ISLAMIC FINANCE & FINTECH AS A TOOL FOR FINANCIAL INCLUSION AND POVERTY ERADICATION

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DECEMBER, 2021

ISLAMIC FINANCE

- Islamic finance refers to **how businesses and individuals raise capital in accordance with Sharia**, or Islamic law. It also refers to the types of investments that are permissible under this form of law. Islamic finance can be seen as a unique form of socially responsible investment.

MAIN PRINCIPLES OF ISLAMIC FINANCE

- Wealth must be generated from legitimate trade and asset-based investment. (The use of money for the purposes of making money is expressly forbidden.)
- Investment should also have a social and an ethical benefit to wider society beyond pure return.
- Risk should be shared.
- All harmful activities (*haram*) should be avoided.

THE FOLLOWING ACTIVITIES ARE PROHIBITED:

- Charging and receiving interest (*riba*).
- Investments in businesses dealing with alcohol, gambling, drugs, pork, pornography or anything else that the Shariah considers unlawful or undesirable (*haram*).
- Uncertainty, where transactions involve speculation, or extreme risk. This is seen as being akin to gambling.
- Uncertainty about the subject matter and terms of contracts – this includes a prohibition on selling something that one does not own.

THE PERMITTED

- *Murabaha* is a form of trade credit for asset acquisition where the bank buys the item and then sells it on to the customer on a deferred basis at a price that includes an agreed mark-up for profit.
- *Ijara* is a lease finance agreement whereby the bank buys an item for a customer and then leases it back over a specific period at an agreed amount.
- *Mudaraba* is essentially like equity finance in which the bank and the customer share any profits. The bank will provide the capital, and the borrower, using their expertise and knowledge, will invest the capital.

- *Musharaka* is a joint venture or investment partnership between two parties. Both parties provide capital towards the financing of projects and both parties share the profits in agreed proportions.
- *Sukuk* is debt finance. A conventional, non-Islamic loan note is a simple debt, and the debt holder's return for providing capital to the bond issuer takes the form of interest. Islamic bonds, or *sukuk*, cannot bear interest. So that the *sukuk* are Shariah-compliant, the *sukuk* holders must have a proprietary interest in the assets which are being financed.
  The *sukuk* holders’ return for providing finance is a share of the income generated by the assets. Most *sukuk*, are ‘asset-based’, not ‘asset-backed’, giving investors ownership of the cash flows but not of the assets themselves. Asset-based is obviously more risky than asset backed in the event of a default.

ISLAMIC FINANCE SOLUTIONS TO ACCESS TO FINANCE

- NON-INTEREST BANKING
- ISLAMIC MICROFINANCE
- TAKAFUL: Islamic Insurance
- ISLAMIC ASSET MANAGEMENT
- SUKUK: Islamic Bonds
- Islamic Cooperative

