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Microfinance and Disasters: Islamic Microfinance A New Paradigm to Serve the Unserved

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ABSTRACT

To mitigate the adverse consequences of disasters, the poor employ various formal and informal strategies. One such source is microfinance that can help the poor in early recovery from the aftermaths of covariates shocks. Study results have revealed formal financial services if available are more effective than informal financial services as their costs outweigh their benefits. Like commercial finance institutions, microfinance institutions are not willing to serve the poor during emergencies due increased default risk. In such cases, Islamic Financial services based on Shariah principles such as Islamic microfinance can serve the economically active and destitute as well. For this purpose, the study also proposed model to serve the economically active and inactive people.

KEY WORDS: coping strategies, disasters, Islamic microfinance, microfinance, poverty

1. INTRODUCTION

The increased severity and frequency of disasters across the world has attracted the international community to find proactive mechanisms for dealing with emergencies because relief and rehabilitation services alone do not protect the poor from the continuing vulnerabilities. Two core elements of natural disasters are 'hazards' and 'vulnerability' and in the absence of any one, a disaster cannot transpire. Hazard is a 'potential threat' that an adverse event can take place which will harm the human society, property, environment, both physically and economically [1]. Vulnerability is the inability or defenselessness of individuals, households or local community to protect themselves against shocks and re-establish their livelihoods [2] Cyclones, Tsunamis, earthquakes or floods are not in themselves disasters but it is their impact on the people and environment that transforms these hazards into disasters. Although, it is difficult to predict or manage natural hazards (e.g. floods, earthquakes, and tsunami), their negative impacts (vulnerability) can be minimized by taking preventive measures [3].

Disasters can be devastating, particularly when they affect low income households. Minimizing their negative effects and maintaining income stream is among the top priorities for the poor. For this purpose, the poor employ different coping strategies. Unfortunately, the costs of these coping strategies outweigh their benefits. In such situations, formal financial institutions such as microfinance (MF) can serve the poor because "Social security measures especially to reduce the disaster risk and vulnerabilities are increasingly seen as an integral part of the development process" [4:22]. Hence, MF can also become a credible tool to mitigate the effects of disasters to make poor less dependent on the state's resources.

Unfortunately, commercial institutions including microfinance (MFIs) are not willing to serve the poor after disasters as they perceive them risky target population. Furthermore, MFIs have adopted the role of 'moneylenders' by charging high interest on micro loans e.g. Compartmos Bank in Mexico is charging over 100% interest rates on microloans. Microfinance has taken a wrong turn by drifting away from its original mission of social inclusion and poverty reduction. These institutions motivated by low-risks, low transactions costs and increased profitability; prefer to serve better-off poor [5]. Building on this, this study argues that the major element that is contributing to the suppression of the poor is interest rates (*Riba*) charged by the moneylenders as well as by MFIs. The hypothesis here is that micro-finance services based on Islamic principles can significantly contribute to poverty and vulnerability reduction. The purpose of this paper is to explore the role microfinance institutions can play in mitigating the impact of natural disasters on the poor and their potential in contributing towards effective recovery from disasters. To evaluate the potential role microfinance can play in the management of disasters, it was necessary to understand the coping strategies employed by microfinance clients when they face emergencies. Such analysis allows the understandings of various mechanisms utilized by the poor in the wake of disasters and enable us to make conclusions about the potential of employing Islamic finance vis-à-vis conventional finance.

This section highlights how and why microfinance institutions moved away from their social objectives and transformed themselves into commercial entities followed by an overview of the natural disasters and their impacts on communities. It also discusses why it is necessary for microfinance institutions to provide disasters

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related services followed by role Islamic MF institutions can play. Next section also shows how changes in the objectives of MFIs are allowing a way forward for Islamic microfinance.

Study area is a poverty struck area prone to natural disasters. It is the largest sub-district in Rajanpur and is spread over 2,322 Sq Km. The tehsil (sub-district) is divided into 19 union councils. The estimated population of Jampur in 2012 (based on 1998 census) is 0.675 million and 86% of the population live in rural areas. Agriculture is a major source of income. Owing to its unique location between Indus River and Suleiman mountain range, Jampur is prone to both riverine floods from the eastern side and flash floods from the western side. Mixed methods have been employed for data collection from 250 microfinance clients in Jampur[1] by personally administering a structured questionnaire to explore the coping strategies employed and the role that MF has played in reducing vulnerability against natural disasters. Interview excerpts of respondents were also added where necessary to support and extend the understanding of the statistical results.

