



Research Article

**ISLAMIC MICROFINANCE AND POVERTY REDUCTION IN HODAN DISTRICT
MOGADISHU, SOMALIA.**

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ABSTRACT

This study was carried out to investigate the relationship between Islamic microfinance and poverty reduction in Hodan District of Somalia. It was conducted under three specific objectives namely; (i) to examine the relationship between Murabaha and poverty reduction in Hodan District of Somalia, (ii) to find out the relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia and (iii) to identify the relationship between Salam and poverty reduction in Hodan District of Somalia. The study employed a correlational research design and a quantitative approach. A simple random sampling technique was used to select 148 respondents who were involve in the study. Data was collected using self-administered questionnaires and was analyzed based on a Pearson's Correlation Analysis as used in the SPSS computer program. The study findings based on Pearson's correlations revealed that; (i) there is a statistically significant positive and weak relationship between Murabaha and poverty reduction in Hodan District of Somalia ($r = .264$, Sig-value = $.003 < .01$), (ii) there is a statistically significant positive and strong relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia ($r = .752$, Sig-value = $.000 < .01$) and (iii) there is a statistically significant positive and strong relationship between Salam and poverty reduction in Hodan District of Somalia ($r = .628$, Sig-value = $.000 < .01$). Qardhul hasan was found to be the best model for poverty reduction in Hodan District of Somalia since it had a higher correlation coefficient of ($r = .752$) compared to the other models.

Keywords: Islamic microfinance, Murabaha, Qard-al-Hasan, Salaam Poverty.

1. INTRODUCTION

Islamic microfinance is the provision of financial services provided to the poor or low-income earners who normally do not have access to formal financial assistance from banks due to lack of collateral, unstable job and no credit history. Microfinance provides services such as accepting savings, giving loans or insurance, and transfer of money to less endowed individuals. Also, microfinance provides services such as education and professional training on how to invest and how to use loans to increase profitability. Thus, microfinance provides both financial and non-financial services to individuals in the low-income category, and provide managerial services on how to make use of the funds (Boachie, June 2, 2018). According to (M. Kabir Hassan, 2021).Islamic microfinance is a subset of Islamic finance; accordingly, it follows Shari'ah principles and prohibits riba (interest)-based transactions.

Poverty is unevenly spread throughout Somalia, with income poverty rates reaching nearly 60% in Mogadishu and around 40% in other regions. (World, Bank, 2019). A survey conducted by the Finnish Immigration Service in 2020 found that poverty in the capital city is severe. The report highlighted that the challenges in Mogadishu are largely driven by escalating poverty, disease, malnutrition, and a lack of education and healthcare services. It was also noted that the city faces significant food insecurity, relying heavily on food imports due to inadequate domestic food production, which results in very high food prices. Access to clean water is another major issue, with waterborne diseases widespread throughout the city. Additionally, while most of Somalia's healthcare facilities are located in larger cities, including Mogadishu, experts have expressed concern about the state of healthcare in the capital, describing it as "worrisome." (Heritage Institute and City University of Mogadishu, 2020) or even entirely inadequate. An evaluation carried out by (UNOCHA, 2021). It was also discovered that there are significant obstacles to accessing basic healthcare services in Mogadishu, leading to high rates of illness and mortality. Poverty is even more extreme in the Hodan district of Mogadishu, where only 11% of households have access to food, more than 43% lack a reliable source of safe drinking water, over 76% of household members are illiterate, and the unemployment rate is as high as 85.2%.(Mohamoud, 2017). Additionally, more than 46% of them reside in makeshift or emergency shelters, which are typically constructed with vegetation or consist of plastic sheets and poles. (REACH, Initiative, 2021). The propose of study was investigate the relationship between Islamic microfinance and poverty reduction in Hodan District of Somalia.

- i. To examine the relationship between Murabaha and poverty reduction in Hodan District of Somalia.
- ii. To identify the relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia.
- iii. To investigate the relationship between Salam and poverty reduction in Hodan District of Somalia.

