Chapter 25
Islamic and Conventional Micro-Financing in the MENA Region:
A Performance Analysis

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ABSTRACT

The performance of MicroFinance Institutions (MFIs) is analysed for the period 2004-2015. Sample consists of 67 MFIs in the Middle East and North Africa region. It includes a subsample of 18 Islamic MFIs (IMFIs), whereof Solebusiness grants exclusively Islamic financial services and Window provides both Islamic and conventional services. A model of simultaneous equations with interacting variables tests seven hypotheses addressing financial performance, social performance, and the social and financial performance relationship. Conventional MFIs (CMFIs) experience higher financial performance than IMFIs and Window experiences higher financial performance than Solebusiness; IMFIs do not experience higher social performance than CMFIs; whether conventional or Islamic, MFIs face a financial vs. social performance trade-off.

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INTRODUCTION

Microfinance institutions (MFI) provide funding to customers who are financially excluded from the banking system. Their social mission is to improve the livelihood of the poor (social performance), while ensuring their sustainability (financial performance).

Some MFIs that were funded with subsidies from various national and international donors went bankrupt (Chehade & Negre, 2013) or failed to achieve financial sustainability (Woolcock, 1999). Other MFIs fostered financial performance (Cull *et al.,* 2009) at the expense of drifting from of their social mission towards the poor (Adair & Berguiga, 2014), they impose high interest rates on borrowers to cope with transaction costs, lack of collateral and a substantial default risk.

MFIs are facing a double challenge: they must ensure the inclusion of poor people, while being financially sustainable without depending on subsidies. In conventional microfinance, *Welfarists* and *Institutionists* defend rather opposite approaches. *Welfarists* emphasize social performance without rejecting long-term financial performance (Morduch, 1999, 2000; Woller *et al.,* 1999; Simanowitz & Walter, 2002). A lack in financial sustainability over time hampers ultimately the development of MFIs and their ability to reach the poor, in as much as granting small loan amount to poor people proves expensive, unless they benefit from ongoing large subsidies. *Institutionists* (Consultative Group to Assist the Poor at the World Bank) is currently predominant, advocating short-term financial performance to achieve long-term social performance. MFIs aiming at financial sustainability require high interest rates from or/and grant to less risky and less poor customers, especially if they have to do without subsidies.

Although *Welfarists* target the borrower, whereas *Institutionists* focus on the MFI, both share the same concern for poverty alleviation, trying to achieve short-term trade-off and long-term complementarity between social and financial performances (Adair & Berguiga, 2014), a major issue that remains far from achievement for the microfinance industry, including Islamic microfinance.

Islamic microfinance institutions (hereafter IMFIs) include microfinance within Islamic finance based on the principles of *Shari'ah.* It emerged as a market niche (Karim *et al.,* 2008) promising an alternative for poor Muslims living below the $2 a day poverty headcount (Obaidullah & Khan, 2008). In addition, it provides access to financial services for financially excluded people: 29 per cent adults (21 per cent excluding Gulf countries) dispose of a bank account in 2014. Admittedly, financial inclusion is over 70 per cent in the Gulf Cooperation Council (over 80 per cent in Bahrain); however, it stands below 50 per cent (Lebanon and Morocco), below 30% (Tunisia, Jordan and Palestine), 15 per cent in Egypt and only 8 per cent in Yemen (Chehade *et al.,* 2017). Hence, there is room left enough for the microfinance industry, including Islamic microfinance. Abdul Rahman *et al.,* (2015) acknowledge that IMFIs are still underdeveloped but claims that potential demand is high, quoting Karim, *et al.,* (2008), whereby figures are not grounded on empirical evidence. According to El-Zoghbi & Tarazi (2013), 255 IMFIs operate worldwide, mainly in two regions: 164 in East Asia and Pacific and 72 in Middle East and North Africa (MENA), the region we focus upon. The number of financial service providers for Islamic microfinance products in the MENA region is quite small. The slow growth of Islamic microfinance is attributed to (i) the small size of IMFIs (NGOs, village or rural banks) with limited outreach and (ii) limited access to funding at reasonable cost (Iqbal & Roy, 2018). It is worth mentioning that microfinance is 1% of Islamic financial assets in 2016 (Sidlo, 2017).

IMFIs take up a different strategy from conventional MFIs (hereafter CMFIs) to achieve the same goal of poverty alleviation. They offer poor Muslim clients *Shari'ah*-compliant financial services based on charity donations as well as profit and loss sharing (PLS) contracts. IMFIs claim to be pro-poor ori-

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