Australian Journal of Basic and Applied Sciences, 8(20) Special 2014, Pages: 27-35

AENSI Journals
Australian Journal of Basic and Applied Sciences
ISSN:1991-8178

Journal home page: www.ajbasweb.com

A Review on Microfinancing: Conventional and Islamic Financing

[1]Zuraidah Ahmad, [1]Norhasniza Mohd Hasan Abdullah, [1]Nur Liyana Mohamed Yousop, [1]Nur'asyiqin Ramdhan, [1]Suzana Hassan, [1]Ruziah A. Latif, [2]Suhana Mohamed, [3]Prof. Dr. Haliza Hirza Jaffar, [4]Muharratul Sharifah Shaik Alaudeen and [4]Shaherah Abdul Malik

[1]*Department of Finance, Faculty of Business Management, Universiti Teknologi MARA, Cawangan Johor, Segamat, Johor.*
[2]*Department of Finance, Faculty of Business Management, Universiti Teknologi MARA, Johor Bahru Campus, Malaysia.*
[3]*Academy of Language Studies, Universiti Teknologi MARA, Johor Bahru Campus, Malaysia.*
[4]*Department of Management, Faculty of Business Management, Universiti Teknologi MARA, CawanganJohor, Segamat, Johor.*

ARTICLE INFO

Article history:
Received 19 October 2014
Received in revised form
21 November 2014
Accepted 25 November 2014

Keywords:
Islamic Microfinancing Conventional Microfinancing Microfinancing Development

ABSTRACT

Background: Microfinancing is an important tool for poverty alleviation. It has become a choice for the poor and for those who are excluded from financial services as the system provides convenient facilities and flexible conditions.Although the system was successfully implemented in accordance with its objectives, the existing conventional microfinancing does not embrace the Sha'riah principles. As such, this paper review existing conventional and Islamic microfinancing in its aim to shed light on their differences based on aspects of liabilities, mode of financing, process, target group, and profit. Most noted are advantages of Islamic microfinancing withrespect to the basic principle of interest-free loan, the elimination of riba', more varied source of funding and its ability to encompass the hard core poor. This makes Islamic micro financing a better tool in eradicating poverty. It is hoped that the outcome of the study is valuable to the Muslim community in general and specifically to policy makers in Islamic countries for a more ethical economic and financial development of the poor and micro-entrepreneurs.

To Cite This Article: Zuraidah Ahmad, Norhasniza Mohd Hasan Abdullah, Nur Liyana Mohamed Yousop, Nur'asyiqin Ramdhan, Suzana Hassan, Ruziah A. Latif, Suhana Mohamed, Prof. Dr. Haliza Hirza Jaffar, Muharratul Sharifah Shaik Alaudeen and 4Shaherah Abdul Malik., A Review on Microfinancing: Conventional and Islamic Financing. ***Aust. J. Basic & Appl. Sci.,*** *8(20): 27-35, 2014*

INTRODUCTION

Microfinance means a ''programme that extend small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families'' (Mokhtar, S.H., *et al*., 2012). The World Bank has recognized microfinance programme as an approach to address income inequalities and poverty. The microfinance scheme has been proven to be successful in many countries in addressing the problems of poverty. Furthermore, microfinance programs can assist SMEs to enlarge the existing economic activities and enhancement their income (Saad, M., *et al*., 2011). According to (Mead, C.D. and C. Liedholm, 1998), micro and small enterprises have been recognized as a major source of employment and income in many countries of The Third World. The World Bank has also declared 2005 as the year of microfinance with the aim to expand their poverty eradication campaign.

Microfinance is an efficient tool in helping micro enterprise to start or expand their business, acquire assets and also to help finance during emergency needs. Although only a small credit, it can facilitate micro enterprises to enhance their business and help them meet working capital needs (Rahman, R.A., 2010). Many scholars found micro financing scheme does help the poorest community to improve their business.

The constraint of borrowing from financial institutions had encouraged microfinance to develop rapidly. The objective of microfinance program is to provide a credit facility without collateral to the poor community. However, traditional banks and other financial institutions still leave out these people as they are considered less credit worthy and risky. Financial institutions are unwilling to advance even small loans due to the tedious processing and high cost of monitoring (Kaleem, A. and S. Ahmed, 2009). Such drawbacks of the conventional microfinance practices have led to the emergence of Islamic microfinance in some Muslims countries and communities (Salwana, H., *et al*., 2013).

Due to the various disadvantages with regards to conventional microfinance such as interest-based activities specifically, most Islamic scholars emphasize Islamic microfinance. Some researchers have taken it for granted that Islamic microfinance is nothing more than the conventional microfinance less the interest (Imboden and

Corresponding Author: Zuraidah Ahmad, Department of Finance, Faculty of Business Management, University Teknologi MARA, Johor, Malaysia.
E-mail: zurai692@johor.uitm.edu.my

Kathryn, 2005). However, according to (Hossin, M., *et al*., 2011), Islamic microfinance is different from conventional microfinance not only in terms of abolition of interest but also on some specific areas and dimensions.

