The Role of Islamic Bank in the Development of Small Entrepreneurs

by

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Abstract: Islami Bank Bangladesh Limited (IBBL), the country’s pioneer Islamic Bank, has recently got involved in the development of small entrepreneurs (DSE), through such programmes as Rural Development Scheme (RDS) and Small Business Investment Scheme (SBIS). There are also microfinance schemes of several other government and non-government financial institutions for DSE, which is regarded as a major instrument of poverty alleviation. This paper makes a comparative assessment of the performance of the IBBL programmes, which are shariah-based, and microfinance schemes of other institutions, which are interest-based. The paper also discusses the problems of applying Islamic modes of finance for the rural poor, and, drawing on the experience gained from field surveys, suggests mechanisms to invigorate the role of the IBBL in the development of small entrepreneurs. The need for repeating field surveys at regular intervals to assess the impact of the bank’s financing on the clients is also indicated in the paper.

1. Introduction: Objective, Scope and Methodology

The objective of the paper is to examine the role of the Islami Bank Bangladesh Limited, IBBL for short (henceforth IB), in the development of small entrepreneurs (DSE), which is now regarded as a potent instrument of poverty alleviation. It also measures the impact of different microfinance programmes, e.g., Grameen Bank (GB) and other GOs/NGOs, and suggests mechanisms for invigorating the role of IB in the DSE.

In Bangladesh a large number of financial institutions, both government and private, are now engaged in the development of small entrepreneurs through their credit programmes. Objections raised against these institutions are, however, that (i) there is no direct link between the credit and expansion of output of real goods and services; (ii) there is no built-in mechanism in these institutions for ensuring justice and kindness in the society; and (iii) they practise the age-old interest-based method, which is strictly prohibited in Islam.

The newly emerging interest-free banking system, popularly known as ‘Islamic banking’, is believed to have the capability to overcome these objections. The IB has recently got involved in the development of small entrepreneurs through such programmes as Rural Development Scheme (RDS) and Small Business Investment Scheme (SBIS). The Bank follows the operational procedures of the GB but within the framework of Islam.

The paper is organized as follows. While this introductory section outlines the objective, scope and methodology of the study, section 2 discusses the grass-root level experience of different microfinance programmes and the problems and prospects of applying Islamic modes of finance among the rural poor. Sections 3, 4 and 5 suggest mechanisms to invigorate the role of the Islamic bank in the development of small entrepreneurs. Section 3 discusses motivational tools that will induce potential clients, and to that end, also emphasise the need for ensuring quality services. Section 4 stresses the importance of applying Islamic modes of finance, and section 5 recommends an institutional framework for DSE. Section 6 concludes.

The study is based on data collected from both primary and secondary sources. Primary data was gathered through a sample survey conducted in the country’s three northern districts,

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viz., Rajshahi, Chapai Nawabganj and Naogaon. In all, 600 households - 200 clients/members from each of IB and GB, and 200 'other' – were interviewed in the survey. Here 'other' means those who are not members of either the IB or the GB although they reside around these institutions. The ‘other’ category includes some clients from SBIS, some representatives of the well-to-do people (WTP), and some officials of both IB and GB.

2. Grass-Root Level Experiences

This section presents experiences and lessons derived from field investigation carried out for the study.

2.1 From RDS

(i) Either consciously or unconsciously, none of the existing clients of IB expressed their intention to leave the RDS and join GB in the near future. In order of importance, the reasons cited for their answers are: (a) IB is nearer to their dwelling houses and it delivers the goods (investment) at their door-steps; (b) GB gives undue pressure on the weekly instalment payment; and (c) IB avoids interest (which is Haram in Islam).

(ii) The experiences of IB clients while working with the bank are: (a) it speaks about the Qur’an and the Hadith and gives advice to avoid interest; (b) it is flexible in the case of weekly instalment payment; and (c) Bank workers provide investment money at their doorsteps.

(iii) They expect the following from the IB: (a) increased volume of investible funds and more than one type of finance simultaneously in a single year; (b) special financial assistance for such purposes as house construction, sanitary latrine, tube wells for drinking pure water, medical treatment and daughters' marriages; and (c) training facilities (particularly for women) for tailoring, handicrafts, fish culture and the like.

(iv) In the opinion of its clients, the IB should do the following ( among others) for the expansion of their business: (a) increase the volume of funds and give more than one type of loan in a single year like GB; (b) speak more intensively and extensively about the need for adopting Islamic principles and its various development and poverty alleviation programmes; and (c) reduce the rate of profit (charge) and communicate that in the form of easy-to-understand booklets among prospective members.

2.2 From the SBIS

(i) The observations made by the SBIS members are: (a) there is no supervision; (b) savings are encouraged; and (c) investment is not given without collateral.

(ii) Problems cited by SBIS clients are: (a) they cannot offer the necessary collateral; (b) it is difficult to get a guarantor; and (c) they do business in the footpath.

