Interest-free microfinance in India: a case study of Bait-un-Nasr urban cooperative credit society

Wasiullah Shaik Mohammed and Khalid Waheed
Department of Management Studies, B.S. Abdur Rahman Crescent Institute of Science and Technology, Chennai, India

Received 11 October 2018
Revised 17 November 2018
4 March 2019
5 August 2019
16 August 2019
29 August 2019
Accepted 31 August 2019

Abstract

Purpose – The purpose of this paper is to understand interest-free microfinance practices in India, identify issues and recommend possible solutions.

Design/methodology/approach – To achieve the proposed objectives, Bait-un-Nasr (BuN) Urban Cooperative Credit Society, located in Mumbai, India, is considered for the case study. The study is based on both primary and secondary data. The primary data are collected through questionnaires and secondary data from various sources. Performance of the institution is assessed in terms of growth and sustainability indicators.

Findings – It is found that BuN has been successful in providing interest-free microfinance services in India. A few operational issues have been highlighted and possible solutions are recommended. Moreover, it is found that in comparison to the microfinance industry standards, the performance of BuN has been lower.

Research limitations/implications – BuN is evaluated from only growth and sustainability aspects and not from the aspect of the socio-economic impacts of its services on the lives of customers.

Practical implications – This study would become a documented source of interest-free microfinance practices in India. Moreover, the recommendations provided, if implemented, would help BuN in further growth and development.

Social implications – This study would help create awareness in the society about the practices of interest-free microfinance.

Originality/value – This paper highlights the interest-free microfinance practices in India that have not received the needed attention. The paper also attempts to identify key issues pertaining to interest-free microfinance with possible solutions.

Keywords India, Microfinance, Cooperatives, Islamic microfinance, Sharīʿah, Shariah, Bait-un-Nasr

Paper type Case study

Introduction

Microfinance services generally include savings, credit, insurance and payment services to low-income clients (Ledgerwood, 1999). Microfinance institutions (MFIs) are appreciated for their role in financial inclusion in India (Planning Commission, Government of India, 2009). Indian MFIs served around 35.1 million clients in 2017-2018 (Sa-Dhan, 2018), which is around 3 per cent of the total population. This not only reflects the low penetration of

ISRA International Journal of Islamic Finance
Emerald Publishing Limited
0128-1976
DOI 10.1108/IJIF-10-2018-0114

microfinance services but also indicates the huge scope for expansion of such services in the Indian market through alternative modes. One of such alternative modes existing in India is interest-free microfinance (IFMF) or Islamic microfinance (IMF). IMF is based on Sharīʿah (Islamic law) guidelines. It is prohibited to collect or pay interest (*ribā*) on financial transactions under IFMF (Karim *et al.*, 2008).

Interest-free microfinance institutions (IFMFIs) are operating in different regions of the world (Obaidullah and Khan, 2008). IFMFIs in some nascent forms, such as *Bait-ul-māl* (community-based financial institutions), have been in existence in India since the early 1930s (Bagsiraj, 2003). Presently, most of the IFMFIs are operating as charitable trusts, welfare societies and cooperatives. They provide charitable loans (*qarḍ ḥasan*), consumable loans against service charges and deploy funds in interest-free modes like *mushārakah* (profit and loss sharing partnership), *muḍarābah* (trust financing), *murābaḥah* (cost plus mark-up) and *ijārah* (leasing). Despite their long existence and people-friendly features, the IFMF practices have not received due attention and have not reached the masses of the Indian market.

This paper is based on the case study of Bait-un-Nasr Urban Cooperative Credit Society Limited (BuN) located in Mumbai, India. The current study is meant to study the practices and operations of BuN, to evaluate its performance in terms of its growth and sustainability aspects, and to identify the operational and Sharīʿah issues and provide possible solutions. It also aims to compare the performance of BuN against that of Indian microfinance industry standards and benchmarks, and to document the operations of BuN as a source of reference for future research.

The remainder of the paper is organised as follows. The next section of the paper presents a brief review of the literature, followed by the research methodology. This is then followed by the main discussion, which includes the case study of BuN, performance analysis and comparative study. The final section of the paper presents the recommendations and conclusions.

Literature review

The present literature survey is divided into two broad categories, namely, literature related to global IFMF practices, and literature related to IFMF in India.

Literature related to global interest-free microfinance practices

IFMF is a well-known concept as there are several IFMFIs serving people across the globe. Ample research has been conducted in this area at the global level. For instance, Obaidullah (2008) proposed the theoretical models for IMF, deriving the base from the *aḥadīth* (Prophet's sayings) related to charitable and commercial activities. He proposed various types of microfinance models to facilitate different financial needs of clients. A feasibility study of IMF was done by Karim *et al.* (2008). The authors provided an outlined strategy to build a sustainable IMF model. The authors concluded that IMF with its holistic features has the potential to alleviate poverty. In the opinion of El-Zoghbi and Tarazi (2011), IMF can play a vital role in providing microfinance services to unbanked populations and hence can contribute to financial inclusion.

The operational and policy-level challenges in the practices of IFMF were discussed in detail by Ahmed (2012). The role of IFMF in the sustainable development of society and the nation was studied by Gurgoz (2014). This study is based on the comparative study of conventional and Islamic microfinance institutions (IMFIs), namely, Social Fund for Development (a conventional institution in Sudan) and Sudan Microfinance Development Facility (an IMFI in Sudan). The findings of the research show that the IMFI is performing better than the conventional one. The author opined that, if used efficiently, IMFIs can play a contributory role in sustainable economic development.