Microfinancing In Malaysia:

In Malaysia, microfinancing is nothing new since it has been practised for the last three decades. Microfinancing programs in Malaysia consists of those offered by banking institutions such as Public Bank, AmBank, CIMB Bank, Bank Rakyat and Bank Simpanan Nasional while non-banking institutions involved include government agencies such as TEKUN Nasional (TN), Amanah Ikhtiar Malaysia (AIM), Council of Trust to the Bumiputera (MARA), Permodalan Usahawan Nasional Berhad (PUNB) and Federal Land Development Authority (FELDA). Others include several credit unions that offer microfinance such as Koperasi Kredit Rakyat in Selangor (Rahmah, I., 2001).

Micro enterprises, the main staple of microfinancing, have played an essential role in developing the Malaysian economy. As such, the government plays a vital role in promoting microfinancing by taking the initiative to provide SMEs with improved access to financing at various stages of the business life cycle. This commercially driven microfinance industry complements existing government- sponsored microfinance programme. Key providers of funds for SME start-up are Venture Capital (VC) funds, Development Finance Institutions (DFIs) and the government through grants and soft loans. For further support to SMEs in Malaysia facing tough start up stage, the Ministry of Entrepreneur and Cooperative Development's (MECD) provides microcredit financing for entrepreneurs under TEKUN (Rosalan, A., *et al*., 2011). This is important to guarantee that micro enterprises have sufficient and adequate access to continued financing. The micro credit program offered by both the commercially driven Micro Finance Institutions (MFIs) and government sponsored MFIs has made a positive impact in improving income and upgrading the standard of living of the poors in booth rural and urban areas through micro entrepreneurship and women entrepreneurs' development (Adejoke, A.G., 2010; Chan, S.H., 2005; Ziauddin, A., 1991).

In Malaysia, microfinance institutions incepted during the late 1980's are based on conventional systems embracing all the drawbacks such as high interest rates, and the issue of guarantor and collateral. As such, the central bank, Bank Negara Malaysia has set up various strategies and policies to ensure microfinancing can be sustainable in the country. Some of the strategies to ensure that the financial sector meets the needs across all segments of society include fair and equitable practices coupled with empowered and educated consumers. All these can actually be easily achieved through Islamic microfinancing. There is potential to further develop Islamic based microfinance products for the needs of micro enterprise such as Islamic guarantee scheme (Amirul, A.M. and R. Hardi Emri, 2010).

Besides, a study by (Dalila, D., *et al*., 2011), suggested that micro financing concepts based on WAQAF can become a complementary concepts to the existing Islamic micro credit program based on Ar-Rahnu concept. In Malaysia, microfinance program implemented by AIM has been found to be very effective in increasing program members businesses (Hamdino, H., *et al*., 2012). Nowadays, Islamic microfinancing system is being widely adopted for small and medium enterprises (SMEs) in Malaysia.

Conventional Microfinancing:

Microfinance services provide opportunity to the poor for their social and economic development and this industry is rapidly growing around the world. The growth of microfinance institutions in the world was 35%, that is, from 1,616 in 2005 to 2,178 in 2010.

A conventional microfinancing structure consists of seven elements. Those elements are sources of funds, modes of financing, client need, amount and deviation of the funds, focus group of client and incentives of staff (Hossin, M., *et al*., 2011). The first element of the conventional microfinance is the financial institution and non-banking institution as the sources of fund. The institution provides financial credit assistance to the entrepreneur. Under this structure the element of the incentive of staff is questionable since in conventional micro financing, the main motive of the employees is to obtain profit from the operations (Hossin, M., *et al*., 2011).

The second element is about sources of fund that are used in the micro financing. In conventional micro financing, the money normally come from foreign clients. Sometimes, savings and external funds also become the sources of fund (Habib, A., 2002). In conventional micro financing there are no issues on who contributes to the fund and the legality of the money used in the operations.

The next element is the amount and deviation of the funds. The mode of operation for conventional microfinancing is that the fund will be financed to the entrepreneur. However, before the reimbursement is made, there will be some amount of money deducted from the total amount of fund. In addition, the entrepreneur will also pay interest based on the total amount of loan and not the net amount of fund that he receives. This led to the issue of risk and effective interest rate (Hossin, M., *et al*., 2011).

Then next element is on modes of financing. In conventional microfinancing, the operations are purely based on interest (Hossin, M., *et al*., 2011). One of the purposes of this financial method is to seek profit in order to help the needy entrepreneur. As such, conventional method is not keen on interest free financing loans.

The entrepreneur is the final element in microfinancing structure. Under this element, the client's need is the main concern. Although the client in the structure are needy entrepreneurs, conventional micro financing modes sometimes left out the poorest entrepreneur because of his failure in having collateral (Hossin, M., *et al*., 2011). In this respect, microfinancing's aim of assisting the poorest entrepreneur is not met.