2. LITERATURE REVIEW

For centuries commercial financial institutions did not serve the poor because they were regarded as ‘risky clients’ due to asymmetric information problems. This attitude brought a huge gap in demand and supply of financial services for the poor that has been filled by the donor sponsored formal interventions and informal sector [6]. However, failure of heavily subsidized developmental institutes and the inefficient working of the informal sector’s limited outreach paved the way for microfinance all over the world as well as in Pakistan [7].

Access to credit facilities enables the poor to involve in income generating activities and the improvement of their living standards [8]. The consultative Group to Assist the Poor (CGAP) defines microfinance as *‘the supply of loans, savings, and other basic financial services to the poor’.* A widespread misconception about microfinance that needs clarification is that it can cure miseries of all segments of the poor including destitute and inactive poor. This is not true. Microfinance is intended for the economically active poor who have a source of livelihood or who want to establish their own microenterprises but lack capital to allow them to utilize economic opportunities. The focus of MF is on economically active poor people who work or want to work and their main issue in accomplishing their goals is lack of capital [9]. Destitute or people who do not want to work are not the target cliental of microfinance initiatives because such people do not use microcredit for productive purposes. In fact consuming microfinance credit for purposes other than income generation or sustainability can further trap the poor in the vicious circle of debt that will result in increased poverty. This ultimately will create problems for the microfinance providers in achieving their goals. This rules-out segments of the poor who can be served by MF; this is where Islamic finance can be particularly applied. Current study also proposes a model to serve such clients that will make a contribution in the literature as well as policy making.

Table 1: Potential Microfinance Market in Pakistan

Category	**2000-01**	**2004-05**	**2005-06**
Extremely Poor %age	1.1	1	0.5
Ultra Poor %age	10.8	6.5	5.4
Poor %age	22.5	16.4	16.4
Vulnerable to Poverty %age	22.5	20.5	20.5
Quasi Non-poor %age	30.1	35	36.1
Non-poor %age	13	20	20.9
Total %age	**100**	**100**	**100**

Source: derived from Economic Survey of Pakistan, [10]

2.1 Commercial or Social Microfinance

The transformation of Microcredit to microfinance has been an ongoing process where success of microcredit across the world has sparked new avenues of profit making for the commercial institutions. “Commercialization is referred to as the movement out of the heavily donor dependent sector of subsidized operations into one in which MFIs are financially self-sufficient and sustained and are a part of the regular (or formal) financial system” [11 pp XXV]. Earlier these commercial institutions disregarded the provision of financial services to the poor due to the high risk of default. Thus microcredit services were offered by the NGOs. However, taking into account the huge client market and their willingness to utilize formal financial services, increasing numbers of commercial financial players stepped into this domain and started providing innovative products such as consumer loans, savings accounts, time deposits and microinsurance (E.g. Citi group is providing microfinance services). The proponents of commercialization believe that the provision of social services is the sole responsibility of the government or other developmental agencies. They argue profitable financial ventures will serve greater numbers of the poor and will increase depth and breadth of outreach. Conversely, proponents of microfinance believe that microfinance is a social tool to serve socio-economic objectives and severely criticized the commercialization of microfinance. Younas criticized

[1] Jampur ist Tehsil (sub-district) in Rajanpur Punjab, Pakistan

commercialization of 'Compartamos Bank' in Mexico as they were charging above 100% interest rates on their loans to the poor. "They're absolutely on the wrong track…. their priorities are screwed up… Microcredit was created to fight the moneylender, not to become the moneylender" [12].

High interest rates are charged from the poor on the assumption that the poor are less sensitive to interest and regard high repayments of microloans as a reflection of the poor's payment capacity [13]. Opponents of charging high interest argue that the limited credit options available to the poor are the main reason behind high repayment rates. If poor have wide options available at low interest rates to meet their financial needs they will not consult the MFIs which charge excessive interest rates on the microcredit.

