poverty is growing faster than population growth. In 2011, the population was about 120 million, and the incidence of poverty accounts to more than 18 per cent indicating that more than 15 million people were in poverty trap to 13.8% in 2016, and below 9% in 2018<sup>1</sup>. Various efforts have been put forward in Bangladesh by both past and present governments to alleviate poverty via microfinance. Besides, the private sector and NGOs also complement the efforts of the government by establishing a microfinance scheme in various part of the country. Despites various microfinance initiatives, poverty remains a problem that keeps attracting the attention of government, private sector and NGOs.

Microfinance organisations were established in rural and urban residential areas to provide gain access to capital to the poor and low-income group who have small gain access to the commercial banking institutions. Many of these institutions are conventional but integrate Islamic microfinance screen for poverty alleviation among the poor people. For that reason, the present research evaluated and examined the availability of credit services and outreach as well as propose better effect microfinance services in Bangladesh. Microfinance, seeing that one of the programs adopted to alleviate poverty provides a significant function to play in that path, especially in a developing country, such as Bangladesh. There have been many efforts by the competent and

government authorities towards the reduction of poverty, including non-governmental institutions, private corporations and organisations. The particular goals of this research consist of the following:

i. To identify the availability of credit facilities in microfinance institutions for poverty alleviation.

ii. Analyse the socio-economic impact of conventional and Islamic microfinance programmes in Bangladesh.

The study consists of six sections, starting with section one, which addresses an overview of the research region, problem statement, and objectives of the study and also addresses significant of the research. Section two is the literature review which explained models of microfinance conventional and Islamic microfinance model. Sections three, offers with study methodology, population people and sample, the technique of data collection and evaluation used in the research. Sections four is data analysis which addresses model summary for conventional and Islamic microfinance. Section five is the finding of the study, and lastly, sections six is conclusion and recommendations to be taken for future studies from this study.

## **II LITERATURE REVIEW**

### **A. Models of Microfinance**

Microfinance programs and organisations play a significant role in the field of poverty reduction strategies; these organisations viewed as the primary channels used to enhance the living standard of the poor and low-income group in a particular society<sup>2</sup>. The advancement of microfinance companies in the global environment produces a range of strategies or ideas place forwards by different scholars from different history and measurements.

### **B. Conventional Microfinance Model**

Grameen Bank was established in 1976 and possessed by the debtors of the bank. The primary goals of the bank are to offer credit services to the poor, mainly females. Additionally, Loans had been provided without

any security to the rural poor in purchase to fund their income-producing actions and housing expenditures<sup>3</sup>. Grameen Bank has turned conventional bank practice by merely removing the advantages of collateral and created a savings system depending on mutual reliability, accountability, contribution and creativeness. Grameen Bank gives credit towards the poorest with the poor in rural Bangladesh, without any security. At Grameen Bank, the loan de3finde as a cost-effective system to struggle poverty, and it is a catalyst in the overall development of socio-economic conditions on the poor who have been kept outside of the banking orbit. Professor Dr Muhammad Yunus, the founder of “Grameen Bank” reasoned that if financial resources can be distributed around the poor people on conditions and terms that are suitable and affordable, and these millions of small people who have their millions of small pursuits can add about create an enormous development wonder<sup>4</sup>.

Since December 2018, it is 9.08 million members, ninety-seven per cent of whom are women. With 2, 568 branches, Grameen Bank provides products and services in 81, 677 villages, covering much more than 93 per cent of the villages in Bangladesh<sup>5</sup>. Grameen Bank’s positive impact on their poor and formerly needy borrowers has become documented in several independent research carried out by external agencies such as the World Bank, the International Food Research Policy Institute (IFPRI) as well as the Bangladesh Institute of Development Studies (BIDS).

### **C. Islamic Microfinance Model**

Islamic micro financing can be a substitute way of providing accessible competent to micro-entrepreneurs in the society relative to Islamic principles. The research of Islamic microfinance becomes imperatives as this study assesses the conventional and Islamic microfinance on poverty alleviation activities<sup>6</sup>. The MFIs provides financial services to the indigent that tailored to their needs and condition. Effective microfinance programs centred on the provision of a little number of loans and other products for investment in micro corporations. Microfinance and Islamic financing are similar to Islam emphasise more on moral, sociable and spiritual factors that will enhance equality and justice for the introduction of a specific society<sup>7</sup>. Principles of motivating risk-sharing, a property right in all area of all right the Islamic code underlining the financial

system. Therefore, many components of microfinance are constant with the goals of Islamic financing<sup>8</sup>. Ahmad<sup>9</sup> stated that the primary point of difference between Islamic microfinance from conventional system occurs from the idea of joint liability. Standard microfinance charges interest which violates the concepts of Islamic sharia.