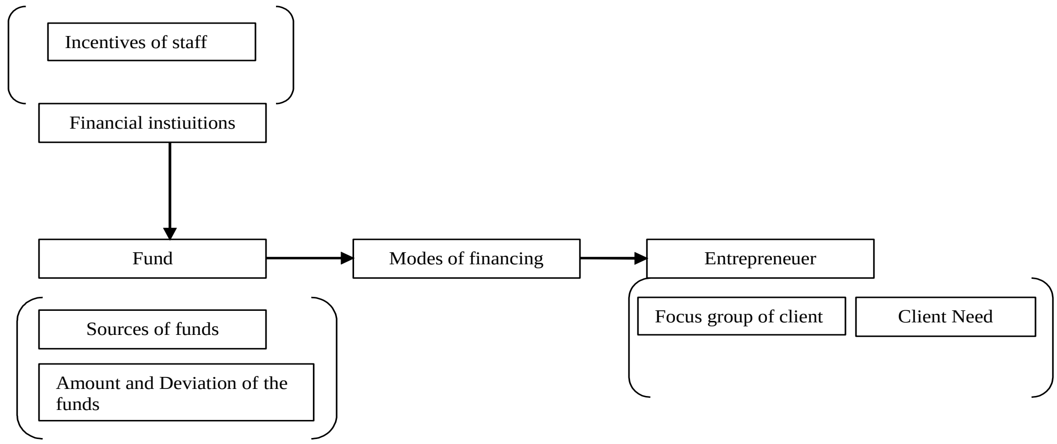

Fig. 1: Element of Conventional Microfinancing structure (Source: Hossin Meisami et.al, 2011)

Other than that, under the element of entrepreneur, another consideration is the focus group of client. Based on past researches, conventional microfinance normally focuses on women as they have found that women use the funds more productively and increase their incomes (Hossin, M., *et al*., 2011). This indicates that the current conventional system have possibly left out the male entrepreneur who also need micro financing assistance.

Islamic Microfinancing: Way Forward:

Islamic financing schemes have moral and ethical attributes that can effectively motivate micro-entrepreneurs to thrive (Roslan, A.H., *et al*., 2007). Furthermore, Islamic financing and organizational instruments, being extensively participatory in nature, generate effective development impact at the grass roots level (Choudhury, M.A., 2002). Examples of success can be found in the experience of Amanah Ikhtiar, a financing agency in Malaysia that loans capital to its clients at zero rate of interest and also participates with them in organizing their income-generating activities. Some paper also argues that Islamic finance has an important role for furthering socio-economic development of the poor and small (micro) entrepreneurs without charging interest (riba'). Thus, the main aim of Islamic finance and banking is to provide the Muslim society with an ethical Islamic alternative to the conventional banking system that was based on riba' (Zouhari, Z., and M.S. Nabi, 2013).

Riba' can be classified into at least two main types, namely credit riba' (riba' al-nasi'ah) and surplus riba' (riba' al-fadl) (Az-Zuhayli, W., 2006). Credit riba' is any delay in settlement of a due debt, regardless whether the debt is of goods sold or loan. On the other hand, surplus riba (riba' al-fadl) is the sale of similar items with a disparity in amount in the six canonically forbidden categories of goods such as gold, silver, wheat, barley, salt, and dry dates. Riba' also exists if there is either inequality or delay in delivery of the goods offered.

As an alternative to riba', the profit and loss sharing arrangements are held as an ideal mode of financing in Islamic finance. It is expected that this profit and loss sharing will be able to significantly remove the inequitable distribution of income and wealth and is likely to control inflation to some extent (UNDP., 2008). Furthermore, the profit and loss sharing may lead to a more efficient and optimal allocation of resources as compared to the interest-based system. Since the depositors are likely to get higher returns leading to richness, it is hoped that progress towards self-reliance will be made through an improved rate of savings. Thus will ensure justice between the parties involved as the return to the bank on finance is dependent on the operational results of the entrepreneur (UNDP., 2008).

According to (Kaleem, A. and S. Ahmed, 2009), Islamic microfinance and Islamic banking share fundamental principle to make sure the wealth circulation can be absorbed by the community and provide benefit to poor individuals. (Roslan, A.H., *et al*., 2007) posits that in order to facilitate loan process for the poor, a loan is given without collateral or guarantor, and normally is based on trust. Microfinance is an alternative to loan because the conventional banking system stigmatised the poor as not-credit worthy. Loan facility is provided based on the belief that ''people should not go to the bank but bank should go to the people''. In order to obtain the loan, the prospective borrower needs to join the recipient group of microfinance. The group members are given small loans, and a new loan will only be given after the previous loans are repaid.

The repayment scheme is on short term basis on a scale of a week or every two weeks. In general, the conventional microfinance schemes, which are specifically based on interest (riba'), are prohibited in Islam and thus, cannot be used by and for Muslims. Hence, various Islamic financing schemes are developed based on the concepts of mudarabah, musharakah, murabahah, ijarah, which have outstanding features and characteristics that can contribute towards a more ethical economic and financial development of the poor and micro-entrepreneurs. Comparatively, according to (Roslan, A.H., *et al*., 2007), Qardhul Hasan, Murabahah and Ijarah schemes are relatively easy to manage and will ensure the capital needs (Qardhul Hasan), equipments (Murabahah), and Leased equipments (Ijarah) for potential micro-entrepreneurs and the poor.

