



Poverty Alleviation through the Islamic Finance Inclusion: Systematic Literature Review



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Abstract: The goal of this study is to evaluate how financial inclusion reduces poverty. The paper first examines how financial inclusion reduces poverty. The research article then compares Islamic and mainstream financial inclusion. Thirdly, the study examines global Islamic financial inclusion components. Islamic finance alleviates poverty and promotes economic growth, environmental sustainability, and social responsibility. The restriction on riba, profit-and-loss sharing, asset-backed lending, ethical investment, zakat and sadqah, and financial education, which are crucial to Islamic financial inclusion, creates these effects. Islamic finance encourages ethical investing, socially responsible business practices, charity, and social welfare. All these behaviours encourage social responsibility. The Islamic Research and Training Institute, International Institute of Islamic Banking and Financing, and UNDP say Islamic financing promotes society. These effects make Islamic financial inclusion a more just and equitable society.

Key Words: Islamic Financial Inclusion, Social Actions, Islamic finance, SLR

JEL Classification:

Introduction

The term "Islamic finance" refers to a set of banking practices that are in line with Islamic teachings. The basic objective of Islamic finance is to promote social welfare and financial inclusion and to ensure the integrity of all financial transactions. Conversely, financial inclusion is the practice of facilitating access to affordable and appropriate financial services and products for individuals and organizations. The use of banking, credit, insurance, and payment systems are all accessible. When people and businesses have

access to basic financial services, they are better equipped to plan for the future, invest in themselves, and contribute to economic progress.

Access to a range of Islamically compliant financial products and services is what is meant by "financial inclusion" in the context of Islamic finance. Islamic finance refers to a wide range of financial services and products that adhere to Islamic principles. Islamic microfinance adheres to tenets of Islam including the prohibition of interest (Riba) and the requirement of profit- and risk-sharing.

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Microloans and other financial services are available from Islamic microfinance institutions for low-income individuals and small businesses. The Islamic insurance system known as *takaful* is predicated on the principles of shared risk and cooperation. It provides insurance for both individuals and businesses while ensuring that all financial dealings are in line with Islamic law. The Islamic banking system is based on Islamic principles such as the prohibition of interest (*Riba*) and the necessity of profit and risk sharing. Investment packages, credit lines, and savings accounts are just some of the banking products and services that Islamic banks provide.

Islamic capital market instruments are financial tools that are compliant with Islamic law. They include Islamic mutual funds, *Sukuk* (Islamic bonds), and Islamic equities. Islamic finance, as a whole, promotes social welfare and financial inclusion via the provision of a range of financial products and services that are consistent with Islamic principles and values.

What are Islamic and conventional Financial Inclusion:

As defined by the World Bank, financial inclusion is "the process of ensuring that mainstream institutional players provide all segments of society with access to the necessary financial products and services at an affordable price in a fair and transparent manner, with a focus on vulnerable groups like low-income, underprivileged, and disadvantaged groups" (RBI, 2021).

Simply put, financial inclusion is the availability of financial services for all individuals and businesses, regardless of their geography or socioeconomic status. Some examples include banking, credit, insurance, and money transfer services. The goal of financial inclusion is to boost economic growth by facilitating individuals' and organizations' ability to budget, save, and invest for the future.

According to a World Bank assessment, around 1.7 billion adults around the world do not have access to formal financial services. As

reported by the World Bank (2018). Fewer work opportunities can worsen poverty and inequality if people can't get their hands on basic banking services. This is why many governments and organizations around the world have made expanding access to financial services a priority.

Low levels of financial knowledge, high transaction costs, and limited access to financial services in rural and remote areas all contribute to financial exclusion. To combat these issues, governments and financial institutions have taken steps such as expanding access to financial services, advocating for the use of digital financial tools, and educating underprivileged populations about money management.

In conclusion, the provision of financial services to all citizens, irrespective of their socioeconomic standing or geographic location, is a critical governmental objective. It may play a crucial role in stimulating economic development and alleviating poverty.

To provide financial services in accordance with Islamic principles and values to all people and businesses, regardless of their income or location, is what is meant by "Islamic financial inclusion." There are a variety of Islamic financial services available, including Islamic banking, Islamic microfinancing, Islamic insurance (*Takaful*), and more.

Shariah law, the basis of Islamic finance, bans interest (*Riba*) and encourages risk and profit sharing. The purpose of Islamic finance is to promote economic and social prosperity in a way that is moral and just.

The goal of Islamic financial inclusion is to ensure that people of all backgrounds, incomes, and beliefs have equal access to the full range of financial services available in the modern economy. In many countries where Muslims make up the majority of the population, Islamic finance has played a crucial role in expanding access to banking services (IFSB, 2016).