(iii) The suggestions given are: (a) money should be given at their doorsteps; (b) investment should be given without any collateral; and (c) the amount of investment should be increased.
2.3 From Grameen Bank

(i) Of the 200 members of GB interviewed, 26 per cent expressed their willingness to leave GB and join IB if opportunities were created. The basic reasons for their answers, among others, were: (a) IB is Islamic in character, and it does not deal with interest; (b) it gives more benefits; and (c) GB very often gives undue pressure on weekly payments even when they are in genuine difficulty. Those who did not intend to join the IB gave some reasons, which include: (a) they are already with GB; (b) IB gives loans in kind, but they need cash; and (c) it is troublesome to be with an unknown institution.

(ii) Noteworthy experiences of the GB clients are: (a) they have grown family type relations with GB workers; (b) they can get more than one type of loan from the GB simultaneously; and (c) GB sometimes gives undue pressure on weekly payments even when they are in genuine difficulty. (iii) About 50% of the GB members believe they would be able to go without any further borrowing in the future. In their opinion, GB should do something more in order to expand their business: (a) increase the volume of credit; (b) should not give undue pressure on weekly repayment when they are in genuine difficulty; and (c) reduce the rate of interest.

2.4 From “Other”

(i) Of the randomly selected 200 respondents falling in the category of 'other', 41 per cent were found to be associated with NGOs (BRAC, ASA, Proshika, etc), 6.5 per cent with GOs (RAKUB and BRDB), and the rest 52.5 per cent with none. When asked if they had any intention to move to IB or GB in the near future from their existing positions, 39 per cent of the respondents expressed their desire to join IB, 4.5 per cent to join GB, and 56.5 per cent to join none. Three important reasons for their willingness to join IB (and not GB) are: (a) IB does not give undue pressure on weekly payment; (b) IB comes to the door-steps of the clients to deliver the goods (investment money); and (c) it avoids interest (which is prohibited in Islam). Three reasons cited for joining GB (and not IB) are: (a) they are already with an NGO/GO; (b) there is no branch of IB around their locality; and (c) all banks to them are equal.

2.5 From Well-to-do People (WTP)

(i) A large majority of 88 per cent of the WTP opined that there should be co-operation between the richer and the poorer sections of the society. This can be accomplished, according to them, through: (a) giving loans; (b) providing them with remunerative works; and (c) helping them to stand on their own feet.

(ii) The WTP’s opinion about IB is that: (a) it is Islamic and avoids interest; (b) it motivates its clients in learning Islamic ways of earning; and (c) it does not insist on weekly repayments.

(iii) The WTP’s ideas about GB, on the other hand, are: (a) its lending conditions are very tough; (b) it exploits its clients by charging very high rate of interest; and (c) it has created scarcity of labour in the locality in which it works.

(iv) Half of the WTP interviewees expressed their willingness to join IB, if opportunities were created, because: (a) it avoids interest; and (b) it does not insist on weekly repayment.
2.6 Impact of Micro-finance Programmes

The impact of different microfinance programmes, viz., GB, IB and OT on poverty alleviation has been assessed on the basis of ten criteria, developed by the GB. Slightly modified, the criteria are: (1) the members should have a respectable housing; (2) they should have access to tubewell water; (3) children above 6 years belonging to the member’s families should go to school; (4) members/borrowers should not pay less than Tk. 300 as their weekly instalment, which means that they borrow more than Tk. 12,000 per year; (5) all members use sanitary latrines; (6) they have sufficient clothing for day-to-day use; (7) they have scope for additional income; (8) members have not defaulted in paying their weekly instalments during the last 3 years; (9) they do not face any food crisis during any time in the year; and (10) they are conscious of their health and have the capacity to undergo treatment in case of illness.

The performance of GB, on the whole, was seen to be much better than that of the two other programmes. For instance, although 12 per cent of the GB members satisfied all the 10 criteria, the percentages for the other two programmes were only 2 and 3. Similarly, of those to whom 9 criteria were applicable, 36 per cent of the GB members appeared to have crossed the poverty line; this percentage was only 12 for the other two cases. Quite interestingly, the percentage of clients satisfying at least 6 criteria was almost the same (88%) for the IB and GB, although for OT this was much smaller (70%). The relatively better performance of the GB can be attributed to the fact the GB has been in operation in the study area for about 10 years whereas the IB’s involvement began only 2 or 3 years ago.

2.7 Application of Islamic Modes of Financing

Field information was gathered about the problems and prospects of applying the Islamic modes of financing among the rural poor.* The results were not very encouraging, although they were not at all unexpected. None of the selected RDS members had any idea about the Islamic modes except that some of them did know that the bank was operating on the basis of profit, and not interest. They had no idea about the importance of, or the distinction between, interest (which is prohibited) and profit. The attitude of different borrowers under alternative microfinance schemes on the application of Islamic modes of financing, as gathered from the survey, can be described in the following paragraphs.