2. LITERATURE REVIEW

Theoretical Framework

Islamic microfinance means "programme that extends small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families. The World Bank has recognized microfinance programme as an approach to address income inequalities and poverty. The microfinance scheme has been proven to be successful in many countries in addressing the problems of poverty. The World Bank has also declared 2005 as the year of microfinance with the aim

to expand their poverty eradication campaign (RAHMAN, 2008). Islamic microfinance institutions assumed to have a vital role in financing the poor and SMEs in the Muslim world. Hence, affirms for bringing initiatives in realizing the potential of Islamic microfinance institution in providing accessible financial services, promoting empowerment through entrepreneurship activities and creating an equitable distribution of wealth for the poor (Yasushi Suzuki, 2016).

Empirical Studies

Murabaha and Poverty Reduction

Through Murabaha financing, Islamic financial institutions not only grow their assets but also assist low-income individuals in financing their businesses, thereby improving their welfare. This aligns with the findings of Ibrahim (2003), who conducted a study in Sudan. The results showed that Murabaha financing enables many individuals to acquire the resources needed to start and operate businesses, which serve as a source of income and subsequently enhance their living standards. (Shams, 2016).

Murabaha is the most commonly available Sharia-compliant agreement utilized to meet the working capital requirements of business owners. Additionally, access to financial solutions such as Murabaha contributes to the economic empowerment and expansion of small businesses, ultimately improving the well-being of individuals. (UNDP, 2014). This is also consistent with (Abdi, 2013).

A study was carried out on Islamic microfinance products and their impact on the welfare of the Muslim community in Kisumu municipality, Kenya. The research found that the use of Islamic microfinance services, such as Murabaha, had a beneficial effect on the well-being of community members. The primary reason for adopting Murabaha financing was to support small-scale farmers and traders who struggle with insufficient funds to maintain their crops and businesses. (Sardar, 2013). As a result, contemporary Islamic financial institutions have adopted Murabaha financing as a key method for supporting trade and agriculture. This approach plays a crucial role in addressing poverty, unemployment, and inflation, while also promoting financial discipline in Islamic practices within the trade and agricultural sectors. (Kassim, 2016).

Qardhul Hasan and Poverty Reduction

Qardhul Hassan is a key mechanism for offering loans to low-income segments of society within the Islamic banking system. By organizing and utilizing this micro-credit tool for income redistribution among the community, it can establish the foundation for poverty reduction initiatives and promote financial inclusion through effective planning and execution of micro-credit projects in the country. (Mojtahed, 2009). Qard al-Hasan financing has the potential to significantly enhance the operations of MSMEs and can be further developed to boost the economy, particularly for the disadvantaged. This study seeks to examine the feasibility of applying Qard al-Hasan in crowdfunding as a viable funding option for micro and small enterprises. To the researcher's knowledge, and based on the reviewed literature, most previous studies have mainly concentrated on recommending Islamic contracts suitable for crowdfunding, with limited research exploring the use of Qard al-Hasan in crowdfunding. (Febianto, 2012).

Salaam and Poverty Reduction

Salam contracts can play a crucial role in alleviating poverty in rural areas by ensuring timely access to advance credit and facilitating priority purchases from small-scale farmers and tenants. These contracts can also help stabilize food prices by securing future prices through pre-agreed terms. With guaranteed incomes, farmers can invest in higher-quality agricultural inputs. Furthermore, the study suggests that these benefits would be more effectively realized if banks, in collaboration with the government, announce crop support prices well in advance of the harvest season. (Kaleem, 2009).

Salam Financing Scheme is more suitable for agricultural financing than the Murabaha financing that are commonly used today. This might be because the Salam financing scheme intends to finance the sale and purchase of new commodities that are to be processed or produced and the delivery of their goods in the future, as well as allow for irregular payment schemes made in the harvest (Utama, 2019).

Salam can be utilized to finance economic activities across short, medium, and long-term periods. It can support a range of sectors, including agriculture, industry, trade, and services. Through Salam, funding can be directed toward covering operating costs or capital expenditures, regardless of the size of the business. Overall, the Salam structure (despite the limitations of the Salam sale) is known for its high level of flexibility and its strong ability to address diverse economic needs (Al-Siddig, 2020).

Gaps in Literature

The literature review reveals a gap in existing research on Islamic microfinance, including focus on SME growth rather than poverty reduction, a lack of studies in underdeveloped countries like Somalia, the absence of a cyclical theory of poverty, and a predominance of descriptive and qualitative methods. This study aims to address these gaps by using correlational and quantitative approaches to explore the relationship between Islamic microfinance and poverty reduction in Hodan District Somalia.