A survey of IFMFIs was carried out by Shirazi *et al.* (2015). The authors conducted a case study of various IMF projects operating around the globe and highlighted their best practices. They also proposed the IMF model integrating waqf (Islamic endowment). According to the findings of the study, the practitioners supported the proposed model. Ahmad *et al.* (2016) carried out a survey of literature produced during 1995 and 2015 to find out the impact of IMF on borrowers' lives. The researchers found that there is a positive impact of IMF services on borrowers' lives. A comparative study of IFMFIs and conventional microfinance institutions in Bangladesh was done by Abdullah *et al.* (2017). According to the authors, IFMFIs are having a more impactful role in socio-economic development of clients than their conventional counterparts.

Mohammad *et al.* (2018) studied IMF services from affordability perspectives and reviewed the operations of IMFIs from cost of capital and cost of operations aspects. According to the authors, to make IMF services cost effective, alternative means such as zakat (Islamic alms) and waqf funds should be used. The potential of providing IMF as an alternative channel for financial inclusion in Senegal was studied by Seck and Biaye (2019). According to the authors, if the potential issues such as qualified human resources and Sharīʿah supervision are addressed properly, then IMFI can be a parallel channel for financial inclusion in Senegal.

A brief literature survey related to international practices shows that the available literature covers a variety of aspects of IFMF starting from basic concepts, to theoretical models, practices, case studies of IFMFIs, performance studies, impact studies and others. It also includes discussions on operational, governance, regulatory and Sharīʿah issues.

Literature related to interest-free microfinance in India

In India, the first practical effort to survey the operations of IFMFIs was made by Bagsiraj (2003). His research was based on 20 small IFMFIs operating during 1999-2000. BuN was one among the 20 institutions which were examined. He evaluated the performance of the IFMFIs from economic viability and practices perspectives. In conclusion, based on the findings of his analysis, the author stated that these institutions are providing effective services at the micro level. A similar study on the impact of IFMF services on the clients of *bait ul māl* institutions (Islamic welfare societies) located in Chennai was done by Ara (2003). According to the author, there is a positive impact on the economic position of clients.

Khan and Nisar (2004) conducted a survey of five leading Muslim funds providing IFMF services in Northern India. According to the authors, the Muslim funds have done impressive work by providing interest-free loans to the needy. A case study of four Muslim funds was also done by Nisar and Syed (2012). The authors presented the model, management strategies, governance and auditing practices of these funds. In conclusion, the authors stressed that minority funds should expand their scope, refine their audit mechanism and make their results available to the public.

Ajmal (2010) cited the performance of Al Khair Cooperative Credit Society – a well-known IFMFI in India. The institution was evaluated in terms of its outreach and financial performance indicators. The author concluded that Al Khair Cooperative Credit Society is performing better than its conventional counterparts. Shaik Mohammed and Waheed (2018) also undertook a case study of Al Khair Cooperative Credit Society. In this paper, the authors tried to present the *modus operandi* of the cooperative credit society. The institution was also evaluated in terms of its current status, outreach, beneficiaries, growth and financial health perspectives. The findings of the authors concur with Ajmal (2010) that the performance of Al Khair has been better than that of the conventional industry.

In terms of models, Sofi (2012) proposed a four-stage hybrid model for IFMF. This model is based on *ijārah wa iqtinā*ʾ (lease and purchase), *bay*ʿ *al-salam* (advance purchase), *muḍārabah* (trust financing) and *qarḍ ḥasan* (benevolent loan). The author also discussed the economic derivation of the proposed model. She further highlighted profitability and operational efficiency as the potential issues.

Khatkhatay and Nisar (2014) discussed the concept of service charges from Sharīʿah and cost perspectives. In their opinion, the service charges calculation method should be based on the actual cost of the operations and should be linked to the nature of the cost being incurred and the amount and period of the loan rather than on an assumption basis. They suggested the implementation of a scientific costing system as the possible solution to ascertain the actual activity-based costs that are used to calculate the applicable service charges.

The impact of services provided by *Bila-Sudi-Qard* (interest-free loan) societies operating in Andaman and Nicobar Islands was studied by Hasan (2014). In his view, IFMF services help in economic development through fruitful management of local common resources.

Another impact study was done by Ameer (2013) taking Athani Welfare Society as case study. According to the author, the IFMF services have a positive impact on poverty alleviation. The author also highlighted fund mobilisation, training, development and repayment problems as the key issues.

A conceptual paper discussing the operational structure of *nidhis* (interest-free mutual funds) existing in Kerala state was produced by Mohammed (2016). In his research, the author highlighted the role played by *nidhis* in the promotion of IFMF practices in Kerala region. Syed (2017) has done a case study of Islami Baitul Maal (IBM) located in Vaniyambadi District, Tamil Nadu. The institution was assessed in terms of self-sufficiency, outreach and performance as well as its socio-economic impact on beneficiaries. Around 40 beneficiaries of IBM were considered as the sample. The author concluded that IBM performed well on self-sufficiency, outreach and performance. It has a positive impact on the socio-economic lives of the beneficiaries.

In contrast to the growth of IFMF practices globally, the practices in India have not developed from their nascent stage. Due to regulatory and operational issues, the scope of these services could not expand as expected, which led to a dearth of literature in the Indian context. Though the researchers have tried to address this issue, there is still scope for more discussion in this area from the Indian perspective. Hence, it is in this context that the present study has been considered.

Research methodology

In view of the fact that the exact number of institutions providing IFMF services in India is unknown (infinite population), to choose the sample for the study the authors had to rely on the convenience sampling method (Kothari, 2004). Moreover, considering the nascent stage in which the IFMFIs are operating, an explorative research methodology is adopted, avoiding comprehensive empirical research due to constraints of availability of enough data required for such an empirical study.

Primary data are collected by visiting the institution and sharing the questionnaire with the Managing Director (Respondent) of BuN. The questionnaire is designed for the collection of primary data related to well-known IFMFIs operating in India. BuN is one of those institutions.