Most of the members are doing business with the IB without understanding its basic philosophy. Only 1 out of every 5 persons was found to be very much conscious about the Islamic way of earning livelihood. They wanted to learn more about the Qur’an and the Hadith. Most others were seen to be too eager to earn more income by borrowing funds, no matter whether it was on the basis of ‘interest’ or ‘profit’.

The GB members were not seen to be at all conscious about the Islamic way of earning income. However, about 44 per cent of the 200 interviewees agreed to take loan in kind. The reasons cited are: (a) they can save time if loans are given in kind; (b) there will be no diversion of money to unproductive sectors; and (c) Bank workers will not be able to make any complaint about the use of loan.

* The Islamic Modes of financing are: (a) Bai-Muajjal, (b) Shirkatul Meelk, (c) Mudaraba, (d) Musharaka, (e) Bai-Salam, and Murabaha.
Persons belonging to the OT group, who expressed their willingness to join IB, mentioned the case of the prohibition of interest in Islam. This means that they are not totally apathetic towards the Islamic principles. Most of the respondents belonging to the WTP group also recognized the ban of interest by the Quran and indicated their willingness to join IB because it was run on Islamic principles.

3. **Invigorating the Role of IB in the DSE**

In order to invigorate the role of the IB in the DSE, the paper suggests actions in four specific areas, namely: (a) devising motivational tools, (b) ensuring quality services, (c) application of the Islamic modes of finance, and (d) the development of an appropriate institutional framework. This section discusses the first two of these issues, while the other two will be taken up in the subsequent sections.

3.1 **Motivational Tools**

Field experience shows that the RDS of the IBBL functions amid a lot of odds. First, it has to face competition with NGOs and GOs. According to the Ministry of Finance (GOB, 1999) and CDF Statistics (1998), of the total funds allocated in the name of poverty alleviation programmes up to June 1998, the share of GB was 47 per cent, followed by NGOs (26%), Banks (19%) and GOs (8%). The present study also shows that out of the randomly selected 200 non-members (i.e., not members of the IB or the GB), about 47 per cent are associated with various NGOs and GOs. Second, the rural poor are in general not aware of the importance of the Islamic modes of finance i.e., finance without the use of interest. They want money, no matter whether that money is given in terms of interest or profit.

Against the background, the DSES - Development of Small Entrepreneurs Scheme - (or RDS or any Islamic rural institution) will have to create demand for its own services, i.e., investment on the basis of Islamic finance. This means that it will have to adopt appropriate strategies for motivating the poor. To that end, the present study makes the following suggestions:

(i) **Extensive mass contact:** For increasing the number of members of the DSES or motivating the poor to join it, the first strategy that should be applied is extensive (and effective) mass contact in the target areas, including seminar type discussions, explaining the objects and working procedure of the DSES.

(ii) **Investment sanctioning procedure:** The investment sanctioning procedure should be as simple as possible and devoid of any troublesome formalities. The principle should be that the investment is sanctioned in time and without long-drawn procedure.

(iii) **Volume of investment:** Increased volume of investment/loan is one of the important tools for motivating the potential clients to come and join the IB. The amount of investment should be increased so that the clients’ demands do not remain unfulfilled.

(iv) **Multiple investments:** The small entrepreneurs remain engaged in various types of activities. They need finance for more than one purpose. One type of assistance (meaning only one type of goods and services) given at any one time may not satisfy everybody. The GB provides more than one time of loan simultaneously, namely, general loan, seasonal loan, housing loan, education loan, etc. to the deserving members. This is one of the important reasons why GB loans are liked by its members. From this it is not suggested that each member of the DSES should be provided with different types of investments simultaneously. What is suggested is that the deserving members should be given more than one loan/investment in a single year, of course, subject to the ability/capability of the clients to properly utilise the multiple investment.
(v) **Amount of installments**: The system of weekly installment should not be generalized for all types of borrowers. For such activities as livestock fattening, pisciculture, the clients may not be able to pay weekly installment. In this case, a token amount may be collected leaving the balance to be collected after the end of the maturity of the activity. This token amount is very important because it keeps reminding the clients that they will have to pay back the loan they owe to the institution concerned. For seasonal products, installments should be fixed. This would attract clients to come forward under the new institution. Perhaps, the most important point is that there should not be any undue pressure on the clients in case they become unable to pay the installment in due time due to genuine reasons.

(iv) **Adequate repayment period**: The repayment period should be made flexible and determined by the type of activities undertaken by the clients. This would ensure justice and kindness in the society. For activities requiring longer maturity, the repayment period should be longer.

(vii) **Transaction costs**: For motivational purpose, minimal transaction and other incidental costs would be considered by the potential entrepreneurs to be an attractive incentive. It is good that the RDS delivers goods (investment) at the doorsteps of the clients. This is highly appreciated by the selected clients and regarded as a plus point when compared with the delivery at-the-office of the GB.

(viii) **Savings and thrift opportunities**: The clients should be given the opportunity to save and become thrifty. The money they will save should be deposited in their own names, and they should have the freedom to handle the account after a lapse of certain period.