3. METHODOLOGY

Research Design

This study was adopting a correlational research design. According to (Lepcha, March 2023) Correlational research is a non-experimental method that examines the relationship between two variables through statistical analysis. The study employed a quantitative approach. According to (Bryman, 2016). Quantitative research depends on the collection and analysis of data, following a logical approach aimed at testing theories, and is guided by empiricist and positivist philosophies.

Study Area

This study was conducted from Hodan District, Mogadishu, Somalia. Hodan District is a District found in the southeastern Banadir region of Somalia. The justification for choosing Hodan District, Mogadishu was because it is one of the areas with the worst poverty indicators since only 11% of the households living in this district, have access to food, over 43% do not have a main source of safe drinking water, over 76% of the household members are illiterate and the overall unemployment rate stands at 85.2% (Mohamoud O. M., 2017).

Data Collection Methods

Questionnaire; The study used Self-Administered Questionnaires (SAQs) as data collection methods.

Sampling Technique

The study used a simple random sampling method to choose participants from various groups. This approach was selected because it helps eliminate any potential bias that could result from the preferences of the person choosing the sample (Abbott, 2016). And sample size for this study was 148 respondents from Amal Bank clients who have been utilizing its Murabaha, Qardhul Hasan, and Salaam financing

Data Analysis

The researcher coded and reviewed the questionnaire data before inputting it into SPSS (Version 20) for analysis. Pearson's Correlation was applied to test the hypotheses and evaluate the connection between Islamic microfinance services and poverty alleviation in Hodan District, Somalia. This method was selected due to its appropriateness for hypothesis testing and examining the relationships between variables.(Kothari, 2004).

Ethical Considerations

The researcher ensured ethical standards by obtaining consents from app participants, guaranteeing confidentiality and anonymity of their responses. All resources were appropriately credited, and findings were presented honestly, based on the data collected.

4. RESULTS

Descriptive Statistics

Demographic Characteristics of Respondents

Category	Frequency	Percent	Valid Percent	Cumulative Percent
Gender				
Male	40	32.3	32.3	32.3
Female	84	67.7	67.7	100.0
Education Level				
Primary level education	13	10.5	10.5	10.5
Secondary l education	56	45.2	45.2	55.6
Ordinary Diploma	32	25.8	25.8	81.5
Bachelor's degree	19	15.3	15.3	96.8

Master's degree	4	3.2	3.2	100.0
Age Group				
18 – 25 years	9	7.3	7.3	7.3
26 – 35 years	5	4.0	4.0	11.3
36 – 45 years	53	42.7	42.7	54.0
46 – 55 years	44	35.5	35.5	89.5
Above 55 years	13	10.5	10.5	100.0

Table 1 provides the demographic details of the respondents. A large majority were female (67.7%), while 32.3% were male, indicating a higher representation of women. Most respondents had secondary education (45.2%), followed by ordinary diploma holders (25.8%), with smaller groups holding primary education (10.5%), a Bachelor's degree (15.3%), and a Master's degree (3.2%). This suggests that most respondents had at least some secondary education. In terms of age, the most common group was 36–45 years (42.7%), followed by 46–55 years (35.5%). Smaller percentages were aged 18–25 years (7.3%), 26–35 years (4.0%), and above 55 years (10.5%), indicating that most respondents were middle-aged, typical of microfinance clients.

Impact of Islamic Microfinance

Microfinance is considered a long-term solution for helping low-income individuals and their businesses gain access to financial services. It is broadly acknowledged as a key tool for boosting the productivity of poor people and promoting a country's economic growth. Essentially, microfinance is often associated with small, working capital loans that are used to launch small businesses or support productive activities. In simple terms, microfinance involves providing small loans to individuals who have limited financial resources, particularly those who are not accustomed to receiving loans from traditional banks (Mohamud, 2023).