Murabaha, and Ijara bay-salam other services such as savings. However, Islamic MFIs offers to fund under the idea of trade and partnership. One major factor which makes the Islamic strategy not the same as that of conventional is the trust satisfaction of the client<sup>10</sup>. The Islamic strategy takes under consideration Islamic concepts and the perception system of the client, which are not the same as what is being available in the conventional system. Islamic microfinance institutions remain potentially more prosperous on both asset and liability sides<sup>11</sup>, a potential tool for poverty alleviation and sensitive to sculpture and religion<sup>12</sup>. Several studies depict the relevance of Islamic microfinance in various dimensions as provides financial services to the poor and low-income group for business enterprise investment<sup>13</sup>, increases income, expenditure and asset owned<sup>14</sup>, improves business performance and household income of microenterprises<sup>15</sup>. While in terms of challenges, it suffers from administrative transaction cost and segregation among gender<sup>16</sup>.

#### **D. Microfinance Institutions in The Study Area**

The establishment of microfinance in many places in Bangladesh could be traced back to 1980 when a new policy framework on microfinance was promulgated. Since then, government, privates and NGOs set up microfinance institutions in various places to meet the high demand for financial service<sup>17</sup>. The existing financial institutions in the study area consists of commercial banks, development banks, cooperative societies, saving and loans associations, self-help groups, credit union, microfinance banks and informal money lenders. Out of these financial markets, the study focuses on microfinance banks which include Freedom microfinance bank, Grameen Bank, BRAC and Microcredit Regulatory Authority (MRA) and Islamic microfinance institutions such as Rural Development Scheme<sup>18</sup>.

The country's economy is an agrarian one with a more significant part of living in rural areas. Rural areas are seen as stagnant agriculture and scanty sectors — Rural Development Scheme (RDS) in 1995. In 2019 the meantime, 295 Branches of the Bank have been operating the activities of the Scheme in their particular districts Underemployment and unemployment is a normal phenomenon, especially in rural areas<sup>19</sup>. The substantial human resources have continued to be unutilized credited to insufficient education. It leads to unequal distribution of income which in turn causes a severe problem in balanced geographical development as well as the growth of GDP. Rural Development Scheme (RDS) in 1995. In 2019 the meantime, 295 Branches of the Bank have been operating the activities of the Scheme in their particular districts<sup>20</sup>. These Branches are working amongst the poor in 23,450 villages of 64 regions of the country. The total number of members is 1,135,574 as beginning the scheme. The member has given investment facilities, an amount of BDT 265,981.26 million (3,325 million USD) compared to which the outstanding was USD 365 million (Islamic Bank Bangladesh limited, 2019). As a result, bank branches were encouraged to obtain their deposits in certain areas for the financial upgrading of the rural population<sup>21</sup>.

Human being requirements are the most substantial concern in Islam. Understanding, lineage or offspring and prosperity<sup>22</sup>. For that reason, Islam at all times places deep interest in the satisfaction of these fundamental necessities. On the other hand, the framework of conventional microcredit is usually revenue-focused where human being requirements occasionally are becoming ignored<sup>23</sup>. Reported that Conventional MFIs often generally place more profound concern on steady and optimum come back. All these microfinance institutions are conventional, but some operate Islamic microfinance windows. The products under the Islamic window comprise of Musharakah, Mudarabah and Ijarah with Baysalam in few of the microfinance institutions. Therefore, it is clear that in the study, microfinance was accepted and received more recognition from both state holders and potential investors<sup>24</sup>.

## **E. Poverty Alleviation Programs in Bangladesh**

Bangladesh has witnessed several initiatives at various points in time aimed at alleviating poverty among the general population<sup>25</sup>. The relevance of reviewing these programmes and institutions to the present study cannot be underscored as it guides the research regarding the success or failure of each of the plans to provide accompanying intervention system that will help in minimising the incidence of poverty in Bangladesh<sup>26</sup>. It is evident that governments in Bangladesh, past and present, have launched several programs, policies and institutions to improve the living standard of the poor and the low-income group. These programs geared towards improving essential social services, infrastructure, agriculture, housing, and increasing access to credit and creating employment<sup>27</sup>. However, among these programmes some are multi-sectoral (water, sanitation and environment) while some are sector-specific programs in agriculture, health, education, transport and nutrition all to reduce poverty<sup>28</sup>.