Microfinance has also been accused of promoting long-term poverty because at "lower levels of income there is greater risk that unlucky or improvident borrowers may be forced by their exposure to debt into selling assets which will permanently lower their income possibilities" [14: pp. 71]. The poor do not opt for microfinance because they feel forced to sell their household items in case of default and lenders threaten to retain defaulters' family and relatives for credit recovery [15]. [16] Found, in Bangladesh, nearly 50% of potential microfinance clients do not want to utilize microfinance services due to the fear of debt trap. They think they would not make enough returns on their investments to pay back loans [16]. Large numbers of male headed households do not allow females to participate in microfinance programs due to crop or microenterprise failure and MFIs demands loan repayment when the poor needed it most [17]. Considering these negative consequences imposed by the MF, [18] deems microfinance detrimental to the local economy. Additionally, many MFIs are focusing solely on providing credit facilities without increasing their service profile.

2.2 Disasters: A Historical Review

Natural disasters have terrorizing consequences such as loss of lives, disruption of economic growth and escalation of poverty. People across the world regard disasters as "Acts of GOD" for moral misbehaving [40]. Contrary to this scientists regard believe disaster are trigger by political, social, economic and ecological factors [1] and their impacts can be lessened by adopting certain preventive measures.

Direct economic losses from these disasters have increased 14-fold since the 1950s. During 1987-1997, the total direct economic losses from natural catastrophes were US$ 700 billion whereas losses caused by disasters in 2005 only were US$ 210 billion [19]. The total number of people affected by natural disasters from 1984-1993 were 1.6 billion which jumped to 2.6 billion in the following decade (1994-2003). In 1999, economic losses from natural disasters were around US$ 100 billion and nearly 105,000 people died, of which 95% of deaths and two thirds of economic losses were in developing countries [20]. The year 2002 witnessed 500 natural catastrophes killing 10,000 people. The 2004 Tsunami in the Indian Ocean killed more than 220,000 people and displaced more than 1.5 million people. In 2006, some 262 million people were affected by disasters and over 98% of them belonged to developing countries [21].

Common trends from the data revealed, these events occur both in the developed and underdeveloped world but inflict long-term negative impacts on the underdeveloped countries. Due to a lack of available data on developing countries, potential losses can be much larger. Like increased damages caused by disasters, frequency has also increased many folds since 1960. Nearly 100 major disasters occurred around the globe in 1975 but they rose to 700 in 2005 [22].

2.3 Microfinance and Disasters

While it may be easy for the poor households to cope with idiosyncratic events, systematic shocks such as floods which affect wider society are more difficult to cope with [23]. Due to diminished resources including social, physical and financial it becomes difficult for the poor to maintain the income stream and they fall into the poverty trap. However, "access to financial markets (insurance, savings, and lending) can help alleviate some of the conditions that tend to trap households in chronic poverty" [24 pp. 2]. Such findings justify the intervention of microfinance institutions by providing access to temporary services, extending loan repayment dates, offering introductory housing loans and facilitating livelihoods through availability of financial services.

The flexibility inherent in microfinance enables it to serve a wide range of rehabilitation needs after a disaster [4 pp. 15]. "Microcredit is a wonderful tool for dealing with a natural disaster and mitigating its negative effects, because it can keep the poor from slipping further down the economic ladder" [9 pp. 40]. By incorporating such services microfinance institutions cannot only solve the issue of existing poverty but can also facilitate disaster prevention strategies. [25 pp. 118) propose products and services which can help the poor to deal with idiosyncratic risk and can also be useful for disaster risks. On the other hand, poor people dwell in vulnerable localities that make microfinance institutions' business risky. Negative impacts inflicted by the disasters on the MF clients can challenge the operational and financial sustainability of these institutions [26]. Thus, this is another reason for which MFIs should integrate disaster related services in their programs.

However, despite the obvious potential, microfinance institutions have ruled-out the provision of such services to the poor for disasters. "Not a single experience could be found where a microfinance institution has expressly decided to integrate disaster risk into its risk management system" [26 pp. 33]. Later, Islam (2008) also highlighted this important issue being ignored. Here question arises, in the absence of support from formal sources, how can the poor cope with the aftermaths of such events? This will be answered below.