Participatory schemes such as Mudarabah and Musharakah have great potentials for microfinance purposes as these schemes can satisfy the risk sharing needs of the micro-entrepreneurs. These schemes, however, require specialized skills in managing the risks inherent in the structure of the contract. In theory, different schemes can be used for different purposes depending on the risk profile of the micro-entrepreneurs. (Alamgir, D.A.H., *et al*., 2010), noted several distinctions that distinguish conventional microfinance from Islamic microfinance. Both conventional microfinance and Islamic microfinance can mobilize external funds and saving of clients as their source of fund. However, Islamic microfinance can also exploit Islamic charity such as zakat and waqf as their source of fund for funding. For modes of financing, conventional microfinance can easily adapt interest-based financing while Islamic microfinance should eliminate interest in their operation. Therefore, Islamic microfinance should explore possible modes of Islamic financing as instruments in their operation.

According to Islamic Research and Training Institute, 1/3rd of world's poor are Muslims. It was reported that 72% of them did not use formal financial services. About 25-40 percent of Muslims refrain from utilising interest-based finance or conventional financing. Islamic microfinance in the global microfinance programs only represents less than 1%. Microfinance has been acknowledged as an important element tool in boosting the productivity with their principles to help finance micro entrepreneurs and poor by small loan besides the terms and conditions of these loans are generally flexible and easy to understand (Abdelkader, I.B. and A.B. Salem, 2013). This was also highlighted by (Abdul Rahman, A.R., 2007), this type of financing has an important role for promoting socio-economic development of the poor and small entrepreneurs without charging interest (riba). Islamic microfinance emerged as conventional microfinanceis not suitable for the culture and belief of Muslims because of the existence of prohibited non-Islam element (Muhammad, A.D. and Z. Hassan, 2009). The basis of Islamic microfinance is significant to the rapid development of two sectors which are microfinance and Islamic finance (CGAP Khaled Mohamed, 2011). Both sectors are prohibited to implement any sources that are related to interest (riba) a widely known feature in Islamic finance system compared to conventional ones. Therefore Islamic microfinance related institutions can earn profits from three sources which are through trading, leasing and financing (by implementing Profit Loss Sharing contracts (Al-Omar, F. and M. Abdel-Haq, 1996). To make it clear, the mechanism of lending in Islamic microfinance differs from conventional microfinance due to the prohibition of interest. Unlike conventional microfinance, it offers an interest-free way to give small loans to people who are poor and in need.

The concept of Islamic microfinance is related to the principles of Islam and is a form of socially responsible investment. Investors who use their wealth for Islamic microfinance projects only involve themselves in halal projects. Such projects include zakat, which is charity based, or trade and industry to develop a country's economy. Utilising Islamic financial instruments, Islamic microfinancing are done according to sale or lease contract and the widely available Islamic principle types such Murabahah sale (cost plus mark-up), Ijarah (leasing), Mudharabah (profit sharing), Musharakah (profit and loss sharing) and Qardh (loan) to help in facilitating Islamic microfinance which not only spur the related sector but can also increase the options of Islamic finance and make it more accessible to poverty stricken countries. Due to the significance of Islamic microfinance in poverty prevention, The Financial Express has reviewed a study by (Mannan, M.A., 2012) on Islamic microfinance structure and found that it helps improve the poor's well-being through Zakah and Charity.

A study by Bank Negara Malaysia found that there are 13 percent microenterprises that focus on financing. The majority of the enterprises (34 percent) are funded using their own money followed by friends and family by 24 percent. SMEs contribution to the Malaysia GDP was at 32 percent in 2010 and is expected to increase ntill 41 percent in the year 2020. The microfinance industry has targeted the poor and bottom group as is proven by studies conducted by Amanah Ikhtiar Malaysia (Rahman, R.A., 2010). Malaysia's current population of more than 28 million with an estimated 60 percent of Muslims shows that the opportunity for the development of the Islamic microfinance is very good. The differences in concepts between shari'ah and conventional financing have led to the development of several NGOs or government based agencies that supply microfinancing. Considering the lack of broad-based ownership in microfinancing highlighted by (Chapra, M.U., 1992; Salwana, H., *et al*., 2013) has come out with a view that there is agitation that microfinance has not been able to achieve its objective of fighting poverty due to the shift of the industry from poverty-focused to profit oriented business. Thus, there has been a call for a shariah compliant microfinance product in Islamic banking operations, particularly in Malaysia.

Australian Journal of Basic and Applied Sciences, 8(20) Special 2014, Pages: 27-35

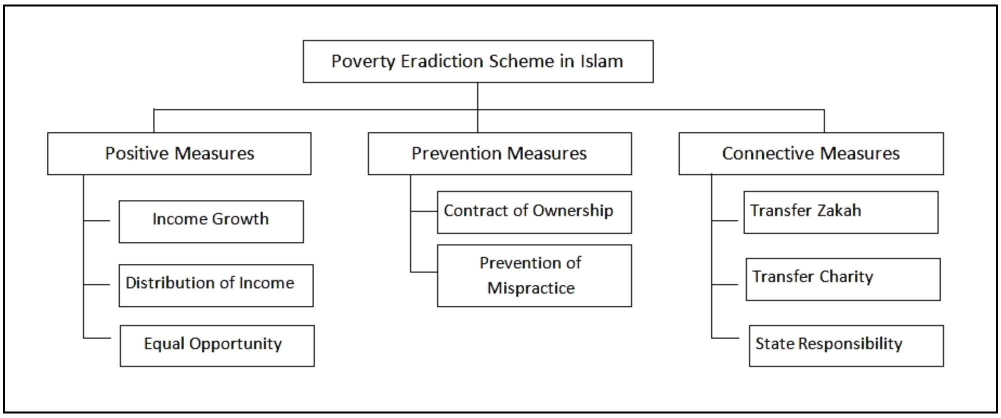

Fig. 2: Poverty Eradiction Scheme in Islam (Source: Salwana et. al, 2013)