(ix) **Consumption credit**: The provisions of consumption credit to help clients meet various emergencies would be an important motivational tool. Such credit should be treated as a special service to the clients, the cost of which will have to be met from special funds.

(x) **Proper and courteous services**: Courtesy of officials, including field workers, is highly valued by clients, and hence the DSES should provide proper and courteous services at all times to their borrowers.

### 3.2 Ensuring Quality Services

Providing quality services is essential for the DSE. In this regard, the IB’s responsibilities should be the following:

(i) **Selection and training of staff**: The human factor plays a decisive role in the endeavour to provide quality services to poor entrepreneurs. Better human relation is expected to generate conditions favourable to quality output. Perhaps the most important aspect in relation to ensuring quality service is the selection and training of the staff, managers and field workers.

For **Managers**: Managers are to be recruited from well qualified persons through competition. They should have strong commitment to poverty alleviation through Islamically permitted ways.

The appointees should be imparted theoretical training so that they thoroughly understand the working mechanisms of the DSES, particularly the application of the Islamic modes of financing among the small entrepreneurs.

For **Field Workers**: Field Workers, too, are to be recruited through competition. They should be fresh with no previous experience (particularly from conventional NGOs). They should possess pleasing personality and have good and amiable behaviour. They must be hard
working and committed to poverty alleviation through Islamically permitted principles. Women supervisors may also be recruited with the same conditions as for the males. The selected field workers should be given short training of at least one week about the operational procedure of the DSES. Special training should be given as to how to motivate the clients for joining the programme.

**(ii) Selection of areas:**

The sufficiently trained and motivated managers will first visit the potential areas, make preliminary selection of the village (or urban area), meet the people and collect the necessary information (through a short but structured questionnaire). After reviewing the collected information, the Manager will arrange a projection meeting of the local people including government officials, village/local leaders, religious personalities and others. It would be advisable not to criticize the activities of the exiting institutions but to propagate the aims and objectives of the new institution. Socio-economic development aspect of the programme should be given preference over the pure religious activities at least during the preparatory period.

After selection of the village/area, the subsequent meetings would be held with the target people only. In the meeting the basic philosophy of the DSES should be explained. The potential entrepreneurs should be asked not only to memorise the "Ten Decisions" (see Appendix) and believe, but also to promise to act upon them if they want to join the DSES.

**(iii) Strategies for meeting investment demands:**

Regarding investments, the strategies relate to the mobilization of savings, the volume and number of investments granted, the number of instalments, adequate repayment period, and reduction of transaction costs. The DSES should be prepared to meet the clients’ investment demands and at the same time earn adequate income to be in the business. The following strategies may be suggested for achieving these apparently two contradictory objectives.

**Savings products**

The DSES will not necessarily deal with only micro-credit/micro-investment but with micro-finance. This concept of micro-finance includes investment plus mobilization of resources, particularly local savings. As a component of micro-finance, this saving will have to play a dominant role in the DSES.

**Amount of savings:** Since mobilization of funds from external sources may not be very easy for the DSES, it is suggested that it gives more attention to mobilize more savings. It may encourage its members (or even outsiders) to open DPS or Fixed Deposit Accounts.

**Withdrawal of savings:** Members should be given the opportunity to withdraw their savings subject, of course, to some restrictions. The number and level of withdrawal per year many be determined in consultation with the Centre. In case of discontinuation of membership (including death), savings should be refunded to the members (heirs) after adjustment with the outstanding investment.

**Utilisation of savings:** Savings may be utilized in several ways. A part of it can be invested in Mudaraba Bond/Certificates. Another part may be kept in the savings account in order to meet the withdrawal demand of the members. A portion of the funds may be disbursed among members on terms and conditions to be determined by the Centre.
Profit rate: It is suggested that the DSES/IBBL offer a rate either equal to or even more than the rate normally given to PLS accounts. This will definitely act as an additional incentive for the potential entrepreneurs.

Management of funds: Management of funds is very crucial. Savings should be pooled into a central account to reduce bank charge. The Field Workers should reconcile the savings balance with Group members at weekly meetings. In any case, the DSES/IBBL should maintain a very high quality of portfolio management to keep their promises with the members.

Investment products

Investment activities: The DSES may diversify its investment activities beyond the traditional boundary. It should finance the crop sector, the fisheries sector, etc, applying appropriate modes of Islamic finance. The SBIS programme of the IBBL should get merged with the DSES programme with necessary adjustments in its investment schedules.

Duration of investment period: DSES should offer investments for both shorter (say 6 months) and longer periods (more than one year). The former may be applicable in the case of seasonal crop production as well as seasonal businesses. The main advantage of this shorter period investment would be that the same amount of funds could be used twice in a year. There are many clients who may be interested to have investments for this shorter period.

Rate of profit: There are some potential entrepreneurs who do not care about the rate of interest/profit charged by the banks. They want money, more and more money. There are many others who are very much concerned about the rate of interest/profit. These are actually the good customers. They try to compare the rates charged by different institutions. Although it is necessary to make them understand the rate of profit charged, it is more important to tell them (with simple example) that the rate charged by the RDS is one of the lowest among the leading NGOs working in rural Bangladesh.

