THE EFFECT OF ISLAMIC MICROFINANCE ON POVERTY ALLEVIATION: STUDY BASED ON EASTERN PROVINCE IN SRI LANKA

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ABSTRACT

Microfinance is recognized as a developmental tool to fight poverty. Islam defines poverty as a state whereby an individual fails to fulfill any of the five basic human requirements of life: Religion, Physical self, Intellect or Knowledge, Offspring and Wealth. Recent studies have shown positive impacts of the microfinance on the income and health of the clients. However, Muslims face the challenges in accepting the conventional microfinance whereby it does not tailor with Islamic commercial law. While the Muslims are restricted the involving in interest based finance, the necessity of Islamic microfinance as an alternative system has been developed for the purpose of extension of the industry to alleviate the poverty. The objective of this study is to examine the relationship of Islamic microfinance on poverty alleviation in Eastern province of Sri Lanka. The study uses five dimensions to examine the impact of microfinance on poverty alleviation. The five dimensions are basic needs, education, health, income and empowerment. The study assumes that if these five variables have positively impacted poverty alleviation, then the poverty is alleviated by Islamic microfinance received. This study utilizes the primary data collected from 273 customers using questionnaires. The data were analyzed using descriptive, correlation, regression analysis and hypothesis testing by SPSS 20.0 software. In addition, the regression model shows that there is positive impact between poverty alleviation and the dimensions of Islamic microfinance (basic needs, education, health, income and empowerment). The finding of this study shows that there is significant relationship between Islamic microfinance and poverty alleviation. This study concludes that Islamic microfinance program statistically helps poor people to uplift their live in Shariah compliant manner. The study recommends that the Islamic microfinance services to be disseminated and started based on Islamic non-profit organization such as Mosques, Zakath or Sadqah foundations, welfare associations, Islamic NGOs and other social service institutions.

Keywords: Microfinance, Islamic microfinance, Poverty alleviation

1. INTRODUCTION

The word microfinance is literally comprised of two words: micro and finance, which literally mean small credit; the concept of microfinance goes beyond the provision of small credit to the poor.” Microfinance is a type of finance that deals with providing financial assistance to the poor and needy people. Microfinance services can be provided by various institutions such as rural banks, cooperatives and Non-Government Organizations (NGOs) (Ali, 2014).Christen (1997) defines microfinance as ‘the means of providing a variety of financial services to the poor based on market-driven and commercial approaches' (Christen R.P., 1997). Based on Christen (1997) definition, Doktoer den Agrarwissenschaften (2007) says "the industry provide micro credit services is not limited to the non-governmental organization micro financial institutions (NGO MFIs) but also include other institutions like financial co-operatives, Savings Associations/Clubs, some welfare associations and the like.

Islamic microfinance (IMF) which is the main focus of this study is an alternative system of microfinance model that is targeted to avoid the elements that are prohibited in Shariah perspective, including interest based credit as well as comply with Shariah principles to alleviate the poverty from the society (Salwana Hassan, 2013). Islamic micro finance is a growing industry in several Muslim countries such as Bangladesh, Nigeria, and Malaysia and Non-Muslim countries such as Kenya and Sri Lanka. Islamic microfinance is at the heart of Islamic finance as it addresses one of the fundamental roles of financial intermediaries demanded by Shariah. Over the past few decades, many initiatives have taken place to alleviate poverty in Muslim countries (Shaheen Mansori, 2015).

The Eastern Province is one of the nine provinces of Sri Lanka, the first level administrative division of the country. The Eastern Province is divided into three administrative districts, 45 Divisional Secretary's Divisions (DS Divisions) and 1,085 Grama Niladhari Divisions (GN Divisions) (Department of Census and Statistics Ministry of Finance and Planning, 2012).

In addition to the conventional microfinance institutions in the research area, a wide range of Islamic microfinance institutions, private Islamic institutions such as Islamic NGOs, mosques and some social institutions are also practicing micro finance. Even though these institutions provide financial services, the province has been suffering from poverty. According to Department of Census and Statistics, Ministry of Finance and Planning (2017), Poverty headcount index and percentage of poor households in eastern province, Sri Lanka has recorded as 7.3%. Surprisingly it is 2nd place out of nine provinces of the country.

Al though some studies are carried on microfinance in Sri Lanka generally, only few them focus the status of Eastern province. Thus, In order to fill this research gap, this study is aimed to investigate on the impact of Islamic microfinance on poverty alleviation in the Eastern Province of Sri Lanka.