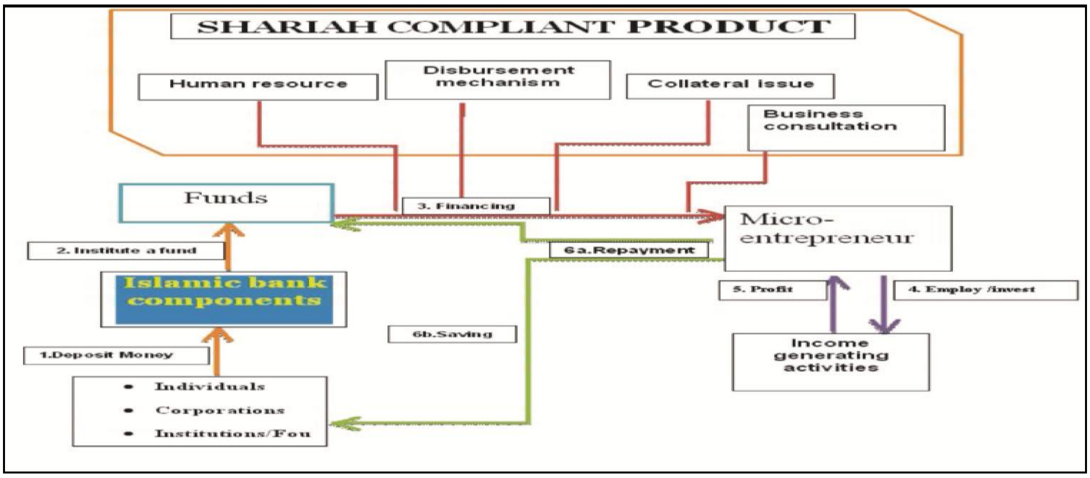

Fig. 3: Islamic Microfinance Products for Islamic Banks in Malaysia (Source: Salwana et. al, 2013)

Figure 2 is a review of a combination of most shariah compliant products to be gathered to fight poverty. They also higlighted several viable modes for this model such as Al-Ijarah, Musyaraka Mutanaqisa, Murabahah as well as Mudharabah contract. The bright future of Islamic microfinance has been agreed and proposed by the Malaysian Prime Minister Datuk Sri Najib by saying that this industry represents an opportunity for Islamic finance to develop ethical and yet more profitable products which are shariah compliant (Bernama, 2012).

Micro financing programmes that have been implemented the last three decades in Malaysia are clearly not Sha'riah compliant. Even though it is successfully adopted at international level and has also proven to help the poorest in a Third World, it cannot be fully implemented in Islamic countries. According to (Hossin, M., *et al*., 2011), understanding the differences between Islamic and conventional micro financing will help policy makers in different Islamic countries to be able to design the best microfinance models that is suitable for their needs.

Today, Islamic microfinance has grown progressively in the world particularly in poor countries as a reliable alternative which gives the poor community access to basic financial services at low cost. Thus, Islamic microfinance can be considered as an effective and efficient instrument to boost up an entrepreneurship and facilitate Small and Medium Enterprises (Alamgir, D.A.H., *et al*., 2010). Currently, Islamic MFIs used models based on Grameen model and this model eliminates interest charged. Hence, Islamic MFIs are different from conventional MFIs based on several characteristics on the following areas:

a) Liabilities:

Sources of funding are different. Conventional MFIs ususally get the funds from foreign donors where they finance themselves from savings of the cleints and external funds (Habib, A., 2002). Islamic MFIs finance themselves from external funds, clients savings and Islamic charitable bodies or funds from religious institutions such as Waqf, Zakat, Sadaqah and Anfal which are prevailing in most of the Islamic countries. Zakat and Sadaqah are instruments of charity in the Islamic scheme of poverty alleviation. Rules of Sha'riah clearly defines who should pay zakat and who can get benefit from zakat. Thus, the potential beneficiaries are the poor

Australian Journal of Basic and Applied Sciences, 8(20) Special 2014, Pages: 27-35

and the destitute through mobilization of resources via obtaining funds or accepting savings deposit (Hossin, M., *et al*., 2012).

b) Mode of Financing:

Conventional MFIs are based on interest charged whereas Islamic MFIs eliminate interest . There are many instrument of modes in Islamic MFIs such as Mudarabah, Musharakah, Bay Bithamin Ajil, Ijarah, Murabaha and Istisna. Thus, Islamic microfinancing allows the integration of the poorest through savings schemes via wadiah and mudarabah deposits, money transfer through zakat and sadaqah and insurance via takaful concept (Abdelkader, I.B. and A.B. Salem, 2013). The impact of conventional microfinance has been questioned and criticized in terms of its process (Adejoke, A.G., 2010). According to (Alamgir, D.A.H., *et al*., 2012), conventional microfinancing is criticised because of a high interest rate of up to 30% levied on the to poor loan receivers meanwhile Islamic microfinance uses Islamic instruments which are based on Profit and Loss Scheme.