Challenges and Opportunities

The expensive Murabaha assets and the bank's limited focus on small business restrict access for the poor. Amal bank could reduce prices and give more attention to financing small business to create income opportunities. For Qardhul Hasan, the requirement for collateral and the complicated application process makes it difficult for the poor to access loans. Simplifying these processes and eliminating the collateral requirement would better serve vulnerable groups. Regarding Salam, the need for collateral and inadequate loan amounts limit accessibility. Increasing the loan amounts and prioritizing the feasibility of projects over collateral would make it easier for people to access financing.

5. Discussion

Interpretation of Findings

Objective One: To Examine the Relationship between Murabaha and Poverty Reduction in Hodan District of Somalia and results reveal that Murabaha has a weak but positive relationship with poverty reduction in Hodan District of Somalia ($r = .264$). The relationship is also statistically significant

since the Sig-value is .003 which is less than .01.

Objective Two: To Examine the Relationship between Qardhul Hasan and Poverty Reduction in Hodan District of Somalia and the results reveal that Qardhul hasan has a strong positive significant relationship with poverty reduction in Hodan District of Somalia ($r = .752$). The relationship is also statistically significant since the Sig-value is .000 which is less than .01.

Objective Three: To Examine the Relationship between Salam and Poverty Reduction in Hodan District of Somalia and the results reveal that Salam has a strong positive significant relationship with poverty reduction in Hodan District of Somalia ($r = .628$). The relationship is also statistically significant since the Sig-value is .000 which is less than .01.

Implications for Policy and Practice

These findings indicate that Islamic microfinance products, especially when tailored to needs of the poor and vulnerable, can play significant role in reducing poverty. Policymakers and microfinance institutions can work together to enhance affordability, target vulnerable groups and expand access to financing, thereby fostering economic empowerment and improving livelihoods in areas like Hodan District in Somalia.

Limitations of the Study

The limitations of this study include external economic and political factors that were beyond its scope, which may have influenced poverty reduction efforts. Additionally, the sample size may constrain the generalizability of the findings to the wider population of Hodan District. Furthermore, the reliance on quantitative methods may have restricted a more in-depth exploration of contextual factors affecting poverty reduction.

6. CONCLUSION AND RECOMMENDATIONS

Conclusion

Murabaha and Poverty Reduction: the results indicated that there is a statistically significant positive and weak relationship between Murabaha and poverty reduction in Hodan District of Somalia ($r = .264$, Sig-value = .003 < .01). Based on these findings, the null hypothesis which stated that “there is no statistically significant relationship between Murabaha and poverty reduction in Hodan District of Somalia” was rejected in favor of the alternative. It was hence concluded that there is a statistically significant positive relationship between Murabaha and poverty reduction in Hodan District of Somalia.

Qardhul Hasan and Poverty Reduction the results indicated that there is a statistically significant positive and very strong relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia ($r = .752$, Sig-value = .000 < .01). Based on these findings, the null hypothesis which stated that “there is no statistically significant relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia” was rejected in favor of the alternative. It was hence concluded that there is a statistically significant positive relationship between Qardhul hasan and poverty reduction in Hodan District of Somalia.

Salam and Poverty Reduction: the results indicated that there is a statistically significant positive and strong relationship between Salam and poverty reduction in Hodan District of Somalia ($r = .628$, Sig-value = .000 < .01). Based on these findings, the null hypothesis which stated that “there is no statistically significant relationship between Salam and poverty reduction in Hodan District of Somalia” was rejected

in favor of the alternative. It was hence concluded that there is a statistically significant positive relationship between Salam and poverty reduction in Hodan District of Somalia.

Recommendations

Based on the study findings and conclusions, it was recommended that Amal bank should adjust the prices of its Murabaha assets and make them affordable to the poor people of Hodan district. This will help the poor people in this area to get the assets they need to start and run businesses which would act as a source of income and hence reduce the levels of poverty in the area. Additionally, in the provision of Qardhul hasan loans to the people, focus should be put on the vulnerable members of the society such as the poor, the widow, women, small business owners and others as these are the ones that need these loans most. Amal bank should also consider increasing on the money provided to its Salam financing clients at least to levels that could enable them meet their household needs.

Areas for Future Research

This study examined the impact of Islamic microfinance on poverty reduction in Hodan District, Somalia, and recommends similar research in other areas for comparison. Future studies could also include qualitative methods like interviews, as this one was purely quantitative.

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