Wholesale lending: Quite a number of Islamic NGOs now work in different parts of Bangladesh. Mainly because of fund constraints, they are not able to run their programmes properly. The IB should come forward and provide a portion of its idle funds to these Islamic NGOs at reasonable rates of profits.

4. Applying Islamic Modes of Finance to Invigorate the Role of IB

For invigorating the role of IB in the DSE, Islamic modes of financing may be applied to different activities performed by the small entrepreneurs. The chosen Islamic modes are: (1) Bai-Muajjal/ Bai-Murabaha, (2) Hire purchase, (3) Leasing, (4) Mujara/ Renting, (5) Mudaraba, (6) Bai-Salam, and (7) Qard Hasana. It may not be possible to apply Musharaka for the small entrepreneurs at the initial period. The activities to which the chosen Islamic modes of financing can be applied are: (1) Agriculture and forestry, (2) Livestock and fisheries, (3) Processing and manufacturing, (4) Trading, (5) Services, (6) Shop keeping, (7) Peddling, and (8) consumption. The mechanisms of applying the various Islamic modes for development of small entrepreneurs in the chosen activities are discussed in the following.

A. AGRICULTURE AND FORESTRY

This sector includes such activities as production of food grain, mustard, pulses, sugarcane, vegetable, fruits and nursery. These are seasonal products. The duration of the season may vary from a few months (vegetables) to one year (sugarcane). The clients falling in this sector may demand investments in any of the following forms:
1) To purchase some well-specified inputs in well-specified quantities;
2) To purchase some well-specified inputs in well-specified quantities plus some cash to meet some unforeseen needs in the future; and
3) To have a specified amount of cash (say, Tk. 5,000) to buy some unspecified inputs as when and required.

Practically speaking, the DSES should be prepared to finance all the three categories of demands. To meet the demand for specified inputs, for example, shallow tube wells, fertilizers, insecticides, etc., the appropriate Islamic financial modes could be: (i) Bai-Muajjal / Bai-Murabaha, (ii) Hire Purchase/ Leasing, and (iii) Bai-Salam.

The demand for cash can be met in several ways. For example suppose a particular client wants 2 units of fertilizers and ready cash of Tk 100. Assuming that the price of fertilizer is Tk 100 per unit, he actually demands Tk 300. In this case, he may be given 3 units of fertilizer valuing Tk 300 on the understanding that he will sell out 1 unit to meet his cash demand. But he will have to give mark-up for 3 units of fertilizers. Alternatively, he gives markup for 3 units of fertilizers but gets 2 units instead and 100 taka cash on Qard Hasana basis. These new ideas would of course need approval of the Shariah Council.* It can also be given separately as Zakat or Sadaqa or loan in terms of Qard Hasana. This of course would require a special fund.

B. LIVESTOCK AND FISHERIES

This sector refers to production of livestock and fisheries products and includes such products as fattening of livestock, milching cows, draught animals, rearing poultry, ducks, and pisciculture. Duration of production may vary from a few months to one year. These may be treated as seasonal products. Its period may be vary from 4 months to one year, or even more (in case of fish production). The modes of finance may be selected in a similar fashion as for agriculture and forestry products.

The Clients in this sector may demand investments in any of the following forms:

1) To purchase some well-specified number of animals or specified quantities of fish fry along with specified amounts of their feeds;
2) To purchase some well-specified number of animals (or fish fry) or their feeds plus some cash to meet some unforeseen needs in the future; and
3) To have a specified amount of cash (say, Tk 10,000) to buy some unspecified animals and their feeds as when and required.

To meet the demand for specified things, the appropriate modes are: (i) Bai-Muajjal / Bai-Murabaha, and (ii) Hire Purchase/ Leasing. The demand for cash can be met in the same ways as have been suggested for the agriculture and forestry sector.

C. PROCESSING AND MANUFACTURING

Activities under this category include the making of puffed rice, beaten rice (cheera), Chanachur, molasses, khoi, fried peanuts, sweet, yoghurt, bakery goods, cake (pitha), mustard oil, palmyra fan, coconut-choir, candle, container, spices, pickles, fire-wood, hogla-pati, bamboo products, jute products, packets, pottery products, fishing net, katha, mosquito net, quilt, bicycle, rickshaw, van, tube well, bricks, optical glass, and the like; processing paddy, wheat, pulses, animal skin, etc.; crushing sugarcane; weaving clothes; garments, including

* While discussing this with the Shariah experts individually, conclusive opinion could not be obtained.
woolen garments; yarn dying; goldsmith works, blacksmith works, thread works, embroidery works, printing works, sanitary goods, boat making etc.