c) Funds transfer:

In conventional microfinance, institutions directly give cash to client to finance their micro enterprise meanwhile Islamic microfinance does not provide cash or loan, but it is based on Profit and Loss sharing scheme. Loans that are permissible in Islam must not be interest based or have any incremental amount charged on loan. Although Islamic micro financing uses similar technique of conventional micro financing where group lending is a way to mitigate risk in the operation, they also develop Islamic ethical principles to ensure borrower can pay regularly (Adejoke, A.G., 2010). In Malaysia, Mahmood and Rosli (Muhammad, A.D. and Z. Hassan, 2009; UNDP., 2008; Al-Omar, F. and M. Abdel-Haq, 1996; Rahmah, I., 2001) as well as Hamdino *et al* (Hassan, S., *et al*., 2013) found positive impact of Islamic microfinancing. (Rahmah, I., 2001) has found that borrowers who work in agriculture such as farming, animal husbandry and fisheries have difficulties in repaying the loan due to irregularity of income from producing agricultural products.

d) Deduction at Contract Inception:

The amount and deviation of funds in conventional micro financing is deducted from the loan before disbursement. The deduction is different based on group and emergency funds. Besides, the beneficiary has to pay an interest based on total amount; making the interest rate paid by beneficiary to micro financing increases (Hossin, M., *et al*., 2011; Habib, A., 2002). Moreover, once the cash is received or transferred to the poor, it might be used to funds to non-productive activities. In Islamic micro financing, there is no deduction made during the inception. Normally, it is based on the total amount needed to purchase the goods and those goods are transferred directly to the beneficiary. Thus, the risk of giving funds for non-productive activity is minimized (Habib, A., 2002).

e) Financing for Marginalized Group:

The early creation of conventional microfinance institutions in Malaysia is mainly concentrated on financing the poor, micro entrepreneurs and for those who are excluded from financial services. These groups of people are usually denied loans by conventional banks because they have no valuable, tangible assets that could be used as collateral (Obaidullah, M., 2008). Thus, small size loans or microloans are introduced for these groups of people in order to encourage them to start a new business and generate more income. Loan procedures and contract are required to be mutual agreement (Dalila, D., *et al*., 2011) and terms and conditions applied in a loan contract must be flexible and easy to understand (Adejoke, A.G., 2010) without any exploitation (Dalila, D., *et al*., 2011). Even though the current system works well, however, the implementation of the system still does not focus on the other isolated group which is the “poorest” group. Since the main objective of microfinance is to alleviate poverty, the poorest group cannot be ignored. Moreover, according to (Nasrin, Shahinpoor, 2009), microfinance can be effective for a broad group of clients, including those who are living in the bottom half or below country’s poverty line. In, Malaysia for instance, poorest group can be classified to three main regions and average monthly income for these regions are RM560 and below. Table 1 shows the monthly household income in Malaysia.

Table 1: Malaysia Monthly Income,Household

Categories	Peninsular Malaysia	Sabah	Sarawak
Poorest	RM460 and below	RM630 and below	RM590 and below
Poor	RM760 and below	RM1,050 and below	RM910 and below
Low-income Household	RM2,300 and below	RM2,300 and below	RM2,300 and below

f) Target Group:

Current microfinance practises focus largely on women participation. Research done by (Karim, N., *et al*., 2008), stated that the main reason of targeting women is because women represents eighty five percent microfinance clients and they register for higher repayment rates. Thus, some Islamic microfinance institutions seek to shift their target from “women empowerment” to “family empowerment” approach because women empowerment may weaken the family institution and induce grave financial risk (Obaidullah, M., T. Khan, 2008).

g) Deal with Default

Conventional microfinancing use group-based lending approach as the main system of delivery of microfinance services. This approach was well developed with the concept of risk sharing as well as profit sharing among group members. However the approach also has a problem. In case of loan default by a member, the whole group has to take responsibility for the repayment of the defaulted loan. For instance, according to (Ahmed, H., 2002), when one member or borrower failed to repay, the other four members in a group will feel pressure. Moreover, one can argue that group lending can potentially result in moral hazard problems as well. In Islamic microfinancing, since the target group is a "family", in a case of default by one group member, other members of the group will feel less pressure because there is a guarantee from spouse. Moreover, Islamic microfinancing can also use Islamic charity such as zakah and waqf as their source of fund for funding (Adejoke, A.G., 2010).

h) Social Development Program:

Some conventional micofinancing have grown into full-fledged national programs. Therefore, the source of financing depends on government budget and grant. TEKUN Nasional of Malaysia for example, received funds from government grant. The government has allocated RM40million to help and settle the loans taken by fisherman from the middleman (News Strait Time, February 2014). In Islamic microfinancing, (Obaidullah, M., T. Khan, 2008) had also mentioned that "charity has played a major role in the birth and subsequent growth of the global microfinance industry". Islamic charity or donation can be categorized into four; zakah, waqf, qard al-hasan and sadqah. Donation from donors helps the microfinancing institutions, which are mostly developed by non-profit-organization or non-government institutions, to develop the sector and to reduce the dependency of such institutions on the government.