3. ANALYSIS AND DISCUSSION

Data was collected from 250 respondents. Male respondents were 96% of the total sample. Female participation was low due to social restrictions as they were not allowed to take interact with male microfinance field officers. As mentioned earlier income from agriculture related activities are major source of livelihood, greater majority occupation was comprised of agriculture labor. The greater chunk of microfinance clients formed the group of 36-45 years old. As the age is increasing the greater number of people are participating in the microfinance initiatives. The study area is least developed in the province Punjab where people face extreme poverty that does not allow the poor to enroll into educational institutions and 80% respondents are illiterate. This thing is also evident for the current study respondents where mean education is less than primary. Table 2 below provided descriptive statistics about the study.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Occupation	250	1.00	8.00	2.9480	1.94123
Respondent age[2]	250	1.00	5.00	3.1080	.99816
Education	250	1.000	4.000	1.50400	.841914
Valid N (listwise)	250				

Coping strategies are various measures taken to lessen the adverse impacts of disasters. These strategies can be divided into *ex-ante* and *ex-post*. Both, *ex-ante* and *ex-post* strategies can be divided into formal and informal where informal strategies are comprised of interest free loans from friends and family, mutual labor exchange and borrowing from moneylenders. Formal arrangements include market-based activities and publicly provided mechanisms.

3.1 Savings as coping strategy

The poor deem savings as a crisis coping tool [27]. Surprisingly, a significant majority (80.40%) of the study's respondents held some form of savings. More than half (56%) of the respondents reported an increase in savings after they joined the microfinance program. Around 60% of such respondents preferred to invest in some assets (livestock or physical) and 20% held cash savings. Respondents with accumulated savings performed better and made an early recovery after floods. Around 42% of the respondents with savings did not face any difficulties in paying back their debts after disasters. In contrast only 4.42% respondents without savings not faced difficulties when repaying loans and remaining 95.8% respondents faced difficulties and made a late recovery from disaster.

Table 3: Difficulties in Paying Back Debt after Disasters

		Difficulties in Debt Repayment		Total
		Yes	**No**	
Savings	**Yes**	58.0%	42.0%	100%
	No	95.8%	4.2%	100%
Total		65.3%	34.7%	100%

3.2 Borrowing from relatives or friends

To minimize the impact of natural disasters, the poor also develop different risk sharing networks. Extended kin relations are networks for exchange, mutual assistance and social contact. In times of stress, relatives living outside the immediate community can become particularly important. [28] Del Found 70% respondents borrowed for food consumption after the 1998 floods in Bangladesh. Only 13.2% respondents were able to utilize this source after the disasters compared to 44.2% of the respondents borrowing money from relatives or friends without any interest before the disaster. The prime advantage of such coping strategies is fewer severe negative consequences and greater probability of early recovery. Some 35% of the respondents who used assistance from friends and relatives were able to recover and restore their livelihoods within six months of the disaster compared to 21% of respondents who took exuberant interest based loans from informal moneylenders.

Respondents age 1 = 18–25; 2 = 26-35; 3= 36-45; 4 = 46–55; 5 56-60
Education: 1 = illiterate; 2= Primary; 3= Middle; 4= Secondary and higher secondary; 5 Graduation

3.3 Borrowing from goods suppliers

Large numbers of goods suppliers are operating in the study area and providing goods to the poor on credit. Goods suppliers can be divided into two categories: those who are providing goods for consumption and others who are providing agriculture inputs. Goods suppliers within the first category usually do not charge interest on goods for whereas goods suppliers in the second category charge very high interest on loans. Payments are made at crop harvesting and borrowers pay significantly high interest rates on the supply of goods but relatively less than moneylenders. Interest rates charged by the good suppliers for credit fluctuate and largely depends on the financial position of the borrower with social standing. Due to the high interest applicable to such credit, a minority (17.2%) of the respondents purchased goods on credit after the disaster compare to 54% before disasters.

3.4 Borrowing from informal moneylenders

Loans from local moneylenders are another important coping mechanism employed by the poor during post-disaster situations. However, these moneylenders charge exorbitant interest rates. The high interest on loans charged by moneylenders offsets the benefits of investments made by the poor. A great majority of respondents did not consider loans from informal moneylenders among their top priorities. However, when all other sources are inaccessible, severely affected households contact moneylenders who exploit the weak bargaining power of the poor by undervaluing the collateral and applying high interest rates.