The entrepreneurs in this sector need finance basically in terms of cash. This is due to the fact that they need to buy too many things from too many places, and that too very frequently, perhaps on daily basis. The modes suggested for this sector are: (i) Mudaraba, (ii) Bai-Muajjal/Bai-Murabaha, and (iii) Hire Purchase/Leasing. The demand for cash can be met in several ways as described for other sectors described above.

D. TRADING

Trading simply means buying and selling. However, this activity involves many other activities in between, namely, transporting, storing, grading, and others. If investment is given without recognizing the steps involved in the trading, either the money will not be utilized for the purpose it is given, or the repayment will become very poor. For small entrepreneurs, trading may include any or more of the following commodities: milk, fish, spices, egg, puffed rice, beaten rice, khoi, dry-fish; green vegetables, fire wood; betel leaf, bidi, cigarette; livestock, poultry, animal skin; cottage industry products; seasonal fruits, molasses; grocery and stationery goods; house construction materials; rice paddy, pulses, tea, coffee, sugar and other food items; medicine; books; agricultural inputs like fertilizers, insecticides, and seeds; household and kitchen materials; clothing, garments, second-hand clothes, yarn, accessories of weaving; wood, and log.

These commodities may be broadly grouped into two categories namely, durable trading goods such as clothing, house construction materials, stationery goods and beverages, and perishable trading goods such as vegetables, fish, milk, and fruits. The clients in this sector may demand investments in any of the following forms:

1) To purchase some well specified durable goods in well specified quantities;
2) To purchase some well specified durable goods in well specified quantities plus some cash to meet some unforeseen needs in the future; and
3) To have a specified amount of cash to buy some unspecified durable goods as when and required.
4) The same types of demands may be made for perishable goods.

To meet these types of demand, appropriate financing modes are: (i) Bia-Muajjal/ Bai-Murabaha, (ii) Hire purchase/Instalment sale and (iii) Mudaraba. These modes may be applied in several ways as indicated for other sectors described above.

E. SERVICES

This activity involves only providing services by the clients to the people. No production of any commodity is involved here. The clients need finance for buying necessary goods, tools and equipments for such services as hotel/restaurant; tea stall, drinks, juices; butchery; decoration of house, shops, etc for renting out; rice mill, laundry, saloon, dentistry, medicare services; rickshaw, van, trolley, Mishuk, shallow tube well engine for boat/irrigation, welding, repairing cycle, rickshaw, van, tube well, shallow tube well, Mishuk, taxi, trolley, thresher machine, TV, radio, computer, VCR, other mechanical equipment; shuttering; buying household goods like TV, freeze, radio, furniture, ornaments, cot accessories, etc); tailoring; fishing; book binding, photo binding, printing signboard; and house repairing.
For financing the clients’ need for purchasing the necessary tools required for providing these services, the appropriate financing modes are: (i) Bai-Muajjal/Bai-Murabaha, (ii) Hire Purchase, (iii) Mujara/ Renting, (iv) Installment sales, and (v) Mudaraba.

**F. SHOP KEEPING**

This activity assumes that the clients have shops and that they want to buy and sell the necessary goods. The basic characteristic of shop keeping is that the shopkeeper buys things at the wholesale level and sells them at the retail level. For stock keeping they need finance. The types of shops are grocery, stationery, magazine, medicine, seeds and plants, clothing, sandal, shoes, bicycle, rickshaw, cottage industry products, electric goods, mirror, glass, hardware, trunks-suitcase, umbrella, stone, polythene, betel leaf, bidi-cigarete, seasonal fruits, paddy, rice, pulses, cattle feed, tea stall, sweet meat, etc. The financing modes suggested for the above-mentioned activities are: (i) Bai-Muajjal / Bai-Murabaha and (ii) Mudaraba.

**G. PEDDLING**

Peddling or hawking implies that the clients have no shop at any fixed place. He buys goods from the wholesale market and sells at the retail. He goes from house to house, sometimes carrying his goods on head and sometimes by using bike or van. He needs finance for buying his goods or carrying by van/cycle or both. He needs capital goods plus some cash. The goods include fried groundnut, puffed rice, khoi, ice cream, green vegetables, fish, milk, yoghurt, betel-leaf, bidi-cigarete, eggs, seasonal fruits, bamboo-cane-jute-nylon products, clothing, garments, sandal shoes, cookeries, plastic goods, artificial ornaments, etc. The same financing modes, viz., Bai-Muajjal/ Bai-Murabaha and Mudaraba, as described for shop keeping are applicable in the case peddling as well.

**H. UNPRODUCTIVE INVESTMENT**

Unproductive investment means investments that do not beget any income in the true sense of the term at least in the short run. It includes consumption expenditure, including marital expenses. This type of expenditure, often becomes more important to the clients than their usual productive expenditure. A commercially minded institution will not, however, normally like to meet this type of demand.

5. Institutional Framework for the DSE

A detailed institutional framework for the DSE is outlined here. The name of the institution would be "Development of Small Entrepreneurs Scheme" (DSES) of the Islami Bank Bangladesh Limited.* The need for the institution arises because the existing institutions and policies often act as barriers. What is needed is to create an environment that can provide entrepreneurship opportunities for the poor and the landless in rural and urban areas. The DSES is expected to create opportunities for generation of employment and raising income with a view to alleviating poverty.