Conclusion:

According to (Hossin, M., *et al*., 2011), most problems with regards to poverty come from Islamic world, specifically the OIC member countries. It has also been proven that solution brought by microfinancing is internationally successful for poverty eradication. However, microfinancing cannot be wholly adopted in the Islamic world without some modifications.

This paper has reviewed existing conventional and Islamic microfinancing in its aim to shed light on their differences based on aspects of liabilities, mode of financing, process, target group, and profit gained. Most noted advantages of Islamic microfinancing over conventional microfinancing are with respect to its basic principle of interest-free loan, the elimination of riba', are having a more varied source of funding and its ability to encompass the hard core poor. This makes Islamic micro financing a better tool in eradicating poverty and in helping small businesses develop.

Hence, this study has tried to explain the differences in theoretical concepts between Islamic microfinancing and conventional microfinancing. Understanding this conceptual paper will aid policy makers to design the best microfinance models that are suitable with Islamic needs. It is hoped that this theoretical paper helps future research conduct in-depth indepth studies on Islamic microfinancing.

REFERENCES

Abdelkader, I.B. and A.B. Salem, 2013. Islamic vs Conventional Microfinance Institutions: Performance analysis in MENA countries, International Journal of Business and Social Research (IJBSR), pp: 3(5)

Abdul Rahman, A.R., 2007. Islamic Microfinance: A Missing Component in Islamic Banking, Kyoto Bulletin of Islamic Area Studies, 1(2): 38-53.

Adejoke, A.G., 2010: Sustainable Microfinance Institutions for Poverty Reduction: Malaysia Experience, OIDA International Journal of Sustainable Development., 2(4): 47-56.

Aghion, B.A. De, and J. Morduch, 2004. Microfinance : Where do, pp: 135-148.

Ahmed, H., 2002: Financing Micro Enterprises: An Analytical Study of Islamic Microfinance Institutions, Journal of Islamic Economic Studies, 9(2)

Alamgir, D.A.H., M.K. Hassan and H.H. Dewan, 2010. A Comparative Review of Islamic Versus Conventional Microfinance In. 8th International Conference on Islamic Economics and Finance, pp: 1-35.

Al-Mamun, A., J. Adaikalam, M.N.H. Mazumder and S.A. Wahab, 2011. Comparing the effect of Amanah Ikhtiar Malaysia's (AIM) microcredit program on quality of life in urban and rural Malaysia. African Journal of Business Management., 5(34): 12981-12995.

Al-Omar, F. and M. Abdel-Haq, 1996. Islamic Banking: Theory, Practice & Challenges,ZED Books, UK, ISBN 1 85649 343 I Hb;

Amirul, A.M. and R. Hardi Emri, 2010. Credit Guarantee Corporation (CGC) Malaysia Berhad Operations: An Extending Credit Guarantee to Malaysian SMEs. Business and Management Quarterly Review, 1(4): 22-33.

Az-Zuhayli, W., 2006. The juridical meaning of Riba in Abdulkader Thomas (Ed.), Interest in Islamic Economics: Understanding Riba, Routledge, Oxon.

Chan, S.H., 2005. An Exploratory Study of Using Micro-Credit to Encourage the Setting Up of Small Business in the Rural Sector of Malaysia", Asian Business & Management., 4: 455-479.

Chapra, M.U., 1992. Islam and the Economic Challenge. Leicester: Islamic Foundation.

Choudhury, M.A., 2002. Microenterprise Development Using Islamic Financing and Organizational Instruments. International Journal of Social Economics, 29(1/2)

CGAP Khaled Mohamed, 2011. Why Has Islamic Microfinance Not Reached Scale Yet?, Washington D.C.: CGAP 09 March 2011.

CGAP, 2008. Advancing financial access for the world's poor.

Dalila, D., A.R. Rashidah and S. Zaluddin, 2011. WAQF Reporting to Fulfill Stakeholder Attribution in WAQF Islamic Council. Business and Management Quarterly Review, 2(1): 38-53.

Daley-Harris, S., 2009. State of the Microcredit Summit Campaign Report 2009. Microcredit Summit Campaign. Washington. USA.

Habib, A., 2002. Financing microenterprises. An analytical study of Islamic microfinance institutions. Islamic Economic Studies, 9(2): 27-62.

Hailey, P., 2009. Microfinance and Islamic Finance. Can they be reconciled and how can they benefit one another ? HEC Social Business Certificate, (February 1997), pp: 1-28.

Haneef, M.A., A.D. Muhammad, A.H. Pramanik and M.O. Mohammed, 2014. Integrated Waqf Based Islamic Microfinance Model (IWIMM) for Poverty alleviation in OIC Member Countries. Middle-East Journal of Scientific Research, 19(2): 286-298. doi:10.5829/idosi.mejsr.2014.19.2.12565.

Hamdino, H., O. Pazim, W.H. Wan Sabri, 2012. The importance of monitoring and entrepreneurship concept as future direction of microfinance in Malaysia: Case study in the State of Selangor. Journal of Global Entrepreneurship, 3(12)

Hassan, S., R. Abdul Rahman, N. Abu Bakar, R. Mohd and A.D. Muhammad, 2013. Designing Islamic Microfinance Products for Islamic Banks in Malaysia. Middle-East Journal of Scientific Research, 17(3): 359-366. doi:10.5829/idosi.mejsr.2013.17.03.12160

Hossin, M., M. Davood, R. Mehdi, 2011. Islamic vs. conventional microfinance: A comparative theoretical analysis. International Journal of Business and Management Tomorrow, 1(1)

Imboden and Kathryn, 2005. Building Inclusive Financial Sectors: The Road to Growth and Poverty Reduction. Journal of International Affairs, 58(2): 65-86.