> *I had a small piece of agriculture land where I used to cultivate cotton and wheat and lived with my family. After 2008 floods, my entire crop was destroyed and our house got severely damaged. I borrowed one-year loan from a moneylender against my land. Unfortunately, my father died and spent money on his funeral and could not return moneylender's loan. He threatened to sell my land in order to recover his money. He extended loan duration upon local nobles' intervention. This year I had very good crop and I was thinking about returning his money but 2010 floods again destroyed my crops and I believe that I will not be able to return my loan and will have to give up my land.*
> **(Respondent 231)**

[29] Found a 5-9% increase in interest rates during or after disasters. Current study findings significantly differ from Pandey and Bhandari as interest rates were almost double after floods. Figure 1 below shows during the pre-disaster situations only 0.8% of the respondents paid interest between 60-70% that jumped to 19.2% in post-floods scenarios. Even 4% of respondents paid interest in excess of 70% to the local money lenders after the disasters. In the wake of covariates shocks friends and family which are source of interest free financial help become ineffective as only 14% respondents were able to secure interest free loans compare to 45.6% prior to disasters.

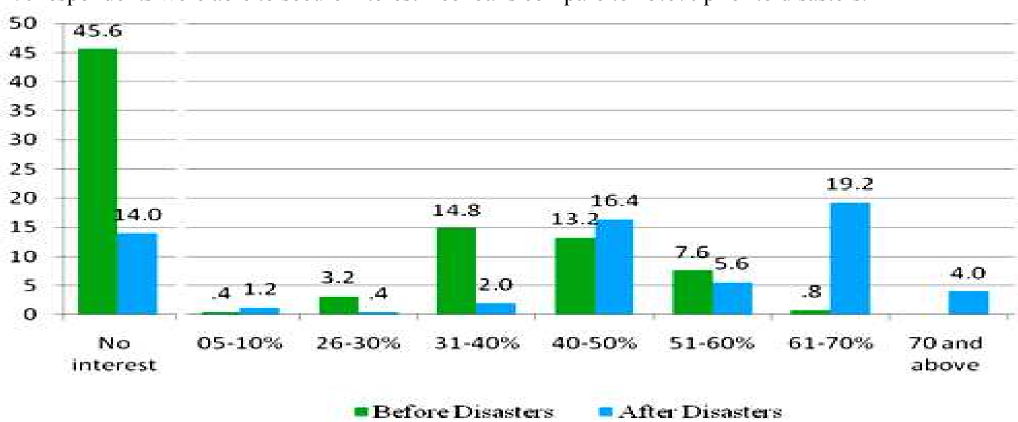

Figure 1: Interest Rate Paid before and after Disasters from Moneylenders

Although a greater number of respondents contacted moneylenders to meet their financial needs, these respondents faced greater difficulties and took more time for restoration of livelihoods because the opportunity cost for borrowing from moneylenders was too high. More than half of the respondents (65.54%) who were able to secure low or interest free loans (friends, relatives and MFIs) after disaster, reported substantial help from such loans compared to only 24% reported substantial contribution of high interest based loans from IML in restoration of livelihoods after disasters. Figure 2 shows that people who secured help from interest free sources make early recovery compare to people who secured loans from moneylenders (See figure 2).

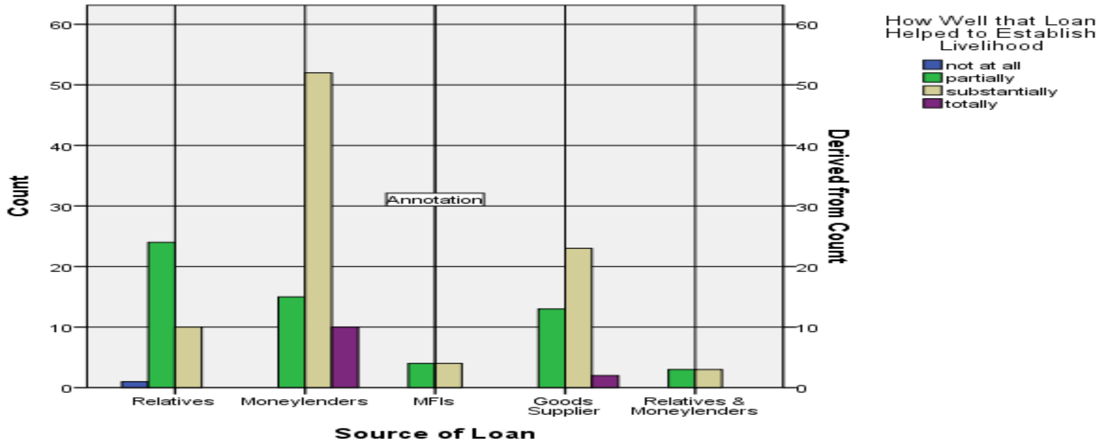

Figure 2: Source of Loan and its Impact

Another salient finding of the research is the different source of credit employed by the respondents who hold property or some other form of savings as compared to those respondents who do not have property and live in houses provided by the agriculture landowners. Due to greater default risk, no one was willing to provide the latter with loans. Here, agriculture landowners performed the role of informal moneylenders by providing loans to their tenants [30]. Tenants did not pay interest on borrowed amounts but they worked extra hours without wages indicating the weak power of the poor farmer and exploitative position of the landowner.