The questionnaire consists of a total of 35 structured questions dealing with aspects such as profile, financials, policies, efficiency and other issues. Due to an unknown population, the pilot study to validate the questionnaire was not possible; hence, the questionnaire was validated by seeking the opinion of the experts (Kothari, 2004).

The secondary data related to the institution is collected from annual reports, website, introductory materials and other documents. The other information required has been collected from relevant books, journals and online databases.

The overall performance of BuN is studied on two broad aspects: growth indicators and sustainability indicators. Using the available data, percentage, means, ratio analysis and compound annual growth rate (CAGR) are computed and conclusions are drawn.

Case study of Bait-un-Nasr

BuN is an Urban Cooperative Credit Society established in 1976 in Bombay (now Mumbai). It can be seen from Table I, as of 31 March 2018, that it has seven branches spread across the city. The Society has a share capital of US$0.26m[1], deposits of US$1.50m and loans outstanding of US$0.95m. There are 94,871 registered members and 9,803 loan beneficiaries associated with Bun (Bait-un-Nasr, 2018).

Particulars	Units	2015-2016	2016-2017	2017-2018	2015-2016 to 2017-2018 CAGR (%)
Share capital	USD Million	0.21	0.24	0.26	9.3
Reserves and surplus	USD Million	1.32	1.41	1.48	5.7
Total deposits	USD Million	1.43	1.34	1.50	2.2
Total loans	USD Million	0.58	0.59	0.95	27.9
Total fixed assets	USD Million	1.68	1.67	1.64	(1.0)
Cash and bank balance	USD Million	0.07	0.52	0.34	117.4
Total assets	USD Million	4.49	3.41	3.48	(12.0)
Income from service charges on loans	USD Million	0.08	0.09	0.10	9.6
Profit on sale of property	USD Million	–	0.25	0.21	–
Other income	USD Million	0.03	0.29	0.02	(31.0)
Total income	USD Million	0.12	0.62	0.33	66.8
Regular admin and operational expenses	USD Million	0.24	0.29	0.27	5.6
Office renovation and other expenses	USD Million	0.01	0.06	0.00	(73.3)
Total expenditure	USD Million	0.25	0.35	0.27	3.3
Total no. of members (Cumulative)	Nos.	86,980	93,114	94,871	4.4
Total no. of deposit accounts (Cumulative)	Nos.	57,581	60,779	62,536	4.2
Total no. of loan beneficiaries (Cumulative)	Nos.	8,063	8,425	9,803	10.3
Total no. of branches (Cumulative)	Nos.	6	7	7	8

Source: Computed based on Bait-un-Nasr Annual Reports for the periods 2015-2016, 2016-2017 and 2017-2018

Table I. Profile of Bait-un-Nasr for the period 2015 to 2018

It is one of the Sharīʿah-compliant microfinance institutions operating with the objective of inculcating the savings habit among its clients and of providing interest-free credit to those who are in need.

Applicable regulations

BuN is registered and regulated under the Maharashtra Cooperative Societies Act (MCSA) 1960 and Maharashtra Cooperative Societies Rules (MCSR) 1961. As per the Department of Registrar of Cooperative Societies, BuN is classified as a financial credit resource society (on the basis of the operations, a cooperative is classified as agriculture, dairy, textile or financial credit resource society).

Governing body

Like every cooperative society, the operational structure is based on BuN's members playing a key role in all decision making. Everyone who is residing within the limits of Mumbai can become its member by subscribing to at least one share. Members take decisions on key operational matters in the Annual General Meeting (AGM) every year. The society members are eligible to take loans only after one month of their membership.

The operations of the Society are looked after by the Board of Directors, which is elected by members. The Board elects the Chairman, Vice Chairman and Managing Director.

BuN has also appointed a Chartered Accountant as the independent financial auditor, a legal firm as a consultant for legal affairs and a Sharīʿah Advisor for Sharīʿah consultancy and audit services.

BuN provides demand deposit and loaning facilities to its members.

Pre-revival period

BuN had successfully operated between 1976 and 2000. In 2000, the institution had to close all its operations due to liquidity problems. The exact reason for this problem could not be traced. However, our interaction with the members of the then management revealed that the crisis at BuN was, in fact, a resonant effect of its sister concern "Barkat Investment Corporation", which was facing operational issues. Following rumours and media reports, the depositors at once rushed to BuN to withdraw their deposits. The management was not able to deal with this situation, and all operations were suspended following the legal guidelines given by a liquidator appointed by the Registrar.

In 2012, following a detailed inspection and scrutiny, the concerned authorities permitted the Society to revive its operations by constituting a new Board of Directors through a Special General Body Meeting of the members. Since then, the Society has been successfully running its operations.

Post-revival achievements

As per the MCSA 1960, in Maharashtra State, the operations of Cooperative Societies are audited by certified auditors empanelled by the Registrar of Cooperative Credit Societies of Maharashtra State on certain specified criteria. Based on the set criteria the Societies are awarded one of four grades: *"A", "B", "C" or "D"*.

As per the statutory audit of 2012-2013, immediately after the revival, BuN was awarded *"D"* grade. But in the next four years of the post-revival period, as per the audit of 2016-2017, the Society was awarded *"B"* grade. It means that within a short period of four years of post-revival the Society was able to regain its status of being an "operationally efficient" institution by the Registrar of Cooperative Credit Societies of Maharashtra State.

In addition, the Society was awarded "Gold Award" in 2016, "Bronze Award" in 2017 and "Silver Award" in 2018 for its contribution as the best IFMFI in India by the Islamic Finance Forum of South Asia (IFFSA) at Colombo, Sri Lanka. These awards reflect the global recognition and appreciation of the IFMF services provided by BuN.

Details of deposit products

Interest-free demand deposits are the main sources of funds for BuN. As of 31 March 2018, BuN had total outstanding deposits of US$1.50m.