WORLD BANK GROUP

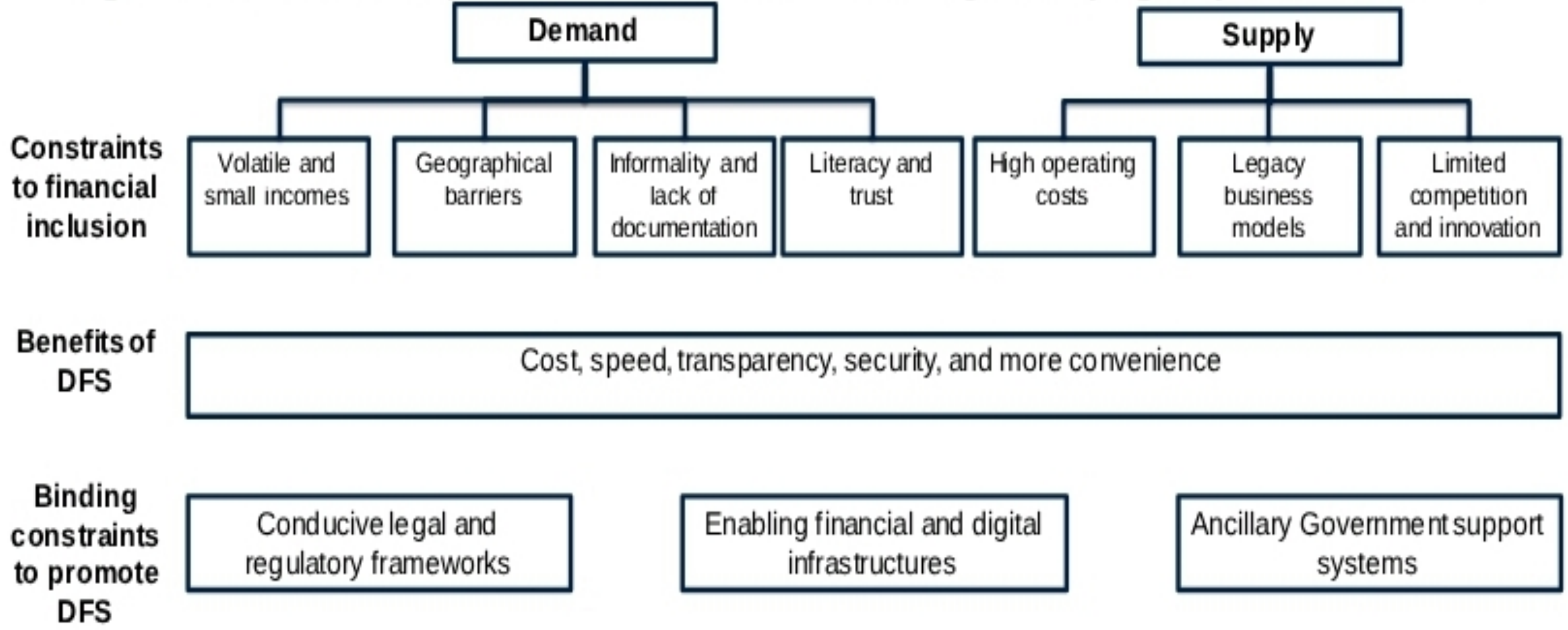
- Financial Inclusion is a Key Enabler to Reducing Poverty and Increasing prosperity
- In a world where access to financial services and high-speed broadband internet is not universal or affordable, fintech can democratize access to finance and the world can move closer to achieving financial inclusion.
- Digital financial services, powered by fintech, have the potential to lower costs by maximizing economies of scale, to increase the speed, security and transparency of transactions and to allow for more tailored financial services that serve the poor.

- **Digital financial services (DFS)** are financial services which rely on digital technologies for their delivery and use by consumers.
- **Fintech** refers to digital technologies that have the potential to transform the provision of financial services spurring the development of new – or modify existing – business models, applications, processes, and products. In practice, the term "fintech" is also broadly used to denote the ongoing wave of new DFS. *Examples of these technologies include* **web, mobile, cloud services, machine learning, digital ID, and Application Programming Interfaces (APIs).**
- A Fintech firm is a new entrant in the financial sector that specializes in offering DFS. Examples of *Fintechs include* **digital payment providers, digital insurers, digital-only banks, and peer-to-peer lending platforms.**

DFS MODELS & FINANCIAL INCLUSION

- **Mobile money.** Mobile technology, along with high phone penetration, M-Pesa in Kenya. **850 million registered mobile money accounts across 90 countries with USD $1.3 billion transacted per day**.
- **Platform eco-systems**. bigtech platforms, such as social media, ecommerce, and ride hailing, have enabled new business models and sparked another wave of DFS by leveraging very large user bases and scale economies. Alibaba's, Alipay, Ride-hailing service Gojek i GoPay. With cloud services and machine learning, the consumer data generated has enabled a further round of DFS innovation for credit, insurance, and savings which can be accessed through a "super app."
- **Open Application Programming Interfaces (APIs)** APIs allow different systems to exchange consumer data and instructions. APIs can be particularly powerful for the poor when they are underpinned by a digital ID system and facilitate interactions between governments, businesses, and citizens.

Figure 1: Constraints to financial inclusion and the development of digital financial services