2. LITERATURE REVIEW

The term microfinance refers to ''the provision of financial services to low-income clients, including self-employed, low-income entrepreneurs in both urban and rural areas'' (Ledgerwood, 1999). Microfinance played a vibrant role in the economy over the past few years. It is an effective tool to reduce poverty and empower the poor and economically and socially vulnerable segments of society. Microfinance builds financial sectors that are closely interconnected with the local economy by facilitating lending to micro and small enterprises, enabling payment systems and creating new saving opportunities for private households.

Islamic finance is established based on Shariah which prohibits riba'(interest). Riba' is one of the major prohibitions in Islamic commercial law. Thus, the consequence feature of Islamic finance is to provide financial services without the element of interest though the interest is the unavoidable attribute of the conventional financial system' (Ziauddin, 1991).

Microfinance refers to a special arrangement to offer small loans to poor people (especially those traditionally excluded from financial services) although the programmes designed to meet their specific needs and circumstances (Khan, 2008). A.M. Inun Jariya (2013) has found that the Islamic Microfinance was effected positively on poverty alleviation through

Employment creation of the working Area; Income Generation; Change in the standard of living; and Knowledge level increase.

The establishment of micro finance is considered to have had a positive effect on helping people to start new businesses or develop an existing business whereby the clients would have improved housing, education, food consumption, and health care. (Jaenal Effendi, 2013)

The World Bank defines poverty as an "unacceptable human deprivation in terms of economic opportunity, education, health and nutrition, as well as lack of empowerment and security." Greeley (2003) identifies the following dimensions in impact assessment. These would include income, health, education and empowerment benefits. Evidence of thousands of microfinance clients and researches in Sri Lanka demonstrates that access to micro financial services enables poor people to increase its dimensions of basic needs, household income, education, health, and empowerment by reducing their vulnerability to the crises that are so much a part of their daily life.

The poverty can be classified into three categories. Extreme poverty is the most severe state of poverty, where people cannot meet their basic needs for survival, such as food, water, clothing, shelter, sanitation, education and health care. Eradication of extreme poverty and hunger by 2015 is a Millennium Development Goal set by United Nations Organization (UNO). To determine the number of extreme poor people around the world, the World Bank characterizes extremely poverty as living on the daily income of US $1 or less. It has been estimated that around 1.1 billion people currently live under these conditions (Mohammad Arifujjaman Khan; Mohammed Anisur Rahaman, 2007).

Moderate poverty: It indicates the condition where people earn about $ 1 to $2 a day, which enables households to just barely meet their basic needs, but they still have gone for many of the other things – education, health care –that many of us take for granted (Mohammad Arifujjaman Khan; Mohammed Anisur Rahaman, 2007). Relative Poverty: It means that a household has an income below the national average income (Mohammad Arifujjaman Khan; Mohammed Anisur Rahaman, 2007)**.**

Sri Lanka uses Official Poverty Line (OPL), which was established by the Department of Census and Statistics (DCS) to measure poverty. The value of the OPL is based on Household Income and Expenditure Survey data. OPL, which was established in 2004, was Rs. 1,423 (real total expenditure per person per month) is updated for the inflation of prices through the Colombo Consumer Price Index (CCPI) calculated monthly by the DCS. According to the average price index values adjusted for Household, Income and Expenditure Survey (HIES) survey months, DCS publishes Headcount index for each survey period. The current value of the OPL is Rs. 4,166 per person per month for 2016 (Department of Census and Statistics, Ministry of Finance and Planning, 2017).

3. PROBLEM STATEMENT

Poverty is ranked in 2nd place in Eastern province of Sri Lanka. The conventional microfinance has played a vital role in poverty alleviation among the poor (Doktor der Agrarwissenschaften, 2007). The conventional microfinance is structured with small interest. Islamic microfinance is designed to save poor with limited funds such as *Sadakah* (Charity), *waqf* (endowment) and other capital and with limited products such as *Waqf,* cash waqf, *murabah, Qard Hassan*) which have challenges in recovery process in microfinance without proper securities Kazim & Haider, 2012). However, Islamic microfinance shows the successful remark in Malaysia and Indonesia (Alpay, S. & Haneef, MH. 2015).

Therefore, this study intends to identify the impact of Islamic microfinance on poor rural household income, and poverty alleviation in the Eastern province of Sri Lanka.