Currently, BuN is offering various deposit schemes[2]:

- Saving Deposit scheme;
- Spot/Current Deposit account;
- Recurring Deposit scheme; and
- Hajj-Umrah Deposit scheme.

The depositors can deposit their monies by visiting any of the branch offices. The Pigmy Deposit Agent (PDA) also collects "pigmy deposits" by visiting the depositors and using deposit collection machines. It is to be noted that no returns are paid to the depositors.

Details of loan products

BuN provides demand loans (*qarḍ ḥasan*), vehicle loans (*qarḍ ḥasan*), profit-sharing consumer goods loans (*murābaḥah*) and business loans (*mushārakah* and *muḍārabah*) to its members. It can be seen from Table I above, as of 31 March 2018, BuN has outstanding loans of US$0.95m.

Under demand loans, the society extends loans generally for consumable purposes. Under vehicle loan, it finances the purchase of vehicles like the two-wheeler, auto rickshaw, taxi and private car for both personal uses and for commercial purposes. Under the profit-sharing consumer goods loans which are named as "Instalment Purchase Loan Scheme", the Society finances the purchase of home appliances. Under profit-sharing business loans, the Society finances the working capital of commercial businesses.

The applicable service charges and share of profit on loans are payable at the end of every quarter along with the instalments. The service charges are determined using the scientific costing system, which enables the segregation of expenditure on demand loans and other types of loans.

The amount of loan ranges between US$77 and US$7,700. The loan period ranges from one month to 36 months. Usually, loans are repaid in monthly instalments.

Nature and mechanism of loan products

In demand loans, the borrower provides Know Your Customer (KYC) information through the Loan Application Form (LAF). The LAF is subjected to due diligence, and if the loan is approved then the borrower is advised to provide loan security (such as personal deposits, gold, shares or member's guarantee). Once the security is deposited, the loan is issued to the borrower.

Every month the applicable service charges are levied and recovered at the time of the instalment payment. The loan instalments are paid by the borrowers at the respective branch or at the head office. In some cases, the Pigmy Deposit Agent (PDA) collects the instalments by visiting the borrower. Once all the instalments are paid, the loan is closed and the loan security is released.

In the case of "Vehicle Loan" and "Instalment Purchase Scheme", the customer identifies the required goods (durable/consumable) or vehicle (new/old) and submits the quotation to BuN. If the terms are agreed between the parties, 25 per cent of the purchase price is collected as a down payment. BuN pays the purchase price to the vendor/supplier.

In case of the vehicle loan, the vehicle is hypothecated to the Society by making a lien mark with the Regional Transport Office and insurance company. The customer pays the loan along with the applicable monthly service charges. Upon payment of the last instalment and service charges, the loan is closed, and the lien mark is cleared by issuing a letter to the Regional Transport Office.

In the case of business loans, the BuN personnel evaluates the economic viability of the borrower's business in which the Society is going to invest. Once the loan is approved, the profit-sharing ratio is negotiated and finalised between the borrower and BuN. As per the agreed ratio, BuN's share of profit from the business is paid by the borrower every month along with the principal amount. Following the reduction of BuN's investment in the business, the profit-sharing ratio is revised (usually) every quarter. The borrower is advised to submit regularly the purchase, sale, stock and cash-drawing reports to BuN.

Notwithstanding the above mechanism, to comply with the applicable regulations, all the loans are generally recorded as interest-based loans in books of accounts, and the service charges and profit share collected on these loans are mentioned as "interest". This is done because the existing cooperative regulations in India do not permit the direct practice of IFMF.

Sources of income

The major sources of income for BuN are as follows:

- one-time admission fee upon membership registration;
- annual ledger fee collected on the spot and current accounts;
- incidental charges for not maintaining minimum account balance;
- applicable service charges collected on loans (including profit share on business loans);
- income generated on the sale of fixed assets;
- rent received from premises given on lease; and
- donations from the members.

During 2017-2018, the society collected a total income of US$0.33m (BuN, 2018).

Information gathered through questionnaires

As per the information gathered, there are 93,114 members (which include around 10,000 new members registered during the post-revival period) registered with BuN. Out of the total members, around 37,500 are women. Women constitute about 39.0 per cent of the members, which is below the women's ratio in conventional MFIs (96.0 per cent). There are 8,425 loan beneficiaries (including 925 beneficiaries who took loans during the post-revival period); which represents 10.0 per cent of the total members.

BuN has a total of 77 employees (including the deposit collection agents). No female employee has been appointed so far on the roll except the three female PDAs. It means 100 per cent of the staff members on the roll are men (whereas the percentage of female staff in conventional MFIs is around 12.0 per cent).

In terms of technology, BuN has implemented a customised Management Information System for maintaining the database of the customers, for generating various reports required to evaluate the performance of the Society, and Tally software for booking and accounts. There are collection machines for generating the acknowledgement receipt for customers on the field, and MS Office for administrative works. It has adopted regular internal reviews and an internal checks system by initiating a separate internal inspection and audit cell to ensure quality in its services.

BuN organises employees training programmes every quarter. It also organises a training programme for its members, including directors, every year. It invites faculties from co-operative training institutes in Pune for the same. So far BuN has not organised any special programme to educate people other than Muslims about IFMF.

On the aspect of Sharīʿah compliance, though BuN does not have an independent Sharīʿah board, it has appointed a Sharīʿah consultant to carry out quarterly Sharīʿah audit and provide Sharīʿah certification every year.