Demand

Supply

Constraints to financial inclusion

Volatile and small incomes

Geographical barriers

Informality and lack of documentation

Literacy and trust

High operating costs

Legacy business models

Limited competition and innovation

Benefits of DFS

Cost, speed, transparency, security, and more convenience

Binding constraints to promote DFS

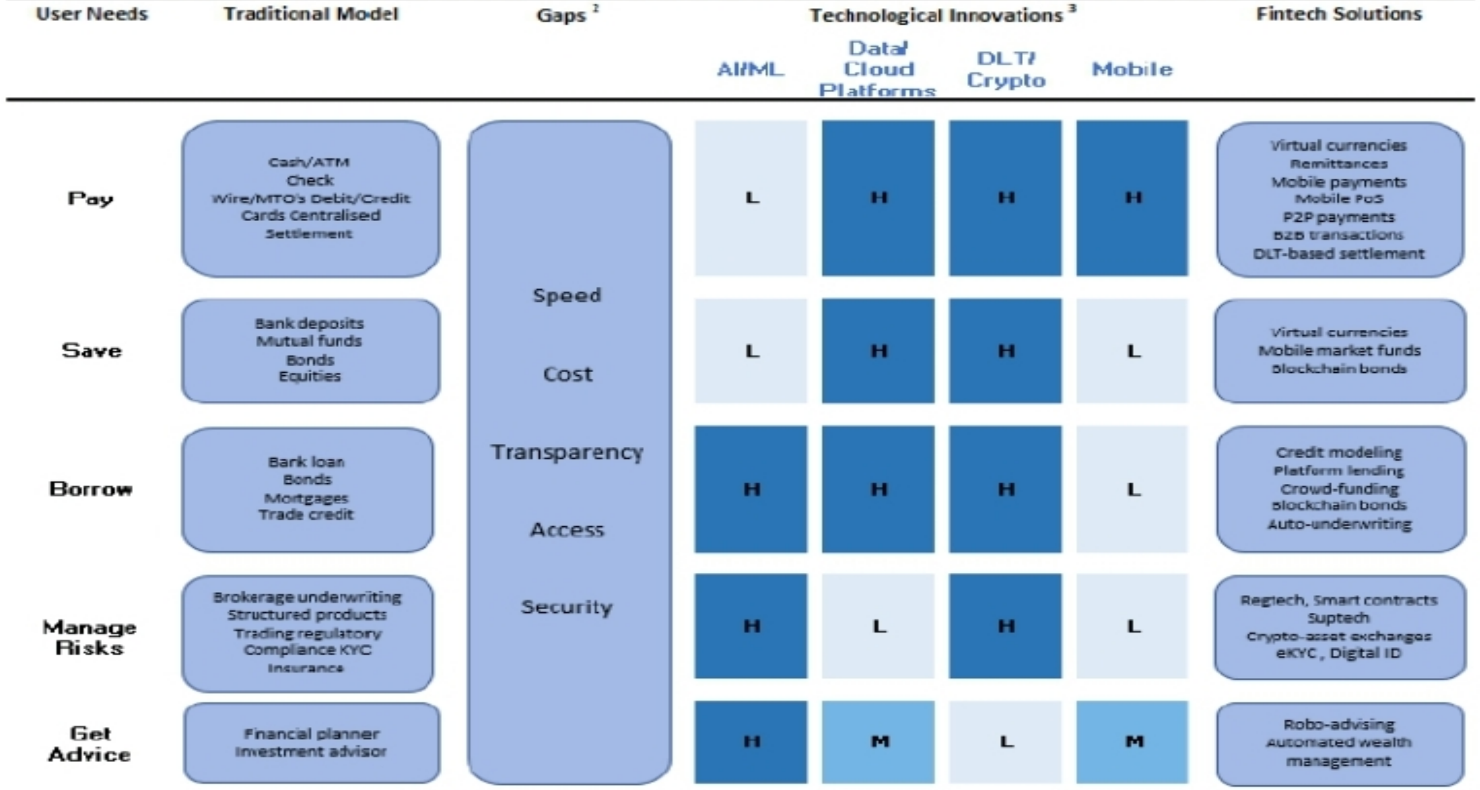
Conducive legal and regulatory frameworks