Islamic microfinance is one type of Islamic financial inclusion. It provides microloans and other financial services to those with low

incomes and small businesses. The rejection of interest (Riba) and the requirement of profit and risk sharing are two core Islamic principles represented in the structure of these loans. The financial needs of rural and female populations, in particular, have been effectively met by Islamic microfinance groups (IMF, [2018](#)).

Islamic insurance (Takaful) is another example of how Islam has helped to expand access to the insurance market. It ensures that all business dealings are in accordance with Islamic principles while providing insurance to individuals and companies. It's based on the ideas of mutual aid and taking turns bearing responsibility for outcomes. Takaful has become an increasingly important aspect of the Islamic finance industry and has played a crucial role in expanding access to Islamic finance. As reported by the World Bank ([2018](#)).

In general, the goal of Islamic financial inclusion is to ensure that all individuals and businesses, regardless of their socioeconomic status or geographic location, have equal access to Islamically compliant financial services. It may play a crucial role in stimulating economic development and alleviating poverty.

The ban on riba (interest), which is also a critical component of Islamic financial inclusion, is one of the foundations of Islamic finance. In Islamic finance, interest on loans or investments is referred to as "riba," which is considered unfair and exploitative. Instead, Islamic finance encourages the lender and borrower to share profits and risks, so that both parties benefit from the investment's gains and losses.

The cornerstone for Islamic finance's restriction on riba is the Quranic edicts that prohibit charging or paying interest. These prohibitions are reflected in the Islamic legal tradition, which provides recommendations on how to conduct financial transactions in conformity with Islamic principles and values (Ali & Ahmad, [2018](#)).

The Riba prohibition has a variety of implications for Islamic financial inclusion. First, it requires financial institutions to

develop alternate profit-and-risk-sharing funding mechanisms. Among these techniques are cost-plus financing, collaborative enterprises, and mudarabah (profit sharing).

Second, the ban on riba helps to reduce financial exclusion by providing access to financial services that adhere to Islamic principles and values. This is critical in Muslim-majority countries where the general public may prefer Islamic finance over conventional finance (El-Gamal, [2006](#)).

Third, the prohibition of riba supports financial stability by minimizing the likelihood of financial crises caused by excessive debt and speculation. Islamic finance promotes ethical investments that benefit social welfare and economic prosperity, and it requires that financing be backed by actual assets (Khan, 2015).

In general, the prohibition of riba is a critical component of Islamic financial inclusion, which promotes access to moral, just, and consistent Islamic standards financial services.

Profit and loss sharing (PLS) is a central tenet of Islamic banking and a foundational principle of Islamic financial inclusion. PLS is a type of financing in which the lender and the borrower share the profits and losses of an investment in accordance with their respective stakes in the enterprise.

In contrast to conventional finance, which employs fixed and predetermined interest rates, Islamic finance makes use of PLS mechanisms like Mudarabah and Musharakah to distribute the risks and rewards of investment among the participants. The money is provided by the lender, while the expertise and work are those of the borrower. The profits from the investment are split between the partners in accordance with the agreed-upon ratio, while any losses are shared equally. According to (El-Hawary, Grais, & Iqbal, 2004).

The use of PLS in Islamic finance has several outcomes for broadening access to credit. First, it promotes a more fair allocation

of wealth by allowing individuals and organizations to share in the benefits and costs of the economy. This is especially important in Muslim-majority countries where financial services are scarce and income disparities are high.

Second, PLS processes provide an alternative funding option for small and medium-sized enterprises (SMEs) and start-ups that may not have the collateral or credit history required for conventional financing (Haneef, [2015](#)).

Third, PLS systems help reduce the risk of financial instability because they encourage investments in lawful economic activities while discouraging speculation and excessive debt. Long-term economic growth and development are aided by PLS procedures because they encourage moral and responsible investing (Iqbal, & Mirakhor, [2011](#)).

In sum, PLS is an essential part of Islamic financial inclusion, which promotes people's ability to gain access to financial services that are equitable, sustainable, and consistent with Islamic principles and values.

Asset-backed borrowing is a major mechanism for expanding access to finance in the Islamic financial system. Real estate, machinery, or even shares of stock might serve as collateral for a loan in an asset-backed finance arrangement. In Islamic finance, asset-backed financing is seen as a way to guarantee adherence to Islamic standards, boost financial stability, and lessen risk.

The use of asset-backed financing in Islamic finance has several consequences on access to credit. To begin, it provides a source of capital for individuals and businesses that may not qualify for traditional loans due to a lack of collateral or an inadequate credit history. By employing tangible assets as collateral, asset-backed finance can reduce the risk for lenders while expanding the pool of potential borrowers (Khan, [2015](#)).