The DSES will be operated under the direct control of the Board of Directors of the IBBL. However, for smooth functioning of this new institution, there should be a separate committee, which may be called "Steering Committee" of the DSES constituted by IBBL for the overall supervision of its activities. The Steering Committee may be composed of 7 members

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* The name "RDS" can be retained if the arrangement can be made to include in it the activities of the SBIS.
viz., one convener, one member-secretary, and 5 other members. The meetings of the Steering Committee shall be held at such times and at such places as may be determined by the Committee.

The institutional framework is built up on the basis of the following presumptions:
(a) Poverty is not caused by the poor themselves but is the result of the existing institutions and policies. There is lack of national awareness in this regard.
(b) 'Development' means a positive change in the economic status of the bottom 50% of the people of the country. The richer section of the society should not, however, be overlooked.
(c) Islamic micro-finance is the only sustainable means to improve the quality of the small entrepreneurs.
(d) Absolute reliance on charity can have devastating effects on any effort of poverty alleviation programmes.
(e) Self-employment is preferable to wage-employment.

5.1 DSES and GB Compared

(a) Although the DSES will basically follow the GB model, it will be different in the terms and conditions of investment and in methods of implementation.
(b) Like GB model, the DSES will have savings and micro-credit/micro-investment programmes, but unlike the GB, the DSES will also have non-lending services such as skill training, education, health and sanitation, and above all, moral development. Instead of the 'credit only' programme of GB, it will have 'credit/investment plus' programme.
(c) The relationship between the GB and its clients is one of creditor-debtor relationship, but that of DSES will be one of partnership.

5.2 Objectives of DSES

The objectives of the DSES will be to: (a) extend investment facilities to the rural and urban poor (men and women) for carrying out their activities; (b) finance proposals for creating self-employment, particularly for the unemployed youths; (c) eliminate Riba-based finance and introduce exploitation-free Islamic modes of finance and to prove that giving investment in kind is far more development augmenting than giving finance in pure cash; (d) extend investment facilities to such apparently unproductive activities (at least in the short run) as house-building/repairing, hand tube wells for pure drinking water, sanitary latrine, children's education, medicare and the like; and (e) bring the potential small entrepreneurs within the fold of an institutional framework based on Islamic principles following the experiences of GB.

5.3 Target Area and Target People

The DSES will cover both rural and urban areas of Bangladesh, with emphasis on the former. The target people will include both landless persons of the rural areas and assetless persons of both rural and urban areas. 'Landless person' means any person who or whose family owns less than 0.5 acres of cultivable land in addition to homestead (if any). 'Assetless person' means any person who or whose family owns assets, the value of which does not exceed the value of an acre of medium quality land according to the prevailing market price in the union in which the person normally resides. The DSES will also give access to well-to-do people and the Imams of mosques.
5.4 Group and Centre Formation and Weekly Meetings

Group formation:

Five like-minded people, permanently resident of the village/area, would be allowed to form a group. In effect, the focus of the DSES shall be 'family', and not necessarily the wives or husbands. In the family, preference may, however, be given to the wife as a member, but not necessarily as a user if she has active male member(s) in the family. Male members may have their own groups in the like manner. 7-14 days' training will be given to the group. It would be required that the members sincerely accept the "10 Decisions" (see Appendix) and strive not only to memorise them but also to act upon them.

The Group will have a Chairman and a Vice Chairman with yearly rotation. Each member of the Group would be required to deposit at least Tk 10 per week to the DSES. This money cannot be withdrawn within one year. Profit will be given on this saving at the same rate as given by the IBBL to their formal depositors. There would be no need to form any group for the richer sections of the people.

Centre formation:

About 6-8 Groups would constitute a Centre. Each centre will have 30 to 40 members. All investment activities would be accomplished through this centre. One of the Chairmen of the Groups would be elected as Centre Chief and another as Deputy Chief. Their positions would also rotate on yearly basis. The centre should be considered as the body in which all-important decisions would be taken for the proper functioning of the Centre. This would be a forum where all problems arising out of the operation would be discussed with specific aim to find out practical solutions.

Weekly Meetings

There would be compulsory weekly meetings of the Centre under the leadership of the Centre Chief. A Field Supervisor would attend the meeting. Attendance of each member of the Centre in the meetings should be compulsory. Disbursement of investment, weekly collection of installment, savings, would all be done in these meetings. A Register would be maintained for the purpose.

All discussions would be open. This would imply that a member of the Centre knows the activities carried out by the other members of the Centre. The Group members would know the activities of their fellow members in much more details. In a female Centre, occasional meetings of husbands should be arranged. This would be necessary to convey the message evolved out of the wives' weekly meetings. Otherwise there would be gaps between what is decided by wives and what is acted upon by the husbands. Weekly meetings for the WTP will not be required.