3.5 Institutional microcredit and microfinance

Institutional credit is another strategy employed by the poor during emergencies. Well-designed microfinance initiatives are used by the vulnerable poor to lessen negative impacts of a shock [20]. Unfortunately, institutional credit (both commercial and non-commercial) was neither available nor did MF experts express an interest in the provision of such services. They (MFIs) *told* provision of assistance for emergencies both financial and non-financial is not the responsibility of MFIs. There is a tendency of increased demand for microcredit after disasters [28]. While studying the coping mechanisms of the poor after disasters the study found, more households would use microcredit if it becomes available. The results of the study revealed that no credit facilities are disseminated from the commercial banks or formal microfinance institutions to the local population. Despite the fact that microfinance institutions do not offer in the study area any pre or post-disaster products, 6% of respondents joined MFP after the disasters and secured loans for agriculture purposes. These respondents used loans to cope with the increased expenses after the floods for livelihoods restoration. Half of the respondents (50%) who joined MFP after the floods reported substantial help from the MF loan and 40% reported partial recovery from such loans. On the other hand, only 19.44% of respondents who took loans from informal moneylenders reported substantial help from these loans in restoring their livelihoods. Thus, government should incorporate MFIs in their disaster mitigation strategy and make use of their networks to access and serve the rural poor during natural calamities.

3.6 Sale of assets

The ultimate coping mechanism available for the poor is the sale of assets such as livestock, crop storage, jewelry or other physical assets. However, this strategy is the least desired and adopted when all other options are unavailable e.g. despite the severity only 2% people sold their assets during the Korean crisis [31] whereas in, [20] in Pakistan found that 19% of the households employed this strategy for dealing with extreme shocks. However, extreme poverty, fewer resources and insufficient financial services compelled significant numbers of respondents to adopt this coping strategy after disastrous floods. A quarter (25.10%) of the current study respondents sold their assets (livestock or physical assets) to meet their financial needs. Furthermore, the situation of the poor was being exploited as it was observed that people with access to cash were purchasing jewelry and livestock at considerably lower prices than market price. The forced sale of assets due to emergencies also contributes towards unfair distribution of wealth in a rural area. An interviewee narrated that:

> *To cope with the negative impacts of floods I have sold gold that I saved for my daughter's wedding and I do not now know if my daughter will get married or not.* (Respondent: 121)

4. ISLAMIC BANKING

The Islamic financial system that emerged in 1960s is now actively serving needs of the organizations in ethical ways. Islamic Banking system is based on Shariah laws that prohibits making money from money, eliminates gambling and promotes ethical investment. Muslims scholars 'developed ways to integrate Islamic law on usage of money with modern concepts of ethical investing' [32 pp.7]. This integration resulted in the emergence of a new model that is based on *shariah*. Within a short span of time Islamic banking has become a multibillion dollar industry. Today more than 500 Islamic financial institutions with estimated assets of US$ 2.00 trillion are serving millions of clients in 75 countries.

4.1 Islam, Poverty and Islamic Microfinance:

Above we have seen that MFIs can play a part in lessening the impacts of negative shocks by providing a cushion against increased expense. The availability of formal finance that is relatively cheap, significantly contributed in the recovery period. As discovered above, conventional commercial microfinance providers are not willing to serve the poor in the wake of disasters; Islamic microfinance providers based on Islamic principles can help to reduce wide spread poverty as well as vulnerability heightened by disasters. Below we will see how Islamic microfinance can help during emergencies.

Poverty is a serious matter of concern for the world community as nearly 3 billion people are living below the poverty line in the world [33]. Although, world institutions and governments have repeatedly condemned poverty and taken steps for its eliminations, Islam regards poverty as a curse and its elimination through Zakah, Waqf and Qard-Hasn is obligatory for Muslim society. However, despite obligation to remove poverty, there is wide spread poverty in Muslim countries where 50% of population (600 million) are living in abject poverty [34]. Poverty cannot be eliminated until certain principles are followed "based on cooperation, brotherhood and solidarity rather than on competition which leads to exploitation" [35 pp. 56].