4. OBJECTIVE

The main objective of the study is to examine the relationship of Islamic microfinance on poverty alleviation in Eastern province of Sri Lanka.

The secondary objectives of this study are:

- To identify the factors which are effected by Islamic Microfinance in order to alleviate the poverty of the poor people in the eastern province of Sri Lanka.
- To present evidence of the important contributions made by Islamic microfinance in the eradication of poverty by increasing the income generating activities, empowerment of poor people to access development services such as health and education, and reduction in vulnerability.

5. RESEARCH QUESTION

In the light of the problem, background leads to the following problem statement, which is also be the overarching question/statement for this investigation:

RQ1: Does the Islamic Microfinance Effect on Poverty Alleviation among the people of eastern province?

RQ2: What dimensions are effected by Islamic Microfinance in order to alleviate the poverty?

6. FORMULATION OF CONCEPTUAL FRAMEWORK

The study uses independent variables to examine the impact of microfinance on poverty alleviation among Islamic microfinance participants. The study assumes that if these five variables have positively impacted a participant of Islamic microfinance, then the poverty is reduced by Islamic microfinance received.

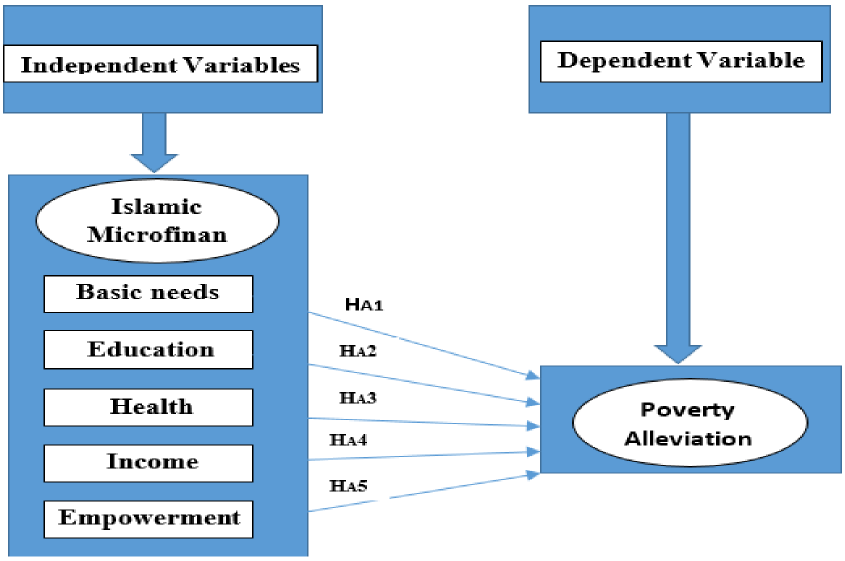

Figure 1 : Conceptual Framework
(Source: Derived from the definition of Dan Matovu, 2006)

7. HYPOTHESIS DEVELOPMENT

On the basis of the conceptual framework, these hypotheses were developed:

H_0: There is no relationship between Islamic microfinance and Poverty alleviation.
H_A: There is a relationship between Islamic microfinance and Poverty alleviation.

- **H_{A1}:** There is a relationship between Basic needs and Poverty alleviation.
- **H_{A2}:** There is a relationship between Education and Poverty alleviation.
- **H_{A3}:** There is a relationship between Health and Poverty alleviation.
- **H_{A4}:** There is a relationship between Income and Poverty alleviation.
- **H_{A5}:** There is a relationship between Empowerment and Poverty alleviation.

8. METHODOLOGY

Research methodologies of the present study are outlined below.

8.1. Population & sample selection

For this study, the Purposive sampling technique was adopted. Purposive sampling is a sampling technique in which Researchers relies on his or her own judgment when choosing members of thepopulation to participate in the study. Purposive sampling is a non-probability sampling method and it occurs when "elements selected for the sample are chosen by the judgment of the Researchers. Researchers often believe that they can obtain a representative sample by using a sound judgment, which will result in saving time and money" (Black, 2010). Alternatively, a purposive sampling method may prove to be effective when only limited numbers of people can serve as primary data sources due to the nature of research design and aims and objectives.

