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## MICROFINANCE IN SAUDI ARABIA

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### **ABSTRACT:**

Finance is broad in terms of concepts and applications. The main aim of microfinance started off by the developing countries to eradicate and mitigate poverty levels from their countries. They have so far been successful in attempting the results but have not reached the extent they were aiming for because of lack of knowledge and less discussed topic in finance. The purpose of this research is to identify the microfinance in Saudi Arabia because there is absence of literature in relation to the microfinance. This research also investigate the growth pattern of the microfinance sector, evaluate the different factors affecting the growth of the microfinance sector as well as the impact of the microfinance sector the economy of the low income earners and the entire economy. The methodology of the research is qualitative and analyses information from different sources available in relation to the microfinance. The results of the research showed that microfinance is yet to develop in Saudi Arabia and mostly is used for the SMEs. The research highlights the importance of the knowledge of microfinance and its use in the modern economy.

### **INTRODUCTION:**

Microfinance refers to an array of financial services, including loans, savings and insurance, available to poor entrepreneurs and small business owners who have no collateral and wouldn't otherwise qualify for a standard bank loan [1]. The biggest pillar of the economy world is the banking industry. Due to rapid changes in the economy there have been many developments in the banking industry. Mobile banking platforms is one of the developments, but it has still not been adapted in many parts of the world. The robust encroachment of microfinances is the other development in the banking industry [2]. In Saudi Arabia, there is high competition among different banks due to establishment

of many banks around the cities. Microfinance is the tool to decrease income inequality, allowing citizens from lower socio-economical classes to contribute in the economy. Moreover, its participation has shown to lead to a downward trend in income inequality [3].

In micro financial institutions, there has been a high establishment due to the expanding of the banking industry. Institutions have developed into banks because of the growing and high demand of the banking industry. For instance in Saudi Arabia, the Arab Gulf Program for Development (AGFUND) supports the institutionalization of microfinance industry [4]. They do this by following the Islamic law, by qualifying the Saudi non-governmental organizations to provide credit. Saudi Arabia is one of the world's fastest growing markets. Specific microfinance institutions working in Saudi Arabia is highlighted as it is one of the strongest and largest economies of the region. There was excellent growth pattern in Saudi Arabia even after the fall of the economy, especially in the oil market. From the past many years Saudi Arabian banks are very well equipped in providing good loan to deposit ratios [5]. Because of the strong and sturdy regulations, the banks even have low exposure to foreign debt. There are high reserve and liquidity requirements for the banks in Saudi Arabia. Saudi Arabia's financial sector is very protective and supportive when compared to the other gulf countries. Micro-financing initiative is set out to improve the standard of living amongst impoverished communities [6].

Microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses. The banking sector's relies on corporate loans which are usually high; this provides the sector's to get its retail loans. This can be done if the banks focus on giving corporate loans and the microfinance industry should give the retail loans. Net interest margins can be improved if there is total concentration and full focus on the retail loans. The economic conditions of the country can be improved if the small income earners give there access to financial services to give low income owners total benefit of their income [7].

As an example, people don't have enough money when they face a need, so they borrow. A poor family might borrow from relatives to buy land, from a moneylender to buy rice, or from a microfinance institution to buy a sewing machine. Since these loans must be repaid by saving after the cost is incurred, Rutherford calls this 'saving down'. This article focuses on how the government, institutions and other users can fetch the information on the new trends of banking sectors and in specific the microfinance institutions. They can get a great help from the microfinance institutions as they are the strongest and fastest growing industry of the world. It also helps in taking the desired and very useful decisions by the authorities for the proper development of the banking sector in particular microfinance it is the largest economy. It has come to light that due to the growth if micro financial institutions in the banking sector, there has been development in the society. The United Kingdom of Saudi Arabia government is pushing itself on empowering towards self-

employment and to come with new job ideas to defeat unemployment. The problem of unemployment can be defeated if the microfinance institutions adapts the microfinance policies which can later provide credit facilities to the low income people. Therefore, this research identifies the contribution of microfinance in the development of financial and other sectors in Saudi Arabia.