The respondent (Managing Director of BuN) has shared the following issues which the institution is grappling with:

- *Cash liquidity maintenance*: Demand deposits are the major source of funds for the Society. The deposit to withdrawal ratio for a day is more than 80 per cent. It means that out of the balance (20 per cent) of funds, loans are created with a maturity period more than the frequency of withdrawal. Due to the mismatch between the maturity period of liabilities and assets, the Society is facing liquidity risk. To tackle this issue, the Society is holding liquidity more than the actual requirement. Hence, liquidity management has become one issue for the Society.
- *Perception of members (due to pre-revival issues)*: As informed above, the Society remained closed for a period of one decade. This event has created a negative perception among the members. Hence, members are reluctant to keep their funds with the Society for a long duration.
- *Lack of association of the community's middle- and upper-middle class members with the Society for deposit accounts*: Most of the members who are associated with the Society are small businessmen and daily wage workers. These people cannot keep large amounts of funds as deposits with the Society. For this purpose, the Society needs middle- and upper-class people, but their association with the Society is negligible.
- *Increasing cost and cost control*: During the post-revival period, the Society has been unable to issue new loans at a high pace which can generate operational income. Moreover, the cost being incurred on administration, the revival of operations, legal fees, repairs and renovation are scaling up the overall costs of the operations. How to control and minimise the cost has become an issue for the Society.
- *Fund mobilisation and retention issues*: Most of the depositors are small businessmen who are depositing their money on a daily basis and withdrawing frequently as per their needs. Due to this, the Society is unable to retain funds for creating loans.
- *Legal restriction on investment of excess funds*: The existing regulations do not allow the Society to invest its funds in avenues such as the stock market or businesses. Due to this, the Society is unable to explore new profitable avenues of investments.
- *Legal restriction on expansion of areas of operation*: The area of operation for the Society is restricted to Mumbai city. Hence, despite being in operation since the last

40 years, the Society is unable to expand its operations to potential areas outside Mumbai.

- *Legal restriction on loaning*: As per existing regulations, the Society is restricted to providing loans that cannot exceed the amount specified by the Registrar of the Cooperative Societies. This has become a hurdle for the Society as the loan requirement of its members is many times higher than the specified ceiling.
- *Irregularity in repayment of loan instalment by borrowers*: Repayment is another common problem which the Society is facing.
- *Human resource training manual*: To be able to provide qualitative services, the Society needs to have well-trained human resources. Though the Society is striving to train and develop the available human resources, a specific and standard training manual is not available.
- *Employee retention*: Employee turnover during the post-revival period has been very high, which is further affecting the operations of the Society. Hence, retention is another issue.
- *Restriction on providing microinsurance*: Microinsurance is the need of the hour. However as per the existing regulations, the Society cannot provide microinsurance services directly. Thus, the Society is not able to provide Sharīʿah-compliant microinsurance products to its members.

The authors of this paper have provided broad recommendations in the last section that may help BuN in addressing some of the listed issues.

Performance analysis of Bait-un-Nasr

The performance of BuN can be studied in terms of growth and sustainability indicators (Ali *et al.*, 2014).

- *Growth indicators*: To study performance, the following factors are considered: growth of members, deposit accounts, beneficiaries, loan accounts, share capital, deposits, loans, assets and income. The performance is analysed by computing the Compound Annual Growth Rate (CAGR) for the period 2015-2016 to 2017-2018.
- *Sustainability indicators*: To study the sustainability, the ratios (indicators) commonly used in the microfinance industry are considered. These include capital adequacy ratio, solvency ratio, fund mobilisation ratio, operating expenditure ratio, operating self-sustainability ratio, yield on portfolio ratio, fixed assets ratio and liquidity ratio. To evaluate the sustainability of the Society during the past three years, the mean for the same ratios is computed for the period 2015-2016 to 2017-2018.

Growth indicators

It can be seen from Table I that in 2015-2016 BuN had 86,980 members (cumulative figure). This figure increased to 94,871 in 2017-2018. In the past three years, the membership grew with a CAGR of 4.4 per cent per annum.

In 2015-2016, BuN had 57,581 deposit accounts, which increased to 62,536 in 2017-2018. In the last three years, the deposit accounts grew with a CAGR of 4.2 per cent per annum.

In 2015-2016, BuN had 8,063 loan beneficiaries, which increased to 9,803 in 2017-2018. The loan beneficiaries grew with a CAGR of 10.3 per cent per annum.

In 2015-2016, BuN had a share capital of US$0.21m, which increased to US$0.26m in 2017-2018. The share capital in the last three years increased with a CAGR of 9.3 per cent per annum. This indicates the slow association of new members with the Society after its revival.

In 2015-2016, BuN had deposits of US$1.43m, which increased to US$1.50m in 2017-2018. The deposits have increased with a CAGR of 2.2 per cent per annum. This indicates the Society is very much behind in mobilising deposits.

In 2015-2016, BuN had loans outstanding of US$0.58m, which increased to US$0.95m in 2017-2018. The loans outstanding increased with a CAGR of 27.9 per cent per annum, reflecting the consistent increase in the ability of BuN to disburse new loans.

In 2015-2016, BuN had assets of US$4.49m, which decreased to US$3.48m in 2017-2018. The assets of BuN in the past three years decreased with a CAGR of −12.0 per cent per annum.

In 2015-2016, the income from operations (service charges on loans) was US$0.08m, which increased to US$0.10m. The income from operations increased with a CAGR of 9.6 per cent.

The above-mentioned data indicate that the Society has been successfully providing interest-free services. There is an increase in membership, deposit accounts, loan beneficiaries, and amount of share capital, deposits and loans. It indicates the confidence and mutual trust between the Society and its members.

Despite reflecting growth on various indicators, BuN's overall growth rate has been less than the growth rate of the conventional microfinance industry, which is 47 per cent (Sa-Dhan, 2018).