Enabling financial and digital infrastructures

Ancillary Government support systems

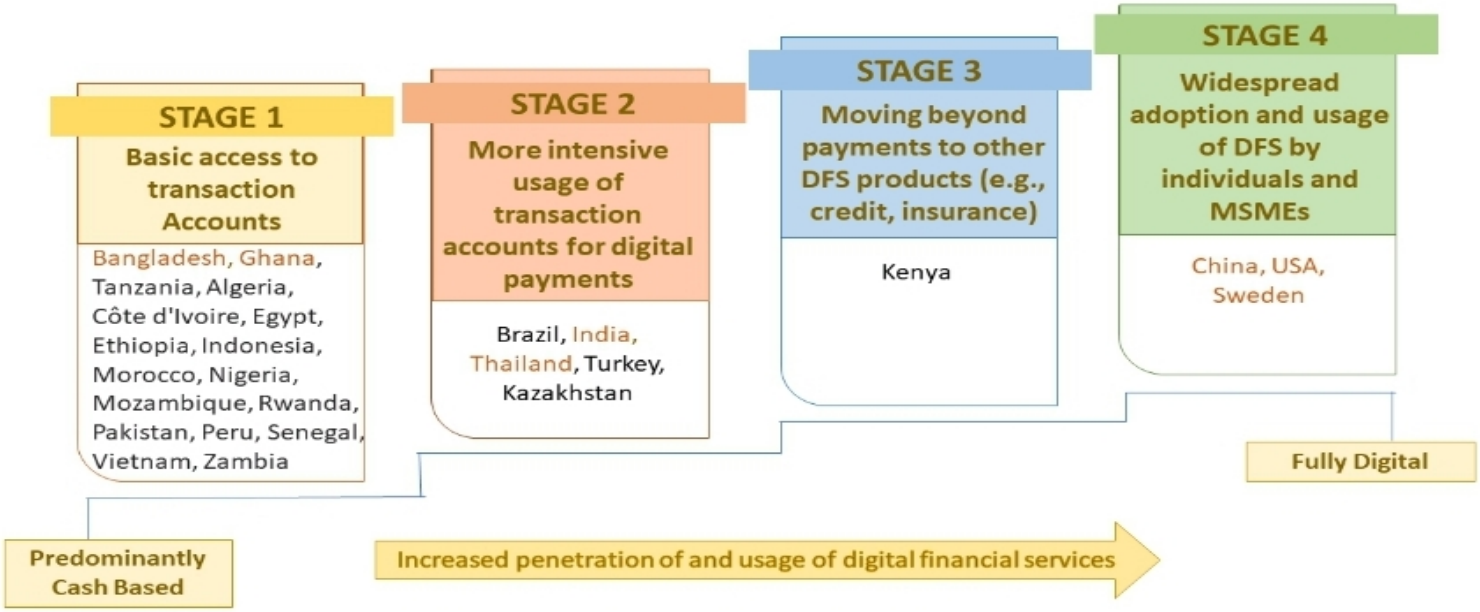
Source: Authors.

Figure 2: Evolution of financial services as a result of digital technologies and new business models



User Needs	Traditional Model	Gaps[1]	Technological Innovations[3]				Fintech Solutions
			AI/ML	Data/ Cloud Platforms	DLT/ Crypto	Mobile	
Pay	Cash/ATM Check Wire/MTO's Debit/Credit Cards Centralised Settlement	Speed Cost Transparency Access Security	L	H	H	H	Virtual currencies Remittances Mobile payments Mobile PoS P2P payments B2B transactions DLT-based settlement
Save	Bank deposits Mutual funds Bonds Equities		L	H	H	L	Virtual currencies Mobile market funds Blockchain bonds
Borrow	Bark loan Bonds Mortgages Trade credit		H	H	H	L	Credit modeling Platform lending Crowd-funding Blockchain bonds Auto-underwriting
Manage Risks	Brokerage underwriting Structured products Trading regulatory Compliance KYC Insurance		H	L	H	L	Regtech, Smart contracts Suptech Crypto-asset exchanges eKYC , Digital ID
Get Advice	Financial planner Investment advisor		H	M	L	M	Robo-advising Automated wealth management

Figure 3: Development stages of Digital Financial Services



STAGE 1

Basic access to transaction Accounts

Bangladesh, Ghana, Tanzania, Algeria, Côte d'Ivoire, Egypt, Ethiopia, Indonesia, Morocco, Nigeria, Mozambique, Rwanda, Pakistan, Peru, Senegal, Vietnam, Zambia

STAGE 2

More intensive usage of transaction accounts for digital payments

Brazil, India, Thailand, Turkey, Kazakhstan

STAGE 3

Moving beyond payments to other DFS products (e.g., credit, insurance)

Kenya

STAGE 4

Widespread adoption and usage of DFS by individuals and MSMEs

China, USA, Sweden

Predominantly Cash Based
Increased penetration of and usage of digital financial services
Fully Digital

Source: Authors.