Second, Asset-backed finance promotes transparency and accountability in monetary dealings by guaranteeing that loans are supported by real assets rather than

speculation or excessive debt. This is in line with Islamic principles, which restrict excessive risk-taking and speculation and emphasize the importance of basing financing on real economic activity (Iqbal, & Mirakhor, 2011).

Third, the purchase of property or equipment, both of which contribute to economic growth and the creation of jobs, can be financed via asset-backed financing (Hasan, [2015](#)).

Asset-backed finance is an important part of Islamic financial inclusion because it promotes the use of honest, transparent, and lawful economic activities as a basis for financial services.

Ethical investment is a cornerstone of Islamic financial inclusion, which is founded on the principle of avoiding haram (prohibited) activities such as gambling, alcohol, and tobacco. Moral investment methods that are socially conscious and boost the well-being of people and society as a whole are encouraged by Islamic finance.

Ethical investment is possible in Islamic finance in a number of ways, including vetting investments for conformity with Islamic principles, funding social and community development projects with Zakat (charitable donations), and investing in sectors that share ethical and socially conscious values.

One of the primary ways in which Islamic finance encourages moral investment is through the use of Shariah-compliant investment vehicles like Islamic mutual funds, which are managed in line with Shariah principles and evaluated for compliance with Islamic values. Since these funds are seen as socially responsible and in line with Islamic ideals, they usually invest in areas like healthcare, education, and renewable energy (El-Gamal, & Ince, 2015).

Another method that Islamic finance promotes moral investment is through the obligatory charity payment known as zakat that Muslims make to help the poor (Obaidullah & Khan, [2008](#)). Education, healthcare, and fighting poverty are just some of the many worthy causes that might benefit

from Zakat donations made through charity organizations or Zakat funds (Sait & Lim, 2006).

Ethical investment is a key component of Islamic financial inclusion, which promotes people's and society's betterment through the provision of financial services consistent with moral and socially conscious objectives.

Zakat and Sadaqah, two essential elements of Islamic financial inclusion, promote economic and social justice, reduce poverty, and encourage personal and community development.

Donating to charity in the form of zakat is obligatory for Muslims who meet specific financial thresholds. Those in need receive it, including the poor, the homeless, the indebted, and those on the road. Muslims are required by faith to pay zakat, which is one of Islam's five pillars.

Sadaqah, on the other hand, is a voluntary charitable contribution made by Muslims at any time that is not subject to Zakat's restrictions. Sadaqah can be provided in the form of money, commodities, or services, and it can be used to fund a wide range of initiatives, such as those focused on improving local infrastructure, providing access to quality healthcare, and bolstering educational opportunities. Researchers Abdul-Rahman and Abdul-Razak (2013).

In the context of Islamic banking, zakat and sadaqah are essential instruments for promoting social justice and financial inclusion. The poor and needy can benefit from Zakat donations made to charity organizations or directly from Zakat monies. By providing a safety net for the poor and needy, zakat can help bring about a more equitable distribution of resources and boost efforts to combat poverty, inequality, and social exclusion.

In a similar vein, sadaqah can be utilized to support a wide range of social and community development projects, including those focused on environmental preservation, medical care, and educational advancement. Poor and disadvantaged people can have access to financial and economic

opportunities by using Sadaqah to support the development of new businesses and microfinance initiatives (M. Obaidullah and T. Khan, 2008). In the Islamic tradition, Zakat and Sadaqah are obligatory charitable contributions that serve to promote economic and social equity, alleviate poverty, and advance local communities. They also play a role in distributing aid to people who require it.

Poverty Reduction

The use of Islamic finance is seen as a significant tool that can help reduce poverty and promote economic development that includes more people. Multiple pieces of research have pointed to the positive impact that Islamic money can have on the alleviation of poverty. For instance, a study conducted by the Islamic Development Bank (IDB) found that Islamic microfinance has the potential to significantly reduce levels of poverty and significantly improve the financial well-being of households with low incomes. According to the findings of the study, Islamic microfinance has the potential to improve living conditions by increasing household incomes, fostering the growth of opportunities for self-employment, and improving the overall quality of life. (IDB, 2011).

A second World Bank study found that providing underprivileged populations with access to financial services through the use of Islamic financing could contribute to an increase in financial inclusion as well as a reduction in poverty. According to the findings of the study, Islamic finance has the potential to contribute to the correction of market inefficiencies within the framework of the financial system and to provide cutting-edge financial products and services that are better adapted to satisfy the needs of the economically disadvantaged and vulnerable. (2013) According to the World Bank.