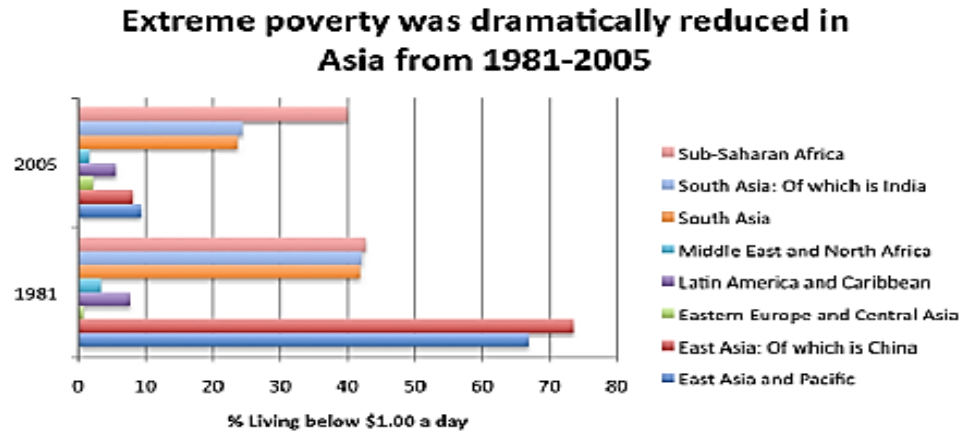
## **METHODOLOGY**

This research used qualitative method whereby the descriptive analysis is conducted by using literature survey. There is no primary data generated for the research although secondary data is being used for the purpose of the research. The data is being collected from different sources to evaluate different studies. The target population in this research is the microfinance institutions, the bank industry, etc. Some economy determiners in the surrounding region can also be involved in comparing the different theories suggested to the topic of micro finance.

## **RESULT AND DISCUSSION**

### ***The initiation of micro finance and role in the economy and financial structures***

Microfinance has been very important to the economic and financial structures over the decade. With the introduction of the idea of the micro finance in the world of finance and economy, things have changed. It is a less discussed topic both in the academics and the practical life, because people associate micro finance with the poor people and do not use it on a large scale. Like every other field and instrument of finance, micro finance has its own sets of benefits and limitations. It was first introduced in the Asian continent due to the presence of extreme poverty. The initial goal of the micro finance was to alleviate poverty from the rural areas and it has been successful in doing so. This has been depicted in the graph (Figure 1). It was incorporated in all the rural areas of Asian economy especially in India and Bangladesh where it all started. These are the countries where it all started and now has an established business in these countries. The topic of micro finance is growing though but on a slow and note on a large scale as people still have misconceptions regarding it as the financial options that is served only in rural areas and the lack of concept of clear return from the micro finance also adds up to the situation. The graph in Figure 1 shows how inclusion of micro finance in the rural areas reduced poverty to a huge extent. Apart from reducing poverty, it participated in the numerous economic activities thus offering solutions to the existing and future challenges.



**Figure 1:** Dramatic decrease in poverty due to micro finance [8]

### *Benefits of micro finance*

When the financial analysts and other people saw that it had more to do rather than just helping poor people on their own, the market for the micro finance institutions grew in a matter of time offering solutions to many problems. Micro finance has been associated to solving existing problems like growth of existing business, employment generation both in the rural and urban areas along with the outreach to the rural clients. The current problems like development of start-up enterprises and growth of small and medium enterprises was almost handled by the micro financial institutions. It has given self-esteem and has raised confidence among the poor people to think about the idea of saving up their money and growing it in value and freeing themselves from the barrier and vicious circle of debt that covered their families and future generation. Many plans and ideas of investment have started up in rural areas and in a matter of few years or so, these areas will also be integrated along with the main market both in terms of the economy and finance. The graph in Figure 2 compares the goals of the MFIs and the outcomes stating that they have been successful in achieving what they had set as a goal earlier. They helped in most of the activities whereby the one activity where they matched their goal was helping the people in rural areas. This was done to include the segregated sector into the financial world as the rural area was considered unfit for financial purposes. It was difficult in the beginning but with time the rural people also understood the financial norms and culture. The main reasons rural areas were not included were because of their lack of financial knowledge, less access to the main financial market, huge default and credit risk set up by poor people in the name of agriculture and other work. The inadequate streaming of income and expenses in the rural areas also generated problems and issues in the financial world. They had nothing to give back if they were at default except for their land which is the only asset they have. The lack of returns and higher risk also stopped many banks and other institutions to help and support these sectors or areas. This is when micro finance came in action and played a tremendous role in gathering all the courage and determination to set up a financial route towards the development of rural people by starting on a less amount. In no time, the market boomed and micro finance attracted many analysts and practitioners to

study about it but due to the huge demand of capital markets and money markets in the financial world, it is still considered as the least noticeable topic under it.