This sampling technique is justifiable because this study focused on the participants who use Islamic microfinance services more than 6 months, and they are limited numbers of people can serve as primary data sources due to the nature of research design and aims and objectives, because the purposive sampling may be the only appropriate method available if there are only limited number of primary data sources who can contribute to the study. A sample was taken from three hundred (300) questionnaires, distributed to participants involved in Islamic microfinance in the Eastern Province in Sri Lanka. The questionnaire distributes between 3 districts of Eastern Province in Sri Lanka. The sample size selection was distributed below.

District	Sample size
Ampara	100
Batticaloa	100
Trincomalee	100
Total	300

Table 1: Sample Size

8.2. Data & data collection method

A structured questionnaire was used to obtain primary data. A Data-collection method was employing the questionnaire survey method. In this study primary source was used for the data collection. A well-designed questionnaire was used for the study. The questionnaire was designed to gather the data. It consists of three parts A, B, and C.

Part – A, it deals with demographic characteristics such as gender, age, number of family members, education, marital status, occupation, and duration with the Islamic microfinance activities.

Part – B, it consists 22 statements to measure the effects of Islamic microfinance. Five dimensions such as Basic needs, Income, Education, Health, and empowerment are considered for measurement of service quality.

Part- C, it consists of 6 statements to measure the poverty level influenced by Islamic microfinance.

By including variables, questionnaire was prepared with five-point Likert- scaling system. A five-point Likert scale ranging from "Strongly agree = 5" to "Strongly disagree = 1"

8.3. Data analysis

Descriptive statistics were allowed to present the data acquired in a structured, accurate and summarized manner (Huysamen, 1994). This study was employed the descriptive statistics such as frequency distribution in order to assess the demographic profile of the respondents. This study was carried out a quantitative research and this involved some quantitative analysis with the use of statistical tools (Descriptive). This study was used the Statistical Product for Social Solutions (SPSS) version 20 for the analysis of data for descriptive statistics mainly involve the mean, and standard deviation in the data analysis. The mean is the average of the sum of all values which is representative of a distribution with several distinct variables that cannot be activated exclusively. Standard deviation seeks to measure the average amount of variability in a set of scores between values and measures. Researchers primarily focuses on that factor to measure poverty alleviated by Islamic microfinance. This study used Pearson correlation analysis to identify the association between poverty alleviation (Depended Variable) and the independent variables (Basic needs; Education; Health, Income, and Empowerment) as well as regression analysis to estimate the causal relationship.

8.4. Validity and Reliability

This section presents the precision methods for this kind of study; meanwhile the test for precision methods used for this study will come in the results section. According to Agresti & Finlay (2009) a measure should have both validity and reliability. That is describing what it is intended to measure and accurately reflecting the concept; being consistent in the sense that a subject will give the same response when asked again. Agresti & Finlay (2009) this is for sure and in contradiction with another author's idea Hopkins (2001), who suggested validity for descriptive study and reliability for experimental study. I.e. because validity represents how well a variable measure what it is supposed to measure and it is good in descriptive studies, while reliability tells one how reproducible the measures are on a retest so good in experimental studies (Hopkins, 2001). The choices of presenting the precision with which things were measured in this study is expressed in terms internal reliability, external and construct validity. Following the design type for this study, only internal reliability could be measured using Cronbach's alpha. Cronbach's alpha coefficient varies from 0 to 1 with 1 indicating perfect reliability and 0 no internal reliability; 0.80 denotes an acceptable level of internal reliability. (Bryman & Bell, 2003). Another author added that if the Cronbach's alpha coefficient is greater than 0.9 it implies excellent, greater than 0.8 is Good, greater than 0.7 is acceptable, greater than 0.6 is questionable, greater than 0.5 is poor, and less than 0.5 is unacceptable" (George & Mallery, 2003).

9. DATA ANALYSIS AND PRESENTATION

The collected data are calculated and verified according to the mathematical formulas; Microsoft Excel software and SPSS software are presented and analyzed with tables. Those tables are helpful for testing the correlation, hypothesis and regression analysis to come across a precise conclusion.

9.1 Instrument reliability

Four different points of reliability were suggested by Hinton et al., (2004), Excellent Reliability (0.90 and above), High Reliability (0.70 – 0.90), High Moderate Reliability (0.50 – 0.70) and Low Reliability (0.50 and below). The reliability test was done to measure the consistency of the data that were collected. The number of cases included for the test was 273. The Basic Needs construct scored the alpha value of 0.871, Education constructs scored a value of 0.818, Health constructs scored an alpha value of 0.865, Income scored alpha value of 0.868, The Empowerment constructs earned 0.851 and the Poverty Alleviation scored alpha value of 0.890. The Cronbach's Alpha value for each construct in this study is shown in Table 2.