Sustainability indicators

In this section, the performance of BuN has been assessed on the selected ratios used by Sa-Dhan (2018) in "The Bharat Microfinance Report 2018" and the indicators mentioned in Pearls Monitoring System issued by the World Council of Credit Unions (Richardson, 2001) for cooperative societies. The ratios selected for the present research are:

- capital adequacy ratio (CAR) = share capital and reserves/assets
- deposit to assets ratio (DAR) = deposits/assets
- solvency ratio (SR) = loans/assets
- fixed assets ratio (FAR) = fixed assets/assets
- liquidity ratio (LR) = cash and bank balance/assets
- yield on portfolio (YoP) = income from operations/average loans outstanding
- operating expense ratio (OER) = operating expenses/average loans outstanding
- operational self-sufficiency (OSS) = operating income/operating expenses

It can be seen from Table II that the CAR of BuN for 2017-2018 is 49.8 per cent, whereas the average for the three-year period (2015-2016 to 2017-2018) is 44.1 per cent. This shows that the CAR of BuN is almost double the industry standards, which is 20-25 per cent. It means that the Society is relying more on share capital and reserves for funds.

The DAR for 2017-2018 is 43.0 per cent, whereas the average for the same ratio for the three-year period is 38.1 per cent. This ratio is almost half of the ratio required as per industry standards of 70-75 per cent. This indicates that the Society is unable to channel its funds requirement from deposits.

Table II.
Comparative study of BuN with selected microfinance standards

Selected ratios	Unit	2015-2016	2016-2017	2017-2018	3 years average	Microfinance industry standards (%)
CAR	%	34.17	48.30	49.8	44.1	20-25
DAR	%	31.82	39.43	43.0	38.1	70-75
SR	%	12.97	17.29	27.4	19.3	70-75
FAR	%	37.33	49.16	47.2	44.6	5-10
LR	%	1.59	15.15	9.7	8.8	10-15
YoP	%	18.36	14.43	13.2	15.3	20-25
OER	%	52.32	48.38	35.0	45.2	10-15
OSS	%	35.10	29.82	37.8	34.2	110-120

Sources: Ratios are computed using the financial information available in Annual Reports of Bait-un-Nasr for the period 2015-2016, 2016-2017 and 2017-2018. The industry standards are selected and modified from the Sa-Dhan (2018) Report and Pearls Monitoring System of WCCU

The SR for 2017-2018 is 27.4 per cent, whereas the average for the same ratio for the three-year period is 19.3 per cent. This ratio is almost three times lower than the industry standards of 70-75 per cent. It means that the Society is not using its financial resources optimally to create loans.

The FAR for 2017-2018 is 47.2 per cent, whereas the average for the same ratio for the three-year period is 44.6 per cent. This ratio is almost five times higher than the industry standards of 5-10 per cent. This indicates that the Society is holding a considerable portion of assets as fixed assets. These assets, if liquidated, could be used for new loans.

In the opinion of the authors, holding excessive fixed assets will have a two-tier effect. On the one side, in case of emergency, these assets may not be convertible to liquid cash immediately to meet the liquidity crunch. On the other side, the Society may use the benefits of appreciation and depreciation, especially to set-off the operational costs and losses.

The LR for 2017-2018 is 9.7 per cent, whereas the average for the last three years is 8.8 per cent. This ratio is also below the industry standards of 10-15 per cent. As the Society is operating with the policy of avoiding interest-based funds, it may not have easy access to interest-free funds to meet its liquidity requirements at the time of emergency. In addition, the Society is operating with an Asset and Liability structure where most of its deposits are demand deposits. From this perspective, the LR being maintained by the Society is very low. Hence, it is advisable to increase this ratio up to 15 to 20 per cent.

The YoP for 2017-2018 is 13.2 per cent, whereas the average for the same for the past three years is 15.3 per cent. The Society is collecting around 13 per cent gross return on loans provided. This ratio is also below the industry standards of 20-25 per cent. This ratio can be increased by issuing more funds in profit sharing loans.

The OER for 2017-2018 is 35.0 per cent, whereas the average for the same for the past three years was 45.2 per cent. This ratio is almost three times higher than the industry standards of 10-15 per cent. It clearly indicates that BuN is incurring high costs on operational activities. Moreover, the OER (35.0 per cent) is higher than the YoP (13.2 per cent), which effectively means that the Society is incurring losses. As these operational losses are being set-off against the income from other sources, the overall operations of the Society are going to be unaffected, but this is not a good situation. The Society needs to work more on cost control so that the operational expenses match the operational income.

The OSS ratio for 2017-2018 is 37.8 per cent and the average for the same ratio for the last three years is 34.2 per cent. This ratio is four times below the industry standard of 110-120 per cent. The lower OSS ratio indicates that the Society is not meeting its operating costs from the income it is earning from operations. This is not a good sign as far as self-sufficiency of the institution is concerned. The society needs to divert its funds in operations so that at least the cost incurred on operations should be met through the income from the operations.

It is worth noting that on the one side, the major part of BuN's income is coming from non-operational activities while on the other side, the cost of operations of BuN is too high. To become a self-sufficient institution, BuN should focus on how to generate additional income through operations and how to control the cost of operations.

Moreover, despite the average cost ratio being 45.2 per cent at present, the Society has implemented a standard policy of collecting service charges at 12 per cent on the loan amount, which is around 25 per cent of the actual cost being incurred. Hence, from the Sharīʿah point of view, it is complying with its objective of providing IFMF services.

Based on the above analysis, it can be said that the overall performance of BuN in comparison to the industry standards during the past three years (2016-2018) has not been very impressive. The Society needs to work on all the sustainability indicators (ratios) to match the industry standards.

It is to be noted that there is a difference in the operational structure and policies between interest-free and interest-based conventional microfinance institutions. Hence, whether it is appropriate to have a direct comparative study of IFMFIs on conventional microfinance industry standards is a question that needs further discussion.

Notwithstanding the above point, BuN has a huge scope for further improvement and growth.