In addition, research conducted by the International Centre for Education in Islamic Financing (INCEIF) found that Islamic financing can contribute to financial inclusion and the alleviation of poverty by facilitating

access to funding for priority sectors. These priority sectors include small and medium-sized businesses (SMEs). According to the findings of the study, the promotion of inclusive economic growth and the elimination of poverty can be aided by the activities of entrepreneurship, innovation, and the mobilization of financial resources (INCEIF, 2014).

In conclusion, Islamic banking has the potential to have a significant positive impact on the fight against poverty through its ability to facilitate access to financial services and goods that are more easily available, equitable, and socially responsible. Islamic financial practices such as profit-loss sharing and zakat can also help underprivileged populations create wealth and find employment opportunities, so reducing poverty and supporting economic growth that is inclusive of more people.

Because of its emphasis on moral and socially aware investing and its dedication to enabling access to credit for small and medium-sized enterprises (SMEs) and other priority industries, Islamic finance has been recognized as having the ability to contribute to economic growth. This is owing to the fact that Islamic finance places a strong emphasis on moral and socially conscious investing. The following is a list of scholarly references that discuss the ways in which Islamic financing influences economic expansion:

According to a report published by the Islamic Development Bank (IDB), small and medium-sized businesses (SMEs) and other critical sectors can have access to funding through Islamic finance. According to the findings of the paper, the promotion of inclusive economic growth and the eradication of poverty are both possible outcomes of entrepreneurialism, innovation, and the effective use of financial resources. (IDB, 2014) .

According to the findings of another study conducted by the World Bank, Islamic finance has the potential to stimulate economic expansion by expanding access to credit to underserved demographics and geographic

regions, such as women and rural communities. According to the findings of the study, Islamic finance has the potential to contribute to the correction of market inefficiencies within the framework of the financial system and to provide cutting-edge financial products and services that are better adapted to satisfy the needs of the economically disadvantaged and vulnerable. (2013) According to the World Bank.

According to the findings of a study conducted by the International Centre for Education in Islamic Finance (INCEIF), Islamic finance can contribute to the advancement of economic growth by investing in ways that are morally and socially appropriate. According to the findings of the study, investing in endeavours that have a positive impact on society as well as the natural environment, such as microfinance and renewable energy, can help to encourage sustainable economic growth and development. (2014) According to the INCEIF.

In conclusion, Islamic finance may encourage ethical and socially responsible investment, enable access to credit for small and medium-sized enterprises and populations that are marginalized, and mobilize financial resources for important industries. Through the promotion of inclusive economic growth and sustainable development, Islamic finance can assist in the production of wealth as well as job possibilities, thereby enhancing social welfare and contributing to the alleviation of poverty.

Sustainability in the Environment: When it comes to matters pertaining to the environment, Islamic finance has a lot to offer in the way of sustainable development. Because Islamic financial practices prohibit investments in activities that are harmful to the environment and place a strong emphasis on social responsibility, they are particularly well-suited to fostering environmental sustainability. This is because Islamic financial practices also place a high emphasis on social responsibility. The following authoritative references show how the use of Islamic money affects the earth's ability to maintain itself:

According to the findings of a study conducted by the International Institute of Islamic Banking and Finance (IIIBF), Islamic finance may encourage investments in environmentally friendly initiatives and promote sustainable corporate practices. According to the findings of the study, Islamic financing has the potential to encourage businesses to adopt environmentally responsible practices and to assist in the mobilization of financial resources for environmental initiatives such as those involving renewable energy and sustainable agriculture. Earlier this year (IIIBF, [2019](#)).

In a separate piece of research, the United Nations Environment Programme (UNEP) found that Islamic money may help promote environmental sustainability since it emphasizes the importance of social responsibility and ethical investment practices. The research showed that Islamic finance can be helpful in coordinating financial decisions with environmental goals and can encourage the adoption of ecologically and socially responsible organizational practices. This was one of the conclusions drawn from the study. (UNEP, 2016) .

According to a study conducted by the World Wildlife Fund (WWF), Islamic money has the potential to encourage investments in renewable energy and other projects that are friendly to the environment, so contributing to an increase in environmental sustainability. According to the findings of the study, Islamic finance has the potential to facilitate the acquisition of money for environmental initiatives and to provide innovative financial mechanisms that are better suited to meet the requirements of an eco-friendly economy. (WWF, [2015](#)) .

In conclusion, Islamic finance has the potential to encourage businesses to embrace environmentally friendly practices, support investments in environmentally friendly activities, and coordinate financial investments with environmental aims. Through the promotion of sustainable development and the reduction of the environmental impacts of economic activity, Islamic banking has the potential to make a positive contribution to the long-term prospects of future generations.

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