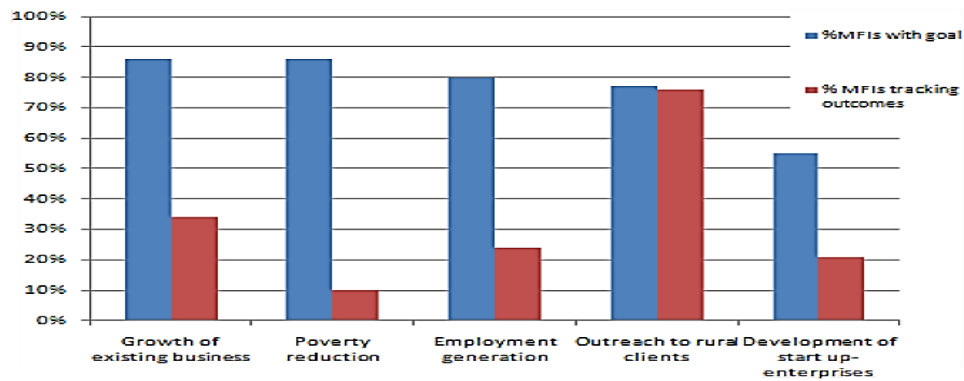


Figure 2: Micro finance goals and outcomes [9]

With so many advantages listed above, it still lacks the idea of having or generating a proper amount of return (Figure 3). There are many limitations added to the idea of micro finance as it is still lacks development in many countries and is used in developing countries. Though the developed countries have given a thought of agreeing to the idea of using it, the micro finance institutions have fewer shares in the market of the developed countries.

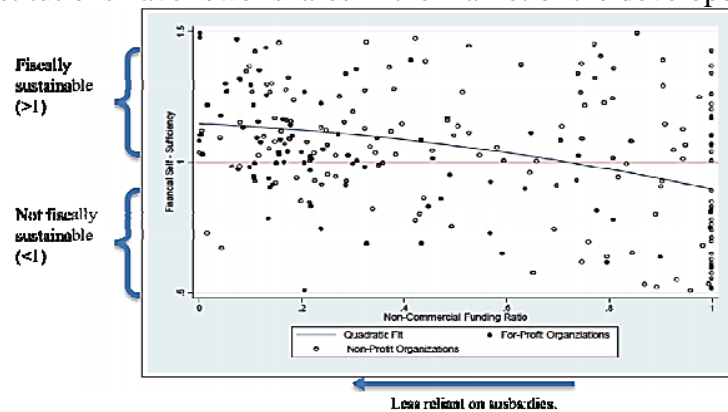
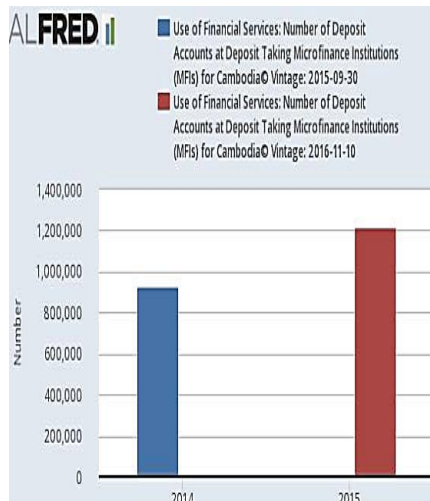


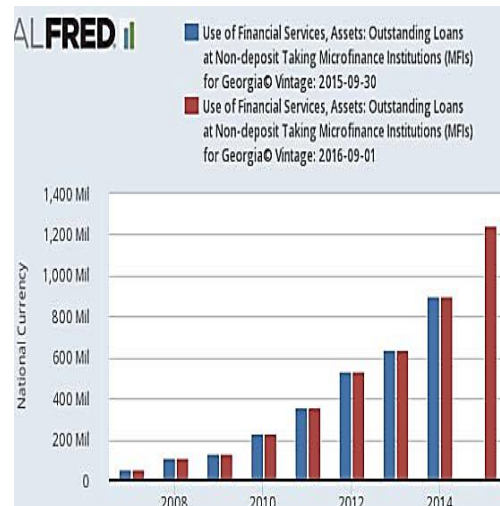
Figure 3: Image of unclear returns [8]