Recommendations

In view of the above findings, the authors have made a few key recommendations as follows to improve the performance of BuN.

- *Regulatory hurdles*: During our interaction with the management of BuN, we noted a few regulatory hurdles such as the definition of interest and service charges, the ceiling on loan amount, restriction on opening branches outside Mumbai, restriction on investment in businesses, and others. These regulatory issues are directly affecting the operations and growth of the Society. It is recommended that the Society should seek legal opinions from the experts to address these issues immediately.
- Sharīʿah *compliance*: The Society is required to comply with Sharīʿah stipulations related to service charges and the nature and mechanism of loan products (especially business loans). There is a possibility that due to the practical difficulty of translating the regulatory and Sharīʿah stipulations into policies and products of the Society, the operations of the Society may unwillingly vitiate either or both standards. Therefore, it is recommended that the Society seek legal and Sharīʿah opinions from the experts to ensure that the Society complies with both legal regulations and Sharīʿah stipulations.
- *The system of performance review*: It is seen in the above paragraphs that the performance of BuN on different indicators is not matching the industry standards. To keep track of its performance, a specific system and regular performance review process is recommended.
- *Regular training and development of employees*: IFMFIs are operating with a very small scope and are scattered across the length and breadth of the nation. Hence, there is a scarcity of trained human resources and training programmes. BuN being

one of the oldest institutions in this area, it is recommended that it should conduct regular training programmes for its staff and the staff of other societies operating in the same area.

- *Awareness programmes for customers*: During our research, it is found that customers of IFMFIs were usually unable to differentiate between interest, service charges and profit sharing. Hence, it is suggested that BuN should also organise awareness campaigns about IFMF. It will enable the Society to bring new members into its fold and expand its objectives.

Conclusion

BuN is one of the oldest IFMF institutions operating in India. Since its inception, it has been complying with its objective of being "interest-free". Throughout the period, it has been striving to provide efficient services by adopting modern technology and bringing quality human resources in its folds.

During the early 2000s, the institution faced some unforeseen liquidity problems, following which the institution remained closed for a decade. However, in due course and with the permission of the regulators, in 2012 the institution revived its operations. It is very rare to find any financial institution reviving its operations after remaining closed for such a long period. The revival of BuN indicates the strong determination of the management and the members associated with the institution.

From a Sharīʿah compliance point of view, BuN is the only organisation which is implementing the correct method of calculation and collection of service charges on demand loans. It is also ensuring that profits on business loans are calculated based on actual outcome of the business and not on assumption basis.

In terms of performance, the overall growth of BuN is satisfactory. However, in comparison to the industry standards (on selected ratios), its performance seems to be not in line with the industry standards. Hence, there is considerable scope for further improvement, growth and expansion.

Though the institution is facing certain issues from regulatory and operational aspects, it is hoped that the recommendations provided above will help BuN in tackling those issues. It can be said that BuN has the potential to become one of the biggest IFMF institutions in India.

Notes

1. The amount in Indian National Rupees (INR) is converted to United States Dollar (US$) with an exchange rate as on closing of the year for which financial data is considered for this study. For 2015-2016 data, the exchange rate is US$1 = INR 66.23, for 2016-2017 it is US$1 = INR 64.81 and for 2017-2018 it is US$1 = INR 65.08.
2. The information related to deposit and loan products are based on the introductory brochure provided by Bait-un-Nasr through email dated 9 October 2017.

References

Abdullah, M.F., Amin, M.R. and Ab Rahman, A. (2017), "Is there any difference between Islamic and conventional microfinance? Evidence from Bangladesh", *International Journal of Business and Society*, Vol. 18 No. S1, pp. 97-112.

Ahmad, S., Bakar, R. and Lubis, Z. (2016), "Islamic microfinance and its impacts on borrowers: a systematic review from 1995-2015", *Mediterranean Journal of Social Sciences*, Vol. 7 No. 6, pp. 113-120.

Ahmed, H. (2012), "Organizational models of Islamic microfinance", in Nazim Ali, S. (Ed.), *Shari'a-Compliant Microfinance*, Routledge, Abingdon, Oxon, pp. 17-32.

Ajmal, A. (2010), "Interest-free microfinance in India: exploring the cooperative mode", paper presented at the International Seminar on Islamic Finance in India: products, Institutions, and Regulations, Kochi, 4-6 October.

Ali, A., Hassan, K.M. and Hippler, W.J. III (2014), "Performance of microfinance institutions in muslim countries", *Humanomics*, Vol. 30 No. 2, pp. 162-182.

Ameer, P.A. (2013), "Finance for the poor: an exploratory study of interest-free microfinance initiative at kuthiyathode panchayath, alappuzha, Kerala, India", *International Journal of Economics, Commerce and Research*, Vol. 3 No. 2, pp. 103-116.

Ara, S. (2003), "Non-banking financial intermediaries: the case of islamic financial institutions in the city of Chennai", Ph.D, Institute of Correspondence Education, University of Madras, Chennai.

Bagsiraj, M.G.I. (2003), *Islamic Financial Institutions of India: Progress Problems and Prospects*, CRIE, King Abdul Aziz University, Jeddah.

Bait-un-Nasr (2018), "Annual report for the period 2017-2018", Bait-un-Nasr Urban Cooperative Credit Society Limited, Mumbai.

El-Zoghbi, M. and Tarazi, M. (2011), "Trends in Sharia-Compliant financial inclusion", Focus Note 84, CGAP, Washington, DC, March.

Gurgoz, Y. (2014), "Islamic apex institution for microfinance and sustainability", *Journal of Economics and Sustainable Development*, Vol. 5 No. 18, pp. 159-176.

Hasan, A. (2014), "The challenge in poverty alleviation: role of Islamic microfinance and social capital", *Humanomics*, Vol. 30 No. 1, pp. 76-90.

