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Research Article

Challenges And Risks In Ghana's Microfinance Sector: Is The Islamic Alternative Any Better?

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Abstract. Ghana fares well on some indicators of financial inclusion compared to other Sub-Saharan African countries, and is comparable to lower middle-income countries. However, it lacks a clear strategy for financial inclusion and development of microfinance institutions (MFIs) and other methodologies of making financial services more widely available. This paper summarizes the situation and development of microfinance institutions in Ghana, reviews progress and problems in implementing the BoG regulations for MFIs, highlights current risks and challenges, and proposes strategies for mitigating risks. The analysis includes three different levels: BoG and Government of Ghana (GoG); MFIs and their associations; and the public. It is aimed at providing information on the complex issues in the microfinance sector as a basis for dialogue on concrete reforms.

Keyword: Challenges, risks, Microfinance, Ghana, Islam

INTRODUCTION

According to Rahman et al. (2015), Microfinance entails the provision of microcredit, insurance, remittances, health, education, skill training and social awareness to the poor who are traditionally excluded by formal financial intermediaries. Lorenzetti et al. on the other hand (2017), looked at microfinance as a platform designed to assist poor families, especially females, to enhance their role in productive activities, improve their economic and material well-being, decrease vulnerability to financial shocks, and smooth consumption.

Juxtaposing the above definitions with that of Islamic microfinance, one may state that Islamic microfinance is the confluence of Islamic financing principles and the concept of financial inclusion. Commonly used are cost-plus sales (Murabaha), interest-free loans (Qard Hassan), but also forward sales (Salam and Ististna'a) and leasing (Ijara).

The role of a Microfinance Institution in the Ghanaian economy also cannot be overemphasized. Microfinance has a direct and positive effect on the financing of Small and Medium Enterprises. They are the major financial institution that provides SMEs with loans in Ghana and other training facilities (Ussif and Ertugrul, 2020). This is not to say that Microfinance Institutions are not confronted with challenges in their operations. In fact, the challenges faced by the microfinance sector have so far prevented the microfinance sector to reach or achieve its goal of reducing poverty in Ghana. The objective of this article is not to investigate the internal and external challenges of a microfinance institution in Ghana, but to rather discuss the role of Islamic microfinance as an alternative to both the internal and external challenges of microfinance institutions in Ghana. The Islamic dimension will help us to explore how to overcome the challenges the institutions faced, and to examine the prospects/opportunities of microfinance institutions in Ghana from the lenses of Islam.

Review of Existing Literature

The current study therefore adopted a desk-based and library-oriented research. The researchers studied the Holy Qur'an, Sunna, available published literatures, research monographs, journals and magazines in this field in order to develop the traits as well as a model of microfinance from the perspective of Islam. The study has been structured in the light of the research objectives. Various literatures were therefore reviewed.

Research conducted by Zeller & Meyer (2002) indicates that microfinance is simply understood to be the financial service provided to the active poor, responding to their demands and needs for these types of services. It emerged as an efficient mechanism of providing financial services to poor people who usually do not fit in the traditional/standard banking system due to the fact that their

savings and loan demand was small, and that they also lacked loan collateral security.

Adjei (2010) in their study concluded that the challenges that microfinance industries are facing in not only Ghana but other developing countries too include: the problem of capacity building. Lack of adequate infrastructure, poor and inefficient delivery of credit and credit management, and ineffective gathering of information and information dissemination, and poor monitoring, regulating, and supervising.

Similarly, Asiama and Osei (2007) argued that "aside from a year of public offering, direction and provision of small loans/microcredit program, players' new entry, the issuing of credits is insufficient". They list some challenges of the institutions which directly or indirectly affect the subsector's ability and capability to perform efficiently as undercapitalization, poor management, ineffective regulatory framework and supervisory.

However, Andah (2008) in their study of MFIs challenges in Ghana concluded that, management funds diversion, lack of capital, constant changes of policies by government, operational and transaction costs high, high default rates, lower capacity building, low or lack of technical skill within the sector as problems and challenges to the growth and success microfinance sector. Andah argued that some of these constraints are the challenging factors that contributed to the unsustainability of past schemes and programs and currently, still affecting microfinance scheme in the country.

RESULTS AND DISCUSSION

The Case of Islamic Microfinance

As indicated earlier, microfinance is a key process used to achieve financial inclusion ranging from "soft" interventions such as financial literacy education and business development support to "hard" interventions such as the provisions of loans, savings, insurance, and money transfers for entrepreneurs, small businesses, and individuals who lack access to traditional banking services. Some of these descriptions under the Islamic Microfinance Institutions (IMFIs) are somewhat different.

It has been established that the conventional microfinance institutions have not been able to salvage the situation of Microfinance Institutions in Ghana. One of the reasons is that conventional microfinance institutions still operate with an interest system, which is prohibited in Islamic teachings because it is part of usury.

In addition, there are still elements that are forbidden in microfinance institution transactions such as maysir (gambling) and gharar (uncertainty).

So, the presence of Islamic microfinance institutions is expected to be a solution for the Ghanaian problem, especially Muslim communities, where many of them are still below the poverty line.

Islamic microfinance institutions operate by applying the values of Islamic teachings. These values include monotheism, the application of Shariah maqasid, prohibition of usury, upholding justice, eliminating injustice, and eliminating elements of gambling in financial transactions. The existing contracts at Islamic microfinance institutions consist of buying and selling based contracts (bai' al-murabahah), business cooperation-based contracts (al-musharakah, al-mudharabah), lease-based contracts (al-ijarah), and loan contracts, pure without interest (qardh-hasan).

IMFIs typically use "financing" instead of "loan" in order to be fully Shari'a compliant. "Loan" denotes the presence of interest, but Islamic offerings are sales or partnerships. However, different institutions approach this issue with varying sensitivity, depending on corporate culture and environment.

Just as the global Islamic Banking and Finance (IBF) industry struggles with a lack of scholars equally educated in theology and finance who can craft more uniform regulatory and accounting standards, so are microfinance clients often similarly unfamiliar with what makes Islamic Microfinance Islamic, especially beyond the absence of riba.

For IMFIs, Shari'a compliance is the paramount duty; the "Islam" of the enterprise resides in faithful attention to Shari'a. By contrast, poor clients have a more complex relationship to the Islam of Islamic microfinance.

The Way Forward

As an effective alternative to conventional micro-financing in Ghana, Islamic micro-financing institutions (IMFIs) are evolving in different countries as well. Some of the elementary differences between IMFIs and conventional MFIs as pointed out by Ahmed (2012) are discussed below. These could help stabilize the vacuum created by conventional banking systems in Ghana:

1. Sources of Funds: Unlike the conventional Microfinance that depend on interest free or low interest foreign aid, Islamic Microfinance Institutions may collect funds from religious contributions through the institutions of Awqaf, Zakat, and other charities. Zakat is an Islamic financial term. As one of the pillars of the faith, it requires all Muslims to donate a portion of their wealth to charity. Muslims must meet a certain threshold before they can qualify for zakat. The amount is 2.5% or 1/40 of an individual's total savings and wealth. On the other hand, **waqf** (Awqaf) is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes.

2. Modes of Financing: Islamic Microfinance has a diverse mode areas of financing. Apart from interest-free loans (Qard-Hasan), the principles of Islamic financing can be broadly classified as partnerships (Shirakat) and exchange contracts (Mu'awadat).

Basic Islamic Microfinance Contracts

- a) **Non-Profit-and-Loss Sharing Modes:** Non-profit-and-loss sharing modes can include different transaction modes such as:
 - 1) Bay'-mu'ajjal: is a mode of deferred sale in which the object of the sale is delivered at the time of the contract but the price is paid later. The price can also be paid in future instalments.
 - 2) Murabaha: is a special type of financial transaction, in which the Islamic Microfinance buys a good or asset and sells it to the client at a mark-up. The client pays for the good or asset at a future date or in instalments.
 - 3) Ijarah: is similar to a conventional leasing contract in which the client uses an asset by paying rent.
 - 4) Ijarah wa iqtina': is similar to a hire-purchase scheme or a lease purchase scheme in which the instalment includes rent as part of the price. When the instalments are fully paid, the ownership of the asset is transferred to the client.
- b) **Profit and loss sharing Modes:** Among different profit and loss sharing modes, the following are most commonly applied:
 - 1) Musharaka: is an equity participation mode of contract where the financier provides both equity and entrepreneurial skills on a project and thus shares profit or loss on a fixed proportion. The Musharakah principle can be used in production (agricultural and non-agricultural). Islamic Microfinance can provide part of the financial capital to produce an output and in return receive a share of the profit.
 - 2) Mudarabah: Production undertaken under the Mudarabah principle implies that the Islamic Microfinance provides financing and the client manages the project.
 - 3) Muzara'ah: is an output-sharing contract specifically for agricultural production where the bank may provide funding for the purchase of irrigation equipment, fertilizers, which the landowner uses on his land to cultivate a certain crop.

CONCLUSION

It can therefore be concluded that, Islamic microfinance business models are still being developed and no performance benchmarks have been established. However, two areas are of particular importance: operational efficiency and risk management.

- a) **Operational efficiency:** Operational efficiency is key to providing affordable financial services to the poor. Managing small transactions is expensive, and MFIs must innovate to reduce transactions costs. In murabaha or ijara transactions, the provider of funds purchases a commodity (such as equipment or inventory) and resells or leases it to the user with a markup. Islamic MFIs may benefit from cheaper prices on the wholesale market, but the costs associated with purchasing, maintaining, selling, or leasing a commodity (such as a sewing machine) are expensive, and the added costs are often passed on to clients. However, some institutions have cut their costs in murabaha transactions by requiring the end user to search for and identify the desired commodity. Islamic institutions should consider developing similarly novel techniques and practices to minimize costs and offer more attractive pricing to their clients.
- b) **Risk management:** Risk management is another important factor to building sustainable institutions. The conventional microfinance industry has developed a set of good practices to manage credit risk, and MFIs boast excellent portfolio quality. Conventional MFIs generally do not secure loans through collateral but instead rely on peer pressure and strict discipline for collection. Such techniques should be adapted to comply with the risk-sharing, and no-interest principles embedded in Islamic finance. For example, some suggest that pressure from the religious community and appeals to a sense of religious duty should complement reliance on peer pressure.

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