The micro finance is full of potentials from all the perspectives and with the innovation of the origination; it has certainly developed a place for itself. But certain limitations still hinder its path of achieving immense success. It lacks the idea of scope of development, slow growth, association with the portfolio, and the main problem is its association to the rate of return. It has unclear idea of returns and it has fragmented market in terms of achieving returns. The graph in Figure 4 shows the number of deposits made over a year in a country. The purpose of this graph is to show the increase in number of deposits through an example. Likewise, there have been loans order taken in the by the MFIs. The popularity is increasing but not to a large extent (Figure 5). The people still availing this facility were poor people till many SMEs also started approaching to the MFIs as well. There are more loans that increased from a 100 million to a surprising amount of 1,200 million over the years. The MFIs

have become a good source of provision of loan and has helped people in accessing credit at good rates.



**Figure 4:** Number of deposits made in over a year [10]



**Figure 5:** Number of loans made in over a year [11]

***The impact of microfinance on the lives of rural people and how it has increased significantly***

As noticeable from the graphs in Figure 4 and Figure 5, micro finance is more into the function of the lending of the loans and is popular among people through the amount of loans they have approved and the number of outstanding loans they have. The number of deposits is still less particularly for the most important reasons. The reasons of why micro finance has not established a place yet is because of the following:

- People have a huge misconception that this is a financial service provided to the rural people.
- It has a slow growth compared to the other financial instruments and services all across the world.
- The huge market is concentrated in the developing countries while the developed countries are yet to seek methods to inculcate it in the big market. The market is fragmented.
- It does not account for a good return like that of other financial assets and the instruments.
- There is more number of loans rather than the deposits. This means that people find it as a means of accessing credit and do not trust it well enough to deposit money in these institutions.

When put in the portfolio for diversification, it is given the least position for these reasons. Saudi Arabia has been increasing its fund towards the budding entrepreneurs. It did see an influential increase in the micro finance due to the global financial crisis. Many banks suffered and were incurring huge losses due to it. The best option for developing enterprises on small and medium scale was through the option of micro finance. It has not only served in

helping these enterprises but has also brought about job creation for both men and women thereby supporting the economy on a large scale. Not many people are still aware of the concept of micro finance as it is having fewer sources that are worked on academically and even in practice. But, the financial analysts have proposed different ideas in terms of micro finance in Saudi Arabia. In fact, Saudi Arabia wants to come up with the different options in comparison to the rest of the world. Saudi Arabia as seen from the Table 1, still has the 1 renowned micro finance institution as people are still in the process of figuring out its market. Saudi Arabia wants it to integrate with the Islamic financing practices and build a different concept in the world of finance altogether. Islamic finance is developing and so is the idea of the micro finance. When both are developing and they integrate their roles, a new and redefined market can be open for the people of Saudi Arabia to access in. The pie chart in Figure 6 shows the distribution of financial sector.

**Table 1:** The micro finance status of Saudi Arabia, Sudan [12]

Jana	2010	NGO	Corporation	2010	Islamic MF only	Sole Business	Not Provided
Muslim Aid Sudan	1991	NGO	SOLE	2008	Islamic MSME Finance	Window	Yes
PASE D	2001	NGO	Corporation	2001	Islamic MF only	Sole Business	Yes
Youth Institution for Micro finance	2011	NBFI	Corporation	2011	Islamic MF only	Sole Business	Yes
Community Development Foundation	2009	NBFI	Corporation	2009	Islamic MF only	Sole Business	Yes
Livestock Bank	1992	Commercial Bank	Corporation	2007	Islamic MSME Finance	Window	Yes
Baraa Institution	2010	NBFI	Corporation	2010	Islamic MSME Finance	Sole Business	Yes
Social Devel	2000	NBFI	Corporation	2000	Islamic MF only	Sole Business	Yes

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Farme rs Com merci al Bank	199 9	Comme rcial Bank	Corpor ation	20 07	Islamic MSME Finance	Window	Yes