Scale	No. of items	Cronbach's Alpha	Type
Basic Needs	5	0.871	High Reliability
Education	4	0.818	High Reliability
Health	4	0.865	High Reliability
Income	5	0.868	High Reliability
Empowerment	4	0.851	High Reliability
Poverty Alleviation	6	0.890	High Reliability

Table 2: Instrument Reliability

These values show that, the constructs achieved High Reliabilities, according to Hinton's cutoff points of reliability. The high Cronbach's alpha values means that constructs were internally consistent and the reliability of the same construct is measured (Field, 2005) and the alpha values indicated that the study's instrument and data were reliable.

9.2 Descriptive statistic

Reviewing the descriptive statistics presented in the following table shows that mean, median and SD values lie within the acceptable range.

S/N	Dimensions	Mean	Median	Std. Deviation
01	Basic Needs	3.98	4.00	.734
02	Education	3.79	3.75	.723
03	Health	3.78	3.75	.764
04	Income	3.76	3.80	.780
05	Empowerment	3.89	4.00	.739
06	Poverty Alleviation	4.06	4.17	.715

Table 3: Measures of Descriptive Statistic
(Sources: Survey Data)

Totally 273 data are included to calculate the above mentioned value for variables. Mean, median and Standard deviation of basic needs are 3.98, 4.00 and 0.734 respectively. The Mean, median and Standard Deviation of education are 3.79, 3.75 and 0.723 respectively. The

Mean, median and Standard Deviation of health are 3.78, 3.75 and 0.764 respectively. The Mean, median and Standard Deviation of income are 3.76, 3.80 and 0.780 respectively. The Mean, median and Standard Deviation of empowerment are 3.89, 4.00 and 0.739 respectively. Finally, poverty alleviation is a dependent variable of the study. Its mean value is 4.06 and median and standard deviation are 4.17, 0.715 respectively.

According to the above-mentioned descriptive statistics for all dimensions, it is notable that the respondents have agreed that the Islamic microfinance has effected positive on basic needs, education, health, income and empowerment. Finally, they have strongly agreed that the program has overall contributed to alleviate the poverty.

9.3 Correlation

The correlation of this study is aimed to evaluate and examine the (positive or negative) relationship between selected variable and describes the relationship between Islamic microfinance services and poverty alleviation among its participants in Eastern province, Sri Lanka.

		Poverty Alleviation	Basic Needs	Education	Health	Income	Empowerment
Poverty Alleviation	Pearson Correlation	1	.735**	.748**	.748**	.828**	.805**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N	273	273	264	273	273	273
Basic Needs	Pearson Correlation	.735**	1	.769**	.760**	.706**	.740**
	Sig. (2-tailed)	.000		.000	.000	.000	.000
	N	273	273	264	273	273	273
Education	Pearson Correlation	.748**	.769**	1	.779**	.747**	.744**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	264	264	264	264	264	264
Health	Pearson Correlation	.748**	.760**	.779**	1	.744**	.774**
	Sig. (2-tailed)	.000	.000	.000		.000	.000
	N	273	273	264	273	273	273
Income	Pearson Correlation	.828**	.706**	.747**	.744**	1	.814**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	273	273	264	273	273	273
Empowerment	Pearson Correlation	.805**	.740**	.744**	.774**	.814**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	273	273	264	273	273	273

**. Correlation is significant at the 0.01 level (2-tailed).

Table 4: Correlation matrix

9.4. Result of Correlation Analysis

R & P Value	Research Hypothesis	Results
R = 0.862 P = 0.000	H_A: There is a relationship between Islamic microfinance and Poverty alleviation	Significant
R = 0.735 P = 0.000	H_{A1}: There is a relationship between Basic needs and Poverty alleviation	Significant
R = 0.748 P = 0.000	H_{A2}: There is a relationship between Education and Poverty alleviation	Significant
R = 0.748 P = 0.000	H_{A3}: There is a relationship between Health and Poverty alleviation	Significant
R = 0.828 P = 0.000	H_{A4}: There is a relationship between Income and Poverty alleviation	Significant
R = 0.805 P = 0.000	H_{A5}: There is a relationship between Empowerment and Poverty alleviation	Significant

Table 5: The Summarized Correlation Results

The above data shows that, there is significant strong positive relationship between Islamic microfinance and poverty alleviation. So, Hypothesis H_A supported. There is significant strong positive relationship between Basic needs and Poverty alleviation. Hypothesis H_{A1} supported. There is significant strong positive relationship between Education and Poverty alleviation. So, Hypothesis H_{A2} supported. There is significant strong positive relationship between Health and Poverty alleviation. Hypothesis H_{A3} supported. There is significant strong positive relationship between Income and Poverty alleviation. So, Hypothesis H_{A4} supported. Finally, there is significant strong positive relationship between Empowerment and Poverty alleviation. So, Hypothesis H_{A5} supported respectively.