International Labour Office, 2007: Small change, Big changes : Women and Microfinance.

Karim, N., M. Tarazi and X. Reille, 2008. Islamic Microfinance :, (March).

Mannan, M.A., 2012: Islamic Microfinance: An instrument for poverty alleviation. Retrieved in Financial Express 28th August 2012.

Mahmood, R. and M.M. Rosli, 2013. Microcredit position in micro and small enterprise performance: the Malaysian case. Management Research Review, 36 (5): 436-453.

Muhammad, A.D. and Z. Hassan, 2009. Microfinance in Nigeria and the prospects of introducing an Islamic Version in the Light of Selected Muslim Countries. Experience, Review of Islamic Economics, 13(1): 155-174.

Morduch, J., and R.F. Wagner, 2002. Analysis of the Effects of Microfinance on Poverty Reduction Analysis of the Effects of Microfinance on Poverty Reduction. pp: 1-63.

Nasrin, Shahinpoor, 2009. The link between Islamic banking and microfinancing. International Journal of Social Economics, 36(10): 996-1007.

Obaidullah, M., 2008. Introduction to Islamic Microfinance. ISBN: 978-81-905822-2-3.

Obaidullah, M., T. Khan, 2008. Islamic Microfinance Development: Challenges and Initiatives. Islamic Development Bank, SSRN Electronic Journal, pp: 1–78, doi:10.2139/ssrn.1506073

Nasrin, Shahinpoor, 2009. The link between Islamic banking and microfinancing. International Journal of Social Economics, 36(10): 996-1007.

Rosalan, A., T. Jasman and S.M. Junaidi, 2011. The role of microfinance in development of micro enterprises in Malaysia, Business and management Quarterly Review, 2(3): 47-57, ISSN 2180-277747

Salwana, H., A.R. Rashidah, A.B. Nordin, M. Rohani and D.M. Aliyu, 2013. Designing Islamic Microfinance Products for Islamic Banks in Malaysia. Middle-East J. Sci. Res., 17(3): 359-366.

Kaleem, A. and S. Ahmed, 2009. The Quran and Poverty Alleviation: A Theoretical Model for Charity-Based Islamic Microfinance Institutions. Nonprofit and Voluntary Sector Quarterly, 9: 4-15.

Mead, C.D. and C. Liedholm, 1998. The Dynamics of Micro and Small Enterprises in Developing Countries. World Development, 26(1): 61-74. http://dx.doi.org/10.1016/S0305-750X(97)10010-9

Microcredit Summit, 2004. State of Microcredit Campaign Summit Report, available at: www.microcreditsummit.org/pubs/reports/socr/2004/SOCR04.pdf

Mokhtar, S.H., G. Nartea, C. Gan, 2012. Determinants of microcredit loans repayment problem among microfinance borrowers in Malaysia. International Journal of Business and Social Research, 2(7): 21-32.

Norhaziah, N. and M.S.M. Noor, 2011. The importance of micro financing to the microenterprises development in Malaysia's experience. Asian Social Science, 7(12).

Rahmah, I., 2001. Economic and Social Impact of Amanah Ikhtiar Malaysia (AIM) Scheme: A Case Study in Kedah and Terengganu. Humanomics, 17(1): 141-155.

Rahman, R.A., 2010.Islamic Micro-financing: An Ethical Alternatives to Poverty Alleviation Humanomics, 26(4) : 284-295.

Roslan, A.H., Z.A. Faudziah, Z.N. Mohd Saifoul and M. Rahimah, 2007. Microfinance Service for Micro-Enterprise: Good Practices and Performance of Selected Microfinance Institutions in Malaysia. Journal ofYala Rajabhat University, 2(1): 31-45.

Saad, M., J. Duasa and Norma, 2011. An economic impact assessment of a microcredit program in Malaysia: the case of Amanah Ikhtiar Malaysia (AIM). International Journal of Business and Society, 12(1): 1-14, ISSN 1511-6670.

Siddiqui, M.N., 2001. Islamic banking: true modes of financing. New Horizon, Institute of Islamic Banking and Insurance, London, pp: 15-20.

UNDP., 2008. Malaysian Nurturing Women Entrepreneurs, The United Nations Development Programme (UNDP), Kuala Lumpur, Malaysia, Retrieved from:http://www.undp.org.my/uploads/UNDP_Malaysia_NurturingWomenEntrepreneurs_publication.pdf

Ziauddin, A., 1991. Islamic banking at the crossroads, in Sadeq, A.H., Pramanik, A.H. and Nik Hassan, N.H. (Eds), Development & Finance in Islam, International Islamic University Press, Kuala Lumpur, pp.: 155-71.

Zouhari, Z., and M.S. Nabi, 2013. Enhancing the Enforceability of Islamic Microfinance Contracts in OIC countries. Muncih Personal RePEc Archive (MPRA*)*, (49816), 1-3.