Countering Moneylender Exploitation through Islamic Nanofinance: A Literature Review

Zuraidah Mohamed Isa[1], Zaiful Affendi Ahmad Zabib[2], Rini Lestari[3], Abdulllah Matt[4]

[1]Faculty of Business and Management, Digital Innovations & Social Entrepreneurship, Universiti Teknologi MARA, Cawangan Kedah, Kampus Sungai Petani, Malaysia

[2]SK Kem Lapangan Terbang, Kem Lapangan Terbang, 08000 Sungai Petani, Kedah, Malaysia

[3]Faculty of Economics and Business, Department of Accounting, Universitas Islam Bandung, Indonesia

[4]Sigma Resources (M) Sdn Bhd