9.5 Results of Regression Analysis

Independent Variable	R Square	Simple Linear Regression
Basic Needs (BN)	0.540	PA = 1.204 + 0.716 BN
Education (Ed)	0.559	PA = 1.215 + 0.745 Ed
Health (H)	0.559	PA = 1.413 + 0.700 H
Income (I)	0.685	PA = 1.206 + 0.759 I
Empowerment (Em)	0.648	PA = 1.022 + 0.799 Em

Table 6: The summarized regression results

The above table shows that there is a linear relationship exist between Basic needs and Poverty alleviation while $r^2 = 0.540$ suggests that 54% of the variance in poverty alleviation can be explained by the basic needs. If a unit of Basic Needs (BN) increases, then Poverty Alleviation (PA) will increase by 0.716. There is a linear relationship exist between Education and Poverty alleviation while $r^2 = 0.559$ suggests that 56% of the variance in poverty alleviation can be explained by the education. If a unit of the Education (Ed) increases, then Poverty Alleviation (PA) will increase by 0.745. There is a linear relationship exist between Health and Poverty alleviation while $r^2 = 0.559$ suggests that 56% of the variance in poverty alleviation can be explained by the health. If a unit of the Health (H) increases, then Poverty Alleviation (PA) will increase by 0.700. There is a linear relationship exist between Income and Poverty alleviation while $r^2 = 0.685$ suggests that 69% of the variance in poverty alleviation can be explained by the income. If a unit of Income (I) increases, then Poverty

Alleviation (PA) will increase by 0.759. There is a linear relationship exist between Empowerment and Poverty alleviation while $r^2 = 0.648$ suggests that 65% of the variance in poverty alleviation can be explained by the empowerment. If a unit of Empowerment (Em) increases, then Poverty Alleviation (PA) will increase by 0.799.

10. CONCLUSION & RECOMMENDATIONS

According to data analysis, the variables that explain the poverty alleviation indicate Islamic microfinance strongly support for poverty alleviation in the eastern province of Sri Lanka. This is because of the correlation relationship (r = 0.862) proves that the poverty can be alleviated by Islamic microfinance around 74% (0.8622). According to identified factors of the study, it is notable that the respondents have agreed that the Islamic microfinance has effected positive on basic needs, education, health, income and empowerment in order to alleviate the poverty. Finally, they have strongly agreed that the program has overall contributed to alleviate the poverty. Accordingly, Islamic microfinance program statistically helps to poor people to uplift their lives which lead to the poverty alleviation in the eastern province of Sri Lanka.

Based on findings and conclusion, the following recommendations are put forward in order to improve more operations and services of Islamic microfinance institutions (IMFI) based on the information collected from the participants of IMFIs in the eastern province of Sri Lanka.

1) In the research area, there are so many INGOs provide their services to the poor people in purpose of building walls, toilets and mosques. This study suggests to such INGOs to restructure their activities based on Islamic microfinance services, which enable the poor people to possess resources to generate incomes and share the profit with INGOs. It will benefit to the clients by getting micro credit based on Islamic principle.

2) Most of the poor people do not have enough knowledge to develop their business. Therefore, a special campaign should be developed after giving the loan. Otherwise, these people lose the capital, which borrowed from an Islamic microfinance institution or fail to earn profit. Both of them lead the sector to collapse.

3) Islamic microfinance institutions should develop a mechanism to monitor and control the borrowed money to purchase unnecessary things as well as to avoid multiple loans received by the beneficiaries. Because, when the poor people receive micro loans from several places, then it can become a burden for settling it.

4) The issue, which was found during the data collecting process is getting the loan from Islamic microfinance institutions, is very difficult. It takes a long time and the people have to fill more documents and perform more procedures. Therefore, it should be remarkable to set up a good system and make it easy.

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