Karim, N. Tarazi, M. and Reille, X. (2008), "Islamic microfinance: an emerging market niche", Focus Note 49, CGAP, Washington, DC, August, available at: http://siteresources.worldbank.org/EXTDEVDIALOGUE/Resources/537297-1241045572558/Islamic_MicroFinance.pdf (accessed 15 November 2018).

Khan, J.A. and Nisar, S. (2004), "Collateral (al rahn) as practiced by muslim funds of North India", *Journal of King Abdulaziz University-Islamic Economics*, Vol. 17 No. 1, pp. 17 -34.

Khatkhatay, M.H. and Nisar, S. (2014), "Conceptual understanding of service charges on loans and its application in Islamic microfinance", *Sahulat – A Journal of Interest Free Microfinance*, Vol. 2 No. 1, pp. 33-48.

Kothari, C.R. (2004), *Research Methodology, Methods and Techniques*, Second Revised Edition, New Age International Publishers, New Delhi, available at: www.modares.ac.ir/uploads/Agr.Oth.Lib.17.pdf (accessed 15 November 2018).

Ledgerwood, J. (1999), *Microfinance Handbook [eBook]*, World Bank, Washington, DC, available at: https://openknowledge.worldbank.org/bitstream/handle/10986/12383/18771.pdf (accessed 15 November 2018).

Mohammed, K.F. (2016), "Interest-free microfinance: a gateway for financial inclusion for Kerala", *International Journal of Research–Granthaalayah*, Vol. 4 No. 4, pp. 51-58.

Mohammad, T., Sabit, H.M., Martin, D. and Eni, S. (2018), "Affordability of islamic microfinance", journal of technology", *Management and Business*, Vol. 5 No. 3, pp. 43-53.

Nisar, S. and Syed, M.R. (2012), "Minority funds in India: institutional mobilizing of micro savings", in Nazim Ali, S. (Ed.), *Shari'a-Compliant Microfinance*, Routledge, Oxon, pp. 181-205.

Obaidullah, M. (2008), *Introduction to Islamic Microfinance*, IBF Net (P), New Delhi.

Obaidullah, M. and Khan, T. (2008), "Islamic microfinance development: challenges and initiatives", Islamic Research and Training Institute Dialogue Paper No. 2, Islamic Development Bank (IDB), Jeddah, 1 May.

Planning Commission, Government of India (2009), *A Hundred Small Steps, Report of the Committee on Financial Sector Reforms*, Sage Publications, New Delhi, available at: http://planningcommission.nic.in/reports/genrep/rep_fr/cfsr_all.pdf (accessed 15 November 2018).

Richardson, C.D. (2001), "Pearls monitoring system", available at: www.microfinancegateway.org/sites/default/files/mfg-en-paper-pearls-monitoring-system-oct-2002_0.pdf (accessed 15 November 2018).

Sa-Dhan (2018), "The Bharat microfinance report 2018", available at: www.sa-dhan.net/wp-content/uploads/2019/04/Bharat-Microfinance-Report-2018A.pdf (accessed 5 August 2019).

Seck, M.S. and Biaye, A. (2019), "The advent of islamic microfinance in Senegal", *International Journal of Innovation, Education and Research*, Vol. 7 No. 3, pp. 246-256.

Shaik Mohammed, W. and Waheed, K. (2018), "Interest-free microfinance in India: a case study of Al khair cooperative credit society", *Journal of King Abdul Aziz University: Islamic Economics*, Vol. 31 No. 1, pp. 47-66.

Shirazi, N.S., Obaidullah, M. and and Haneef, M.A. (2015), "Integration of waqf and islamic microfinance for poverty reduction: Case of Pakistan", IRTI Working Paper 1436-05, Islamic Research and Training Institute (IRTI), Jeddah.

Sofi, F.J. (2012), "Financing microenterprises: creating a potential value-based hybrid model for islamic microfinance", *International Journal of Management and Business Research*, Vol. 2 No. 2, pp. 108-122, available at: http://ijmbr.srbiau.ac.ir/article_539_c087b736952df593dac29a86910ee1d3.pdf (accessed 15 November 2018).

Syed, A.M. (2017), "Impact assessment of islamic microfinance in India: a case study", *Asian Journal of Research in Business Economics and Management*, Vol. 7 No. 6, pp. 148-171.

Further reading

Bait-un-Nasr (2016), "Annual report for the period 2015-2016", Bait-un-Nasr Urban Cooperative Credit Society Limited, Mumbai.

Bait-un-Nasr (2017), "Annual report for the period 2016-2017", Bait-un-Nasr Urban Cooperative Credit Society Limited, Mumbai.

About the authors

Wasiullah Shaik Mohammed is a PhD Research Scholar at the Department of Management Studies, B.S. Abdur Rahman Crescent Institute of Science and Technology (BSACIST), India. He earned his MBA in Finance from the prestigious Osmania University. He has structured Sharīʿah-compliant financial products and has been involved in Sharīʿah audit of interest-free microfinance institutions. More than a dozen of his research papers and articles have been published in national and international publications. He has also presented papers in national and international conferences. Wasiullah Shaik Mohammed is the corresponding author and can be contacted at: wasism@gmail.com

Khalid Waheed, PhD, is an Assistant Professor at the Department of Management Studies, BSACIST, India. He has been teaching Economics and Islamic finance for the past decade. He earned a PhD in Economics with specialization in Islamic banking from Aligarh Muslim University, a premier central university in India. He has also completed a course of Advance Studies in Islamic Jurisprudence from Al-Ma'had al-'Ali al-Islami, Hyderabad, India. He graduated in Sharīʿah and Arabic education from Jamiatul Falah, India. He has worked on various projects sponsored by Government of India and Centre for Inter-Disciplinary Studies (CIDS).