Specialised Microcredit Regulatory Authority and about 700 NGOs. Although their current functionality sounds excellent, however, they failed to achieve the best objective, which can be poverty removal<sup>29</sup>. Likewise, many criticisms have produced by analysts about the weak points of conventional MFIs and their applications. Nevertheless, Ali et al.<sup>30</sup> stated that the high-interest rate of microcredit is usually a main weak point of Conventional MFIs which adversely impacts its objective. It also exposed that reasonable interest rate charged by Conventional MFIs is often around 40% which is without doubt higher than regular bank interest rate. Thrikawala et al.<sup>31</sup> asserted that the real interest rate occasionally turns into even more than 50%. Ahmed and Khan<sup>32</sup> have reported that conventional microcredit offers declined to reach the marginal or hardcore poor due to its high-interest rate. Additionally, some concealed costs charged on credit disbursement, which decreases the credit quantity significantly. The writer provides also looked after them by mentioning that high management costs push MFIs to charge high interest in microcredits loans<sup>33</sup>.

The instalment payment technique of microcredit puts disproportionate impact about poor mainly because most NGOs collect

instalment in a daily and weekly basis. In other words, any default is undoubtedly rewarded with charges. As a result, credit receivers do not obtain more than enough time to use the credit cash to generate income. Likewise, <sup>34</sup> think return from income-producing actions generally requires much more extended time.

Additionally, influencing them is indeed very much more straightforward than guys. Several research workers feel that such issue is playing a significant function to enhance society. In opposite, the outcome of self-sufficiency offers inspired the women to become the decision-maker of the family. For that reason, family members issues and complications have been elevated. It from The past studies found that the number of divorce rate has increased in Bangladesh credited to female's empowerment. <sup>35</sup> Claimed that females empowerment offers a significant impact on the growth of the divorce rate. Similarly, as a result, the researcher thinks that conventional microcredit applications have negatively affected the family relationship.

Furthermore, sometimes, females are just a recipient of the funds, not the users. Anis and Kassim <sup>36</sup> exposed the necessarily man member is the initiator of the finance. Once the finance offered to the woman users, male users try to obtain control of the funds and use it in non-income producing actions. However, the female users are the ones who experience pressure for the loan repayment from MFIs. Therefore, it impacts the relationship between male and female users of the family members.

Generally, microcredit provides for a short time (such as six months and one year. For that reason, the loan receivers do not get more than enough time to invest the fund and generate a return. Nevertheless, the weekly and monthly or daily payment system continuously reduces their capital of expenditure. Anis and Kassim <sup>37</sup> reported that MFIs mainly offers short term micro loans which make it challenging to make use of for income-generating actions.



### **III. METHODOLOGY**

The study assessed awareness, availability, acceptance, as well as socio-economic impacts of conventional and Islamic microfinance programmes on poverty alleviation in Bangladesh. The study involves a large number of respondents; therefore, quantitative survey approach applied as it is most appropriate. The survey technique allows researcher to collect quantitative data which can be analysed 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 its possible to obtain findings that represent the entire population<sup>38</sup>.

The study collected data from the target respondents consisting of microfinance clients in MRA in Bangladesh and Islamic microfinance institutions. The researcher used a questionnaire in collecting the data in selected microfinance institutions within the study area. It is a process of transforming and modelling 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 used SPSS 24 software in running the analysis, and relevant statistical technique has been used to answer each of the research questions. In analysing the descriptive data statistics, Pearson Moment correlations, Multiple Regression Analysis (MRA) and parametric tests such as independent t-test and ANOVA were used.

### **IV. Data Analysis**

#### **A. Model Summary for Islamic Microfinance**

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 1: Model summary of Islamic microfinance.