Islam promotes both charitable initiatives and formal credit mechanisms that create economic activity to deal with the issue of poverty and vulnerability. In line with the Islamic ideology, charitable institutions and individuals are actively initiating projects that meet the basic needs of the poor. These charitable organizations usually provide access to consumption smoothing activities that do not generate economic activity in the society. A program that creates economic activity in society is greatly emphasized in Islam and this paper argues for amalgamation of social and financial objectives to reduce poverty. However, despite its (both products and institutions) tremendous growth over the last 40 years, like conventional commercial financial institutions, Islamic financial institutions have also failed to serve the greater population (the poor) in Muslim countries [36]. According to some estimates nearly 72% of the Muslim population does not have access to financial services [37], a contributory factor for excessive poverty rates in Muslim countries.

The existing figures about poverty get worse when vulnerable poor are hit by an adverse event. From all the tools developed to eradicate poverty microfinance is highly credited. The development of microfinance also attracted the attention of Islamic scholars and they developed innovative microfinance products that are aligned with Shariah principles. However growth of Islamic microfinance is not aligned with the growth of Islamic banking [35]. According to a survey conducted by [31] only 0.3 million clients are served by 126 Islamic microfinance providers in 14 countries whereas conventional microfinance is serving over 100 million clients.

Despite the current limited outreach Islamic microfinance has potential of growth because Islamic microfinance represents the union of two rapidly growing industries: microfinance and Islamic finance. It has the potential to not only respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor. Unlocking this potential could be the key to providing financial access to millions of Muslim poor who currently reject microfinance products that do not comply with Islamic law. Limited access to Islamic Microfinance is also evident in the study area. Though greater majority of respondents (4.24/5) are familiar with Islamic Banking, they do not know or understand the concept of Islamic microfinance. Since the respondents do not understand the Islamic microfinance, greater majority remain indecisive about the joining of Islamic microfinance though they expressed their willingness to join commercial IB which they know and understand. Though greater majority expressed their willingness to join IB, they refused to do so if Islamic microfinance products or services are expensive than conventional finance.

Table 4: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Familiar with IB[a]	250	1.00	5.00	4.2400	.69305
Switch to IB if available	246	1.00	5.00	1.4675	.81125
Reason for account transfer from CB to IMFB[c]	189	1.00	4.00	3.2434	.88967
Continue with IB even services charges are higher than CB[e]	250	1.00	5.00	.2800	.49251
IB contribute to society	250	1.00	5.00	3.2800	.98075
Valid N (list wise)	185				
a. 1Completely Unfamiliar - 5 = Completely familiar					
b. 1 = Strongly Disagree - 5 = Strongly Agree					
c. 4 = Religious					
e. 1 = Strongly Disagree - 5 = Strongly Agree					
f. 1 Strongly Disagree - = Strongly Agree					

As noted above a distinction has been created by the MFIs between economically active and inactive poor, conventional microfinance institutions are not willing to serve the economically inactive poor. This attitude of commercial banking creates a niche market for the Islamic microfinance institutions. A distinct advantage that differentiates Islamic microfinance from others is the provision of financial services to both economically active and extremely poor. According to various definitions discussed above, it is not for destitute or economically inactive people because they will use microcredit for non-productive activities that will result in the debt trap. Providing financial or social services gives rise to two questions, why should Islamic finance institutions serve the poor? And secondly how would they serve the poor?

The answer to the first question lies in the objectives of Shariah. The implicit objective of Islamic finance is betterment of humanity. According to some researchers such as [38 pp. 1], Islamic finance can be better understood "in the context of Islamic attitudes towards ethics, wealth distribution, and social and economic justice". Taking into account the problems that can be created by mal-distribution of wealth in society, Islam can order bring about redistribution through Zakah and as one of five pillars of Islam. The needs of the poor are significantly different from the better-off segments of society. They need a range of services during normal times as well when faced with emergencies. Provision of credit only services will not answer the question of poverty. Islamic MFIs can incorporate a social welfare objective in their offerings by serving the extreme poor.

For the second question, Islamic financial institutions can develop a two-tier program. As the economically inactive group might not be ready for the microfinance services due to their distinct needs compared to economically active poor, Islamic MFIs can use the economically active and inactive division where economically inactive people will be in the lower-tier and better-off poor will be in the upper tier.