5.5 Investment related Issues

Sanctioning and Disbursement

(a) Investment will be given only for income-generating activities, the activities that the clients have themselves chosen and have been doing for year together. New processes of production should be discouraged. The DSES shall not undertake or transact any kind of business other than those permitted by Islamic Shariah.

(b) For purpose of investment sanctioning, 10 decisions, weekly meetings, etc., previous experience in the work, and possession of land if she/he wants to buy agricultural inputs, should be used as testing criteria. Personal character/behavior should also be emphasized.
(c) No distinction should be made between people on ground of religion. Investment will be given to a family for one Year/Season/Activity. More than one type of investment may be given in a single year; one type of investment may help pay the installment of the other types taken simultaneously. Financing for such items as tube wells for pure drinking water and house construction should not be given until the clients have proved good transaction behaviour for at least 3 years.

(d) Depending upon the nature of activities and purpose of investment as discussed in section 4 above, any or more of the following investment modes will be used: (a) Bai-Muajjal/Bai-Murabaha, (b) Hire purchase, (c) Leasing, (d) Mujara-Renting, (e) Mudaraba, (f) Bai-Salam, and (g) Qard Hasana.

(e) For viability reason, the total amount of investment should be around Tk.1 crore.

**Recovery of Investment and Charges and Rate of Return**

Repayment will start after one or two weeks. Collection of dues will be made in the weekly meetings. No severe penalty will be imposed on clients who for genuine reasons are not able to pay their dues in time. Recovery will be made by 45/46 weekly installments. For seasonal activities, installments should be fixed on the basis of harvesting/maturing period. A token installment may, however, be realized on weekly basis.

Regularity in repayments must be observed. Willful defaulters are to be watched carefully. For genuine defaulters, loans should be rescheduled, but not be written off. Repayment rate must be very high, but this should not be used as the sole criterion for the success of the venture.

The rate of return will be at the rate of 7 per cent per annum (approximate). The supervision charge will be at the rate of 4 per cent per annum on the net disbursement, and the Risk Fund contribution of the clients will be at the rate of 1 per cent per annum on the net disbursement.

**Mobilization of Funds**

Funds for the DSES will be raised mainly from (a) members’ deposits and funds provided by the IBBL, (b) group savings at the rate of Tk 10 per week, and (c) collection of Zakat, Ushr and other local contributions.

Each member of the Group will deposit a minimum of Tk 2 per week. This will be deposited by opening a Centre Fund Account (Mudaraba Savings Account). Zakat and Ushr collected from the locality or donations made by the outsiders may also be deposited in this account. This Fund will be utilized for the welfare of the members by way of Qard as per decision of the Centre in the weekly meetings. One of the Zakat and Ushr contributors of the locality and the Centre Chief will jointly operate this account.

Funds may also be raised by the sale of bonds and, if necessary, by creating emergency funds. For purely welfare-oriented activities, outside funds may have to be sought. The GOB may also supply soft funds (or at least a portion of the Zakat funds collected) for promoting welfare activities through the DSES.

Profit may be paid at the rate of 6-8% per annum on the savings deposited by the clients. Members should be allowed to withdraw certain percent of their savings under given conditions.
6. **Concluding Remarks**

The paper highlights the role the IB can play in the DSE. It provides an idea about how small entrepreneurs can be developed through an Islamic way. Drawing on the experience gained through field surveys, some mechanisms for invigorating the Islamic bank’s role in this area are suggested. The IBBL has been striving to develop the small entrepreneurs through the RDS and the SBIS only during the last 2 or 3 years. The time period was, therefore, very short for properly evaluating the performance of the IBBL’s RDS and SBIS programmes. It is suggested that field studies, like the one on the basis of which the recommendations are made in this paper, should be repeated at regular intervals so that more matured opinions of the clients could be obtained and analyzed.

**APPENDIX**

**THE TEN DECISIONS**

1. We shall follow and advance the six principles of the DSES - faith in the Almighty Allah, discipline, unity, courage, hard work and Ribā-free monetary transactions - in all walks of our lives.
2. Prosperity we shall bring to our families *Inshallah*. We shall not depend upon others but stand on our own feet. Whatever resources we have we shall utilize them fully.
3. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.
4. During the plantation season, we shall plant as many seedlings as possible.
5. We shall drink water from tube wells. If it is not available, we shall boil water or use alum to purify it. We shall look after the health of all our family members, including children.
6. We shall use sanitary latrine. If it is not possible, we shall build and use pit-latrines. We shall keep our house and environment clean.
7. We shall not remain illiterate and educate our children at any cost.
8. We shall not take any dowry in our sons’ weddings. Nor shall we give dowry in our daughters’ weddings.
9. We shall not commit any injustice and we will oppose any one who tries to do so. Also, we shall always encourage people to do good works and prevent them from all ill doings. We shall always be ready to help each other. If any one of us is in difficulty, we shall all help him/her.
10. We shall not make false promises and will always try to keep our words.