Model	Unstandardized		Standardized		Correlations			Collinearity		
	Coefficients		Coefficients		Zero-			Statistics		
	Std.		Beta	T	Sig.	order	Partia	Part	Tolerance	VIF
	B	Error								
(Constant)	.145	.113		1.278	.202					
Age	.162	.037	.174	4.357	.000	.541	.232	.141	.655	1.527
Highest.educ.attainment	.110	.023	.206	4.765	.000	.432	.253	.154	.564	1.774
Gender	-.124	.054	-.085	-2.271	.024	.148	-.124	-.074	.747	1.339
Type.of.business	-.026	.031	-.031	-.839	.402	.202	-.046	-.027	.785	1.273
Business.training.acquired	-.006	.029	-.008	-.208	.835	.274	-.011	-.007	.637	1.569
Business.life.to.date	.030	.036	.032	.819	.413	.258	.045	.027	.709	1.410
Date.joined.MFI	.060	.035	.059	1.745	.082	.146	.095	.057	.917	1.091
Amount.of.Islamic.loan	.639	.039	.622	16.512	.000	.759	.671	.535	.740	1.351

**Source:** Author's computations (2019)

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

**B. The conventional Microfinance regression model**

The estimates of parameters in the model with amount of conventional 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 2: Model Summary for Conventional Microfinance

Model	Unstandardized Coefficients		Standardized Coefficients		Correlations			Collinearity Statistics		
	B	Std. Error	Beta	t	Sig.	Zero-order	Partial	Part	Tolerance	VIF
(Constant)	.498	.149		3.329	.001					
Age	.388	.046	.417	8.383	.000	.541	.417	.363	.757	1.320
Level of Education	.127	.032	.237	3.908	.000	.432	.209	.169	.507	1.972
Gender	-.195	.072	-.134	-2.688	.008	.148	-.146	-.116	.752	1.330
Type of business	-.010	.042	-.012	-.246	.806	.202	-.013	-.011	.779	1.283
Amt of conventional loan	.174	.069	.157	2.536	.012	.419	.138	.110	.490	2.041
Business training acquired	-.007	.040	-.010	-.174	.862	.274	-.010	-.008	.621	1.610
Business life to date	.032	.049	.034	.650	.516	.258	.036	.028	.689	1.451
Duration in MFI	-.006	.049	-.006	-.128	.898	.146	-.007	-.006	.810	1.234

Source: Author’s computations (2019)

The model shows household income as a dependent variable while independent variables constitute the amount of conventional loan, age and level of education (B=0.174, B=0.388 & B=0.127) respectively. Gender was also found to be a significant determinant of household income under conventional loan regression mode.

**C. Model Summary for Islamic Microfinance**

Another model was developed to identify the relationship between household assets as the dependent variable with amount of Islamic loan, gender, age, level of education, duration in business, business training and duration in MFI as independent variables.

**Table 3 Regression Model for Islamic Microfinance**

Model	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	.058	.109			.531	.596	
Age	.073	.033	.087	2.231	.026	.767	1.303
Highest.educ.attainment	.161	.022	.336	7.436	.000	.572	1.749
Type.of.business	.020	.030	.026	.677	.499	.770	1.298
Business.training.acquired	.052	.028	.079	1.827	.069	.621	1.610
Business.life.to.date	.087	.034	.103	2.538	.012	.702	1.425
Date.joined.MFI	.208	.033	.226	6.301	.000	.905	1.105
Islamic.loan	.401	.043	.351	9.337	.000	.824	1.214
gender_recode	.016	.052	.012	.315	.753	.749	1.336

**Source:** Author’s computations (2019)

The above regression equation shows the relationship between household assets (dependent variable) and other independent variables. The model reveals that the level of education is a significant predictor of household assets (B=.161). Similarly, duration in microfinance, amount of Islamic loan and age of the recipients are found to be significant predictors of household assets (B=.208, .401 & .073) respectively.

Moreover, the number of years clients spent in business is another variable that is important in increasing household assets. The basic idea behind these findings is that improvement of household assets is much determined by the above variables. However, business training acquired, types of business engage by clients and gender are found to be not significant predictors of household assets.

#### **D. Model Summary for Conventional Microfinance**

This model was developed to identify the relationship between household assets (dependent variable) and level of education, gender, age, amount of conventional loan, business training, and duration in MFI and businesses as independent variables.

Table 4 indicates the regression model.