Varied needs of the poor require a range of services to raise them from poverty. Taking into account all the varied requirements demanded by the poor and the social objective of Islamic finance, we propose a plan where both financial as well social services can be provided by the microfinance providers. Under the proposed plan, extremely poor (lower-tier) will be placed in tier-two that can be further divided into two categories. In the lower category extremely poor people will be served through various charitable programs by securing funds from Zakah and Sadqat programs.

Once their basic needs are met, they will be involved in different economic activities through Qard-hasan where no interest will be charged from them on provided financing. At this stage, poor will also be prepared through various training programs for the second stage. One component of the training program can be financial education where poor will be informed about various financial products such as micro-insurance and micro-savings available for them and their usage. The absence of such education gives incentive to the moneylenders to exploit the weak bargaining power of the poor and charge exorbitant interest rates when faced with emergencies. At this stage MFIs services will be not-for-profit and they will finance their operation through various charitable programs and donations from international donor agencies. Furthermore, to the clients when faced emergencies, Islamic microfinance institutions can also develop an emergency pool. The major source of finance for this emergency pool will be Waqf, Zakah, penalties and other form of Sadaqats.

	Commercial Islamic Banks	**Microfinance Islamic Banks**	**Categories of the Poor**
Loan Purpose	**Rich**	**Poor**	
Production	Commercial FIs	Profit and Loss Sharing	**Tier-One**
Financial Training		Qard-hasan (No interest)	**Tier-Two**
Consumption	Commercial FIs	Charitable Donations (Zakah and Sadqa)	

Emergency Pool Fund Funded by donations, Waqf and penalties payment for non-adherence with Islamic Banking

Figure 3: Proposed Model for Serving Better-off Poor and Extremely Poor

Once the extreme poor have reached a level where they can meet their consumption needs, developed sufficient microenterprise skills and understand basis of financial structure, they will be able to graduate from the first group and shifted to the second-tier where Islamic MFIs can provide financial services for profit. Provision of such services does not mean Islamic MFIs cannot or do not earn profit. Microfinance in Islam need not be restricted to not-for-profit modes alone. Islam permits for-profit trade and creation of wealth. At this stage, Islamic MFI can provide financial services under Murabaha, Musharka and Mudarba contracts. Finally, the provision of financial services based on Shariah principles can also accommodate a large number of poor who do not willingly utilize financial services on "religious grounds". According to CGAP survey (2007) 20-40% survey participants do not use the interest based financial services for 'religious reasons' [39] "…many may opt out of conventional microfinance due to its reliance upon interest-based financing, prohibited by Islam as *riba'*. Hence, there is great potential and a readily available niche market for Islamic microfinance institutions that can be catered for by introducing Shariah compliance Islamic products.

3. CONCLUSION

The use of a particular strategy for dealing with the aftermaths of disasters is a function of the nature and magnitude of the shock and of available coping options [1]. Diverse strategies are used for dealing with idiosyncratic and covariate shocks in varied sequences depending on needs. Fewer people are using preventive strategies for dealing with unexpected incidents due to financial constraints and increasing numbers of people are borrowing from multiple sources that result in increased debts and poverty. In the absence of formal financial services, the poor still rely on coping mechanisms that are likely to have negative welfare consequences or that are very costly. Credit from informal sources and utilization of savings are the two most predominant coping strategies utilized by the poor, whereas reciprocal financial assistance from friends or relatives decreases after covariates shocks. The use of savings and particularly assets can have different consequences depending on whether they were held for precautionary or productive reasons. In such conditions, microfinance institutions can come forward and offer both financial and social services to the poor in the local community. As MFIs' hold a strong position at the grassroots level, government could also incorporate MFIs in their disaster mitigation strategy and make use of their networks to access and serve the rural poor during natural calamities. One form of utilizing the MFI services can be the provision of relief services. This will strengthen the relationship between MFI clients and the organization. However, unfortunately MFIs do not offer such services. In situations where conventional microfinance institutions are not interested in serving the economically active people the Islamic economic model denotes itself different from conventional. Islamic finance based on Shariah principles can provide both social and commercial services. Proposed plan for microfinance that is based on charity, Sadaqat, Waqf and investment provides guidance for poverty alleviation among the economically active people but also brings in the destitute in the economic cycle.

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