

Islamic Finance for Financial Inclusion ¹

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Let me first of all take this opportunity to address the young men and women who are present here. I would like to repeat what I have said on many occasions in the past and won't hesitate repeating this in the future unless it gets hammered in. Please do not shortchange yourselves by chasing degrees, certificates and grades, by memorizing selective material that is likely to be included in question papers and then spit it out at the examinations and then forget about it. You would repent it throughout your adult life if you do not pay heed to it. Knowledge is important more than grades and degrees. The objective of a student must be to absorb and assimilate knowledge and then apply it solve real world problems. As knowledge is changing exponentially, therefore, you must keep updating your knowledge by committing yourselves to continuous life long learning. Higher educational institutions should impart you skills of critical thinking and analytical ability so that you can embark upon this life long journey with confidence. You would then be able to act as change agents, managers and leaders in your respective professions.

I now turn to the topic of today's Conference. How can Islamic finance make a major contribution towards Financial Inclusion? Why is Financial inclusion so important for Pakistan? There are four key issues that are hampering Pakistan's trajectory towards sustained and equitable growth path. We have had booms and busts but not a smooth and orderly path. These impediments are poverty, inequality, regional disparity and illiteracy. Unless we come to grips with these challenges we are not going to make headway for the majority of the population particularly for the youth.

We have 55 million people living below the poverty line and we have to help lift them out of this misery. Moreover, we have stark income, gender and regional disparities which are growing day by day. 22 out of 26 districts of Balochistan have 70 to 90 percent of their population living below the poverty line without access to basic needs while Islamabad, Lahore and Karachi are affluent with less than 10 percent of the population being poor. We are confronted with low female literacy and low female labour force participation rates keeping almost three fourth of our active female working population from enjoying the fruits of a better productive life. We have 60 percent of the population below the age of 30 for whom we have to find gainful jobs and livelihoods.

Research studies show that Finance matters for growth as it provides one of the key factors of production i.e. capital in the hands of an individual who combines it with his labour and therefore produces output. Accumulation of these factors of production along with technical progress then leads to economic development.

Islamic finance can make a difference compared to conventional finance by filling in the missing gaps in access to finance to the poor and low income segments of the population. There are eight possible channels which should be explored but the basic prerequisite is to change the

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mindset which the Islamic bankers have inherited from their past employers , unlearn everything they have practiced so far and retrain themselves in new ways of doing business. It is in this light that I would like to lay down the agenda for financial inclusion for your consideration, debate and further thought. You may rightly say that I keep on changing the agenda but in this dynamic world if we remain static and do not take into account the changing circumstances and adapt ourselves we would be doomed. But the agenda I propose today is specifically tailored to meet the goal of financial inclusion and it is my belief that the Islamic financial services industry is better suited for this purpose. Let me spell out each of the eight points which form the proposed agenda for your industry.

1. It would be difficult to find 9 to 5 regular jobs for all the potential entrants to the labour force every year. We have to encourage entrepreneurship , start ups and supply them financing through seed capital, Venture funds, Angel Funds, private equity. As Islamic finance is based on risk sharing and risk participation this mode of finance very much falls under the ambit of Islamic Finance. The success ratio is low but the gains from the successful ventures are huge offsetting all the losses incurred on the failed start ups.
2. Small and Medium enterprises form the bulk of economic activity in manufacturing, trade, transport and services sectors but get very low quantum of financing from the formal banking sector. Islamic Finance through its instruments such as musharika and ijara can step in and as partners you i.e. the Islamic bankers should be able to develop relationships that result in assistance to the owners and their families in marketing, book keeping and technology upgradation. You have to switch your mental frame which is tuned to the needs of Corporate sector and large companies or high net worth individuals. You have to develop Credit scoring model through Artificial Intelligence and Data analytics , and program lending as tools for SME financing.
3. Rural poverty is twice the level of urban poverty. Agriculture productivity of small farmers is only 40 to 50 percent that of the progressive farmers as they cannot afford to buy the fertilizers, pesticides and other inputs. Islamic banks can supply not only revolving credit for these inputs but also encourage leasing of agriculture equipment for small farmers who cannot afford outright purchase. Middle men are making huge profits by exploiting the farmers and fleecing the urban consumers. There are many remunerative opportunities for financing warehouses and godowns, cold storages that can lease out spaces to farmers after harvest who can then avoid selling their produce at crash prices to these middlemen. Warehouse receipts can be used for providing funds for immediate needs of these farmers.
4. Vendor financing which links suppliers of components and parts or sells the manufactured products through distribution channels has proved to be a less risky mode of financing. Some of the Islamic banks have successfully embarked upon this product line. I would encourage others to follow the suit as it would fill in the working capital, inventory financing needs of small businesses who do not generate adequate cash flow on their own.
5. Low cost affordable housing is one of the priority areas of the present government and the Prime minister is personally guiding and stewarding this initiative. Diminishing musharika, in my view, is an ideal product offered by Islamic banks which helps build up

the equity of the house owner by capturing capital gains while paying monthly instalments to the banks. Mortgage financing in Pakistan is among the lowest in the region and the Islamic banks would find this as an attractive proposition as a home is both a social as well as an economic asset. For a poor family to dispossess from this asset is always going to be last but unavoidable recourse.

6. AS education and health services are becoming expensive depriving many talented students from poor family from pursuing higher and professional education or affording quality health care or medicines the banks can come up with Qarz e Hasna products for students and Takafuls can develop health coverage schemes. The Islamic banks can also provide financing for setting up colleges, universities, professional colleges, technical and vocational training Institutes, hospitals, clinics, laboratories and diversify their product mix towards social and human development.
7. Trusts which have been formed by Islamic banks for channeling the penalties collected from the customers with Zakat Funds should be managed to provide scholarships and stipends and free health services to the musthaqeen . These trusts have to step up their activities and come up with innovative ways to help the underprivileged population and underserved areas of the country in meaningful ways. You may not realize but these students upon completion of their education and getting good jobs become the role models for others in their villages , neighborhoods and communities. They inspire and motivate other young men and women to take their studies seriously and work diligently. . Social mobility can only take place if we invest in the future of these talented but financially challenged kids.
8. Finally, the fintech is the fastest way of reaching out and expanding access to the poor. Branchless banking, mobile wallets, unique identification, payment gateways , connectivity through fibre optic network throughout the country and fast growing use of smart phones are the building blocks along with enterprising individuals who can bring the excluded population within the financial system. Islamic financial institutions should position themselves for this .

To conclude, let us not turn these numerous conferences which are now being held throughout the year as a ritual where we come and talk and then disperse until we meet next at another conference or seminar. We have to debate, discuss and develop action plans on which we have reached a consensus. These incremental steps would pave the way for meeting the goals we have specified for ourselves. I hope that the next time I would listen to the progress you have made on these action plans. Wishing you best of luck in your deliberations today and tomorrow.