Model	Unstandardized Coefficients		Standardized Coefficients		Correlations		Collinearity Statistics			
	B	Std. Error	Beta	t	Sig.	Zero-order	Partial	Part	Tolerance	VIF
(Constant)	.498	.149		3.329	.001					
Age	.388	.046	.417	8.383	.000	.541	.417	.363	.757	1.32
Level of Education	.127	.032	.237	3.908	.000	.432	.209	.169	.507	1.97
Gender	-.195	.072	-.134	-2.688	.008	.148	-.146	-.116	.752	1.33
Type.of.business	-.010	.042	-.012	-.246	.806	.202	-.013	-.011	.779	1.28
Amt of conventional loan	.174	.069	.157	2.536	.012	.419	.138	.110	.490	2.04
Business training acquired	-.007	.040	-.010	-.174	.862	.274	-.010	-.008	.621	1.61
Business life to date	.032	.049	.034	.650	.516	.258	.036	.028	.689	1.45
Duration in MFI	-.006	.049	-.006	-.128	.898	.146	-.007	-.006	.810	1.23

**Source:** Author's computations (2019)

The above regression equation shows the relationship between household assets (dependent variable) and other independent variables. The model reveals that the level of education is a significant predictor of household assets ( $B=.154$ ). This finding shows that the client level of education determined improvement of assets of conventional microfinance recipients.

Similarly, duration in microfinance, amount of conventional loan, duration in business, business training and age of the recipients of conventional microfinance are found to be significant determinants of household assets ( $B=.243$ ,  $.177$ ,  $.117$  &  $.098$ ) respectively. Moreover, business training acquired by clients is another variable that is important in increasing household assets. The significant implication of these findings is that the above variables much determined by the improvement

of household assets. However, types of business engaged by clients and genders are found to be not significant predictors of household assets.

## **V. FINDINGS**

This study assesses the availability, awareness, acceptance and socio-economic impacts of conventional and Islamic microfinance on poverty alleviation in Bangladesh. Results of the descriptive statistics summarised credit facilities are available and accessible in the microfinance institutions irrespective of gender, type of business engaged by the client and the community he/she belongs.<sup>39</sup> In addition, both genders have the same standard of awareness of Islamic microfinance, although clients affiliated with private microfinance have a better level of awareness regarding Islamic microfinance and cover all forms of business engaged by the clients..

Clients from urban communities have higher acceptability of Islamic product over their rural counterparts<sup>40</sup>. Thus, they prefer an Islamic product moreover conventional. Clients affiliated to private MFIs accept Islamic microfinance much better than clients affiliated to other MFIs. Private and NGO structured microfinance institutions have better outreach performance. These findings are constant with the study of Mokhtar et al.<sup>41</sup>. There is a positive relationship between household income and Islamic microfinance, and the finding is consistent with Noordin and Kassim<sup>42</sup>. Finally, there is a positive relationship between Islamic microfinance and indicators such as children education, expenditures, assets and consumption (food security) of the clients.

Islamic microfinance is sufficient to both male and female clients as well as urban and rural clients. The efficiency of Islamic microfinance is significantly dependant on the type of business participate by the client — positive relationships between conventional microfinance and household income and children education. The results are consistent with several studies<sup>43</sup> positive relationships between conventional microfinance and household, expenditure, assets and consumption of the clients. Male clients have better impact of conventional microfinance, and also conventional microfinance is more useful to clients that participate in arts and crafts, services and business classified as others.

## **VI. CONCLUSION AND RECOMMENDATIONS**

Microfinance organisations should design both Islamic and conventional products that are suitable to clients engaging in various types of business and increase the amount of loan to be sufficient enough to start new businesses. Mainly clients are involved in small types of business such as bakery, video shop, trading, frozen foods, vegetable shop etc. Therefore, there is the necessity to assist the client in selecting an appropriate business, for instance, guiding the clients about the availability of raw materials needed.

Microfinance organisations have surveyed do not have separate department or section accountable for training and development which can guide the clients with capacity building in the form of business advisory service especially in the area of loan usage, savings and other managerial training. Although most of the microfinance institutions have proper system of loan repayment, they failed to provide monitoring service to clients. Therefore, to have effective monitoring and evaluation unit responsible for being able to access the progress created by clients in their business activities. Information is a significant factor for efficiency of any intervention program. Most of the microfinance clients are not aware of the existence of some product services, mainly Islamic products.

To establish an advocacy and advertising system that will increase the level of public awareness of the overall microfinance industry. Islamic products are available more in private microfinance institutions mostly located in urban communities. Thus, potential rural clients are excluded, then, microfinance organisations should provide Islamic product to both rural and urban areas. The present study has found positive relationships between microfinance intervention and children education and household income. A new program, such as education insurance can be introduced. The program will facilitate and improve household children to higher levels of education.

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