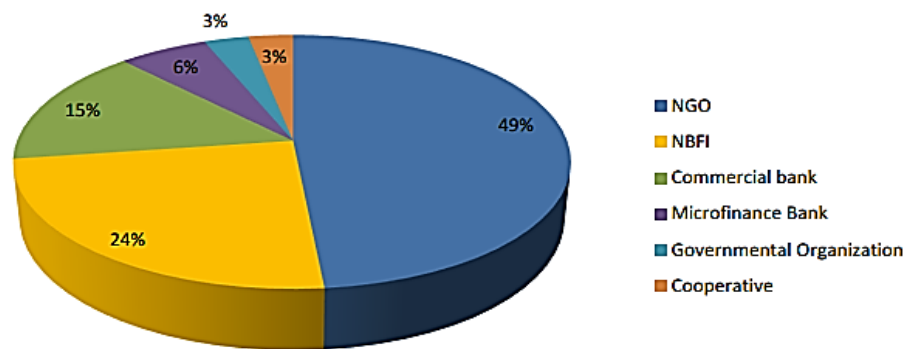
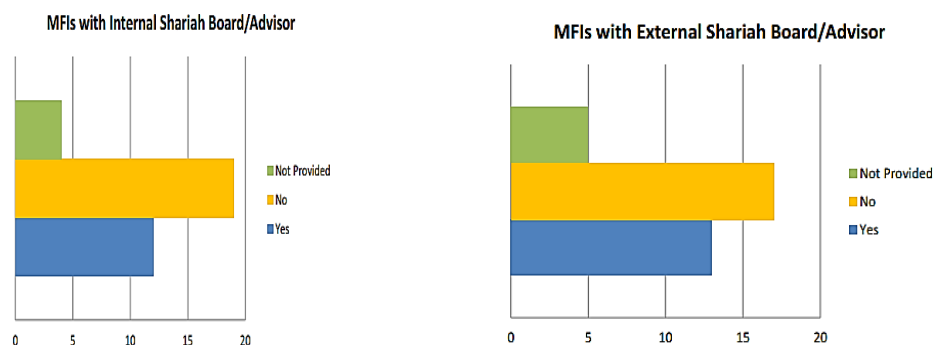
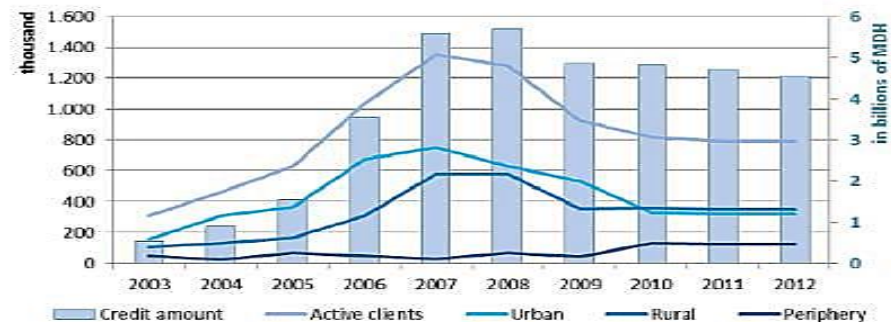


Figure 6: Pie chart showing distribution of financial sector [12]

This started off as a very basic concept and has gained quite a good market share although less compared to others. It still has to develop and bring about a reformation in the market of finance and help support economy by withstanding any kind of crisis that lies within. The MFIs working the Islamic thinking are shown in Figure 7 and Figure 8. They have internal Shariah board advisor as well as external ones too. It has worked on the expansion and thereby is increasing its influence to a certain extent as shown in the Figure 9. The graph shows the growth of micro finance as a whole.





**Figure 7:** MFIs with Internal Shariah advisor [12]**Figure 8:** MFIs with the external Shariah board advisor [12]**Figure 9:** Expansion of micro finance [13]

## CONCLUSION

Microfinance is a financial market that started off for small and medium scale businesses and for the cause of eradicating poverty by helping people who are poor and cannot open bank accounts in the bigger markets and banks. This has offered continuous support to the poor people in terms of supporting their agriculture and looking up for their needs and wants. They even have small rate for interest so that they can pay back money easily. Due to lack of knowledge of MFs and MFIs, people are hesitant in depositing while loans are being offered on small rates has offered many people to cash in. It is gradually moving its work from the rural areas to that of the urban areas whereby they are also supporting small enterprises. In order for the gap between the rich and the poor to be bridged therefore, there is need to change the bank policies and accommodate microfinance. It is therefore that one has to develop strategies and tactics to bring about a change in the reformation and development in the banking sector with the growth of the micro financial institutions and its relation and integration to the Islamic financing. Saudi government has embarked on empowering towards a self-employment and consequently job creation initiative. This is through adoption of microfinance policies which allows establishment of micro financial institution which in turn can provide credit facilities to the low income earners. It is still seeking to earn benefits through the small rate of growth.

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