FINANCIAL EXCLUSION DATA IN NIGERIA

- As at 2008, 53.0% of Adults are Financially Excluded
- The figure reduced to 46.3 % in 2010.
- It further reduced to 39.7% in 2012
- Find next the Zonal Reduction Figures

Source - cbn.gov.ng

- Between 2010 to 2012
- North East, 68.3% to 59.5%,
- North West, 68.1% to 63.8%,
- North Central, 44.2% to 32.4%,
- South East, 31.9% to 25.6%,
- South West, 33.1% to 24.8%
- South South, 36.4% to 30.1%.

POVERTY RATE DATA IN NIGERIA

- As at 2019 40% of Nigerians (about 83 million people) live below Poverty line of 137,430 naira ($381.75) per year.

FINANCIAL INCLUSION

- Financial inclusion is defined as the availability and equality of opportunities to access financial services.
- It refers to a process by which individuals and businesses (most especially vulnerable groups such as weaker sections and low-income groups) can access appropriate, affordable, and timely financial products and services. These include banking, loan, equity, and insurance products.

- **The World Bank (2014)** has defined financial inclusion as the share of households and firms who use financial services.
- **Amidžić et al. (2014)** defined financial inclusion as an economic state where nobody is denied access to primary financial services based on motivations other than efficiency criteria.
- **Demirgüç-Kunt et al. (2013)** conceptualized financial inclusion as the use of formal financial services among different groups that benefit the welfare of many individuals.
- **Sahay et al. (2015)** said that financial inclusion is the access, usage, and delivery of financial services at affordable costs to vulnerable segments of society
- Sarma (2012) gave a comprehensive definition of financial inclusion based on several dimensions including accessibility, availability, and usage of the formal financial system for all members of an economy.

POVERTY ERADICATION – SDG GOAL #1

- Poverty is an amorphous and subjective concept, which is influenced by what people consider to be more valuable in life.
- Poverty reduction, poverty relief, or poverty alleviation, is a set of measures, both economic and humanitarian, that are intended to permanently lift people out of poverty.

FINACIAL INCLUSION & POVERTY ERADICATION

- **Does financial inclusion reduce poverty and income inequality in developing countries?**
- A study conducted by **Md Abdullah Omar & Kazuo Inaba** to **investigate the impact of financial inclusion on reducing poverty and income inequality, and the determinants and conditional effects thereof** in **116 developing countries** using an unbalanced annual panel data for the period of **2004–2016.**

EVANS AND ADEOYE (2016)

- They evaluated the determinants of financial inclusion in Africa by using a dynamic panel data approach for **15 countries** over the period of 2005–2014. The results show that **GDP per capita, money supply as a percentage of GDP, adult literacy rate, internet access, and Islamic banking** activities have great significance in explaining the level of financial inclusion in Africa.

FINDINGS - MD ABDULLAH OMAR & KAZUO INABA

- Per capita real GDP and ratio of internet users positively influence the level of financial inclusion, while age dependency ratio, inflation, and income inequality negatively influence this level.
- There is no evidence of a significant effect of rule of law, population size, and secondary school enrollment ratio on the level of financial inclusion.
- The results show robust evidence that economies with higher financial inclusion significantly reduce poverty rates and income inequality in developing countries
- Effectiveness of financial inclusion depends not only on itself, but also on other conditions in reducing poverty and income inequality.

POLICY IMPLICATIONS

- *1.* Financial institutions should cater innovative and need based formal financial services suited to financially excluded segments of the population as the demand for financial services varies due to differences in culture, customs, beliefs, and income levels.
- 2. *G*overnments, central banks, financial institutions, and development partners should cooperate mutually to develop the financial services infrastructure and upgrade the financial services network in rural and urban areas.
- 3. A concrete time action bound targeted policy on increasing financial literacy in the rural and remote areas is necessary to raise financial awareness and change financial behavior among low-income people.

- 4. *E*fforts should be supplemented by supportive policies like transfer of government subsidy to accountholders for effective use of dormant accounts, as higher rates of inactive accounts are not expanding financial inclusion in a true sense.
- 5. Economies in developing countries must continue to improve per capita income and access to information in order to minimize involuntary financial exclusion of large segments of the population.
- 6. *Finally,* policies should initiate necessary actions regarding specific socio-economic constraints, macroeconomic volatility, institutional inefficiencies, and financial system inefficiencies at country level to promote a more inclusive financial system

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