THE POTENTIAL USE OF *QARḌ ḤASAN* IN ISLAMIC MICROFINANCE[1]

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I. INTRODUCTION

Microfinance is an important tool in alleviating poverty from society. A microfinance institution will be considered successful if there is development in the society as a result of the services provided by the institution. There are generally two main schools of thought with regard to the objectives of microfinance institutions, namely "Institutionist" and "Welfarist". According to the "Institutionist" School, a microfinance institution should aim to increase its business and operation size. The bigger it grows, the greater will be its access to the poor. It should ensure the recovery of the loans advanced to borrowers through the use of collaterals. The growth, profitability, and sustainability of the microfinance institution are considered the key indicators of success and achievement of the objectives. Nonetheless, this approach is strongly criticized by the "Welfarist" School whose adherents believe that there is a significant difference between institutional growth and societal development; and that the former should not be taken as an indicator of the latter. While institutional growth is argued to be more related to the development of the institution itself, the level of societal development achieved

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1 This paper was presented at the Malaysian Finance Association (MFA) conference, 2013 under the title "*Qard Al Hasan* Based Microfinance: The Way Forward to Eradicate Poverty". In the current version of the paper, the critical comments have been incorporated and revisions have been made.

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is to be observed in the society. Therefore, if the institution is not growing and is not sustainable per se, yet it is bringing a positive change in society then, according to the Welfarists, this should be taken as a measure of success. Accordingly, improvement in the overall welfare of the poor is argued to be the real indicator of success of a microfinance institution.

It is observed that the Welfarist approach is similar to that adopted under the Islamic moral economy framework, which likewise targets the welfare of the disadvantaged classes in society. The institutions of *zakāh* (poor due), Bayt al-Māl (state treasury) and *waqf* (endowments) are a manifestation of the means prescribed by Islam to achieve this objective. However, there is another important tool for fulfillment of this objective: *qarḍ ḥasan* (benevolent loan). This has been mentioned in the Qur'ān and further emphasized in the Sunnah of the Prophet (peace be upon him) and by *ijmāʿ* (consensus). It is a contract that can significantly help in poverty alleviation and financial inclusion.

II. RESEARCH OBJECTIVES

In this paper, the use of *qarḍ ḥasan* – as compared to other Sharīʿah-compliant contracts – is proposed as a viable alternative for the eradication of poverty through Islamic microfinance. This mode of financing is not only consonant with the precepts of the Sharīʿah; it is also expected to enhance the reputation of the Islamic finance industry by providing a workable alternative to conventional measures for improving the economic status of the society, especially in poor countries. Microfinance seekers would also prefer this contract as it is free from any extra interest payment to be made to the lender, thus being relieved from an additional financial burden being imposed onto them. Moreover, they would prefer to receive cash loans and buy what they need on their own, instead of having the microcredit institution buying the commodity on their behalf and then selling it to them at a higher price which embeds an element of profit.

This paper accordingly highlights the salient features of *qarḍ ḥasan* and the practicality of using it in Islamic microfinance in the context of the current conventional financing infrastructure that lacks the morality, ethics and social justice of Islamic finance.

III. RESEARCH METHODOLOGY

This study draws from the qualitative research approach to discuss the importance of *qarḍ ḥasan* in the Islamic financial system. It also presents a brief case study of Akhuwat Foundation to examine how *qarḍ ḥasan* based microfinance can be both successful as well as sustainable in practice.

IV. *QARḌ ḤASAN* AS A SOURCE OF FINANCING FOR THE POOR: EVIDENCE FROM THE SHARĪʿAH

Qarḍ ḥasan can be defined as the provision of loans to those who are in need without charging any explicit or implicit rate of interest, the intention being to seek a reward from God. There are approximately five verses in the Qur'ān in which the term *qarḍ ḥasan* has been used as one of the best forms of mutual help. The first verse states:

مَنْ ذَا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ وَلَهُ أَجْرٌ كَرِيمٌ

> "Who will make God a good loan? He will double it for him and reward him generously." (Qur'ān 57:11)

It is evident that the Creator does not need the help of human beings; but He made helping other human beings (in the form of *qarḍ*) equal to helping Him, for which He promises a high reward.

Another verse states:

وَقَالَ اللَّهُ إِنِّي مَعَكُمْ لَئِنْ أَقَمْتُمُ الصَّلَاةَ وَآتَيْتُمُ الزَّكَاةَ وَآمَنْتُمْ بِرُسُلِي وَعَزَّرْتُمُوهُمْ وَأَقْرَضْتُمُ اللَّهَ قَرْضًا حَسَنًا لَأُكَفِّرَنَّ عَنْكُمْ سَيِّئَاتِكُمْ وَلَأُدْخِلَنَّكُمْ جَنَّاتٍ تَجْرِي مِنْ تَحْتِهَا الْأَنْهَارُ

> "And Allah said: 'I am with you: if you keep up the prayer, pay the prescribed alms, believe in My messengers and support them, and lend Allah a good loan, I will wipe out your sins and admit you into Gardens graced with flowing streams." (Qur'ān 5:12)

Again, this act of benevolence towards other fellow beings has been termed as "lending to Allah a good loan". The third verse, as the previous two, promises a multifold reward for generous creditors:

إِنَّ الْمُصَّدِّقِينَ وَالْمُصَّدِّقَاتِ وَأَقْرَضُوا اللَّهَ قَرْضًا حَسَنًا يُضَاعَفُ لَهُمْ وَلَهُمْ أَجْرٌ كَرِيمٌ

> "Charitable men and women who make a good loan to Allah will have it doubled and have a generous reward." (Qur'ān 57:18)

The same subject is repeated in two other verses:

وَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَأَقْرِضُوا اللَّهَ قَرْضًا حَسَنًا

> "…and establish *ṣalāh* and give *zakāh*, and lend to Allah a goodly loan." (Qur'ān 73:20)

إِنْ تُقْرِضُوا اللَّهَ قَرْضًا حَسَنًا يُضَاعِفْهُ لَكُمْ وَيَغْفِرْ لَكُمْ وَاللَّهُ شَكُورٌ حَلِيمٌ

> "If you make a generous loan to Allah, He will multiply it for you and forgive you. Allah is ever thankful and forbearing" (Qur'ān 64:17).

It is evident that this is the only form of contract that is so explicitly mentioned in the Qur'an as a form of mutual help pleasing to God and for which He promises success in the form of multifold reward. It is interesting to look at what the commentators of the Qur'ān state about *qarḍ ḥasan* in the light of these Qur'anic verses. It should suffice here to cite *Tafsīr al-Manār* about the benefits of helping the masses. Raza Riḍā (1350 AH, 2/467-468) states:

> *A nation in which the rich spend their wealth and cooperate with others in deeds, in which the prosperous take care of the poor and the strong protect the weak, their [overall] interests and benefits are amplified, their civilisational attainments*

> *proliferate and happiness increases. Blessings last longer for its individuals as long as they spend and cooperate in the overall general interest....But the nations which did not fulfill this obligation perished or were conquered while those who diligently undertook it achieved honor and success.... It is very strange that, among all the nations today, Muslims are the most ignorant of this divine system, in spite of the fact that they read the Book of Allah day and night. But their hearts are not moved and they do not extend their hands when they recite the verses which exhort spending wealth in the way of Allah...*

The *ḥadīth* literature provides greater detail on the great reward associated with the provision of *qarḍ ḥasan*. For instance, one *ḥadīth* states that it is written on the gate of Paradise: *"The reward for charity (ṣadaqah) is multiplied tenfold while the reward for a loan is eighteen-fold"* (Ibn Mājah, 2: 812, *ḥadīth* no. 2431). When the Prophet (peace be upon him) asked Angel Gabriel the reason for that, he replied that it is because a beggar may ask people even if he possesses what is enough for him whilst a borrower will not ask for a loan except when he has a real need. The spirit and impact of this *ḥadīth* is reflected in the statement of the Companion Abū al-Dardā': *"I prefer to give two dinars as a loan that is later returned to me, which I then loan again [and again]. I prefer this process over ṣadaqah [given once]"* (Al-Shīrāzī, 1976: 302).

It is on the basis of these and other texts that a group of Muslim scholars, albeit a minority, take the stance that offering financial help in the form of a loan is better and preferred over *ṣadaqah* (charity). They provide the following reasons: First, as argued in the above *ḥadīth*, *ṣadaqah* may be asked when needed or even when not needed, but a loan is only sought in case of real need. Second, it is usually difficult for a respectable person to ask or receive *ṣadaqah* because of his self-respect, but there is a general custom of accepting loans as a form of assistance even among the rich. Third, the creditor puts aside his own needs and usually faces some loss in the form of inflation, which represents a sacrifice on his part. Fourth, there is always a risk of the debtor defaulting in payment, which makes a loan a source of permanent worry for the creditor until the day it is received. Fifth, the

creditor may be in need of cash himself after granting the loan, but he will have to look for other sources of revenue if its repayment is not yet due, thus making a sacrifice to help a fellow human being. Sixth, the creditor can be lenient in demanding his loan in case there is delay in payment, which will make him eligible for the prayer of the Prophet: *"May Allah bless the person who is lenient in selling, buying and demanding [his due right]"* (Al-Bukhārī, *ḥadīth* no. 2076).

However, Islam also guides the borrower regarding his duty to repay the amount borrowed. It has been stated in the *ḥadīth* of ʿĀ'ishah that if one takes a loan with the intention of paying it back, Allah helps in effecting payment. This means that the borrower has to ascertain the timely repayment of the loan. Furthermore, he is also expected to be grateful to the lender. It is reported in a *ḥadīth* that once the Prophet took a loan from one of his companions. At the time of payment, the Prophet made *duʿā* for him, saying: *"May Allah put barakah (blessings) in your family and wealth. The reward for a loan [on the part of the borrower] is gratefulness and [timely] payment of it."* (Al-Nasā'ī, 1994, *ḥadīth* no. 4683). Thus, there is a clear demarcation of the rights and liabilities of the parties to a loan transaction: the lender expects high reward from Allah while the borrower is thankful to the lender for the help provided and is determined to pay his due back on time.

The aim of Islam in promoting loans and other types of voluntary financial help is to eradicate poverty from the society. Poverty can be a serious evil as is implied by the fact that the Prophet (peace be upon him) regularly sought refuge with Allah from poverty along with disbelief (Al-Nasā'ī, 1986, *ḥadīth* no. 1347). To this end, Islam channels both the obligatory and optional sources of charity towards the deprived groups of the society. This is evident from many Qur'anic verses including the one detailing the recipients of *zakāh*. The Prophet also stressed the reward for those who help others by saying: *"Allah will continue to help a person who remains busy in helping his brother"* (Al-Nawawi, *ḥadīth* no. 6793). There is indeed ample evidence in the Islamic literature about the reward of such voluntary acts. Based on this, Muslim jurists have divided *qarḍ ḥasan* into several categories including *wājib* (obligatory), *mandūb* (recommended), *mubāḥ* (permissible), *makrūh* (disapproved) or *ḥarām* (prohibited), depending on the given situation of the parties.

It is pertinent to note that *qarḍ ḥasan* as a form of financial assistance can help in increasing the level of self-sufficiency at the level of borrowers instead of turning them into beggars. It is thus suggested that small loans based on *qarḍ ḥasan* can be the best approach for eradicating poverty in Muslim countries. On this basis, it is argued that this contract could be promoted as a workable tool for developing Islamic microfinancing schemes.

V. CASE STUDY OF AKHUWAT FOUNDATION

Akhuwat Foundation, which was set up in 2001, provides Islamic microfinancing to the poor in Pakistan based on *qarḍ ḥasan*. The main source of funds of Akhuwat Foundation is charity from the common people. The following table represents the basic position and performance of Akhuwat Foundation as at August 2013:

Table 1: *Progress Report of Akhuwat Foundation as at August 31, 2013*

Progress Indicator	Total
Total Benefiting Families	355,451
Loans provided to Male Entrepreneurs	224,308
Loans provided to Female Entrepreneurs	131,143
Amount Disbursed	PKR 5,355,331,842
Percentage Loan Recovery	99.84%
Active Loans	172,058
Outstanding Loan Portfolio	PKR 1,593,269,619
Number of Branches in Pakistan	175
Number of Cities and Towns	116

Source: Akhuwat Foundation

It is interesting to note that on average, there are five to seven members in a Pakistani family, and Akhuwat Foundation has provided loans to 355,451 families in all, as at August, 2013. In other words, it has helped a total population of 1.7 to 2.4 million people.

The four pillars adopted by Akhuwat Foundation for operating their model for microfinance are interest-free loans; use of religious places, in order to revive the important role of mosques; the spirit

of volunteerism; and transforming borrowers into donors whose repayments are reused to provide further *qarḍ ḥasan* facilities. Akhuwat Foundation offers nine types of microfinance products to its customers.

There are many features of Akhuwat Foundation which give it a unique status. Profitability is commonly considered a prerequisite for sustainability in the conventional sense. But Akhuwat Foundation depicts a different story. According to its progress report, it has successfully survived and grown without registering profits. The importance of client sustainability over organization sustainability is another hallmark of the Foundation (Islam, 2011). It does not receive loans from outside the country or from the government. This shows that every society has sufficient resources to help its poor.

VI. CONCLUSION AND FINDINGS

Qarḍ ḥasan is an interest-free loan given to one in dire need of it. The provider of this loan gives it with the intention of seeking reward from Allah in this world and the hereafter. It has been explicitly mentioned in the Islamic literature, and there is no debate among Muslim scholars about the validity and preferability of interest-free loans. Apart from its religious importance, it is also a source of mutual help and brotherhood among the members of society and, economically speaking, its successful implementation can increase social capital in the form of higher trust and good will. Looking at the current economic scenario, there are compelling reasons for Islamic financial institutions to use this mode for microfinance. The main idea of the paper is to share evidence from the Sharīʿah regarding the importance, value, usefulness and reward of *qarḍ ḥasan* for a society. Islamic microfinance institutions as well as Islamic banks generally avoid giving interest-free loans to small entrepreneurs of the society. These institutions give several reasons for their non-preference of this mode of financing including moral hazard, information asymmetry and loan recovery issues.

Akhuwat Foundation in Pakistan is a successful example of an Islamic microfinance institution which has made significant improvement and innovation in the lives of poor people of Pakistan

through interest-free loans. The loan recovery rate of the Foundation is almost 100 percent. It has successfully operated for the last twelve years in Pakistan and has also resolved the issue of sustainability. Its experience shows that the poor of the society are trustworthy and reliable, present a low level of moral hazard, and are willing to pay back the loans on a timely basis.

Pakistan shares many common social aspects with Muslim-majority countries like Malaysia. A significant number of mosques, which are a leading symbol of Muslim society, are found in both the countries. Furthermore, the existence of three major communities in Malaysia can increase and make unique the number of "free offices" – in terms of religious places like mosques and temples – for the operational development of such a model in Malaysia. This will help overcome the issue of high operational and transactional charges, which are a common and major hurdle faced by microfinance institutions. It will also bring the three communities closer to each other by infusing a sense of brotherhood among them, which is the essence of Akhuwat Foundation in Pakistan.

The regulatory environment for Islamic financial institutions, including Islamic microfinance institutions, is also more favorable in Malaysia than anywhere else. Furthermore, the government of Malaysia and its central bank are supportive of the industry. Therefore, with some minor changes in this model that may be needed in the context of Malaysia, it should be considered an equal alternative to other Sharīʿah-compliant modes of microfinance. Its success can lead to a positive change in the lives of the poor entrepreneurs of the country and it will also help in restoring the trust of the masses and will bring a good name to the Islamic finance industry worldwide. It is also hoped that the success of this mode of finance will help revive the spirit of Islamic finance, which has been called for by many groups of the society, including academicians, the pioneers of Islamic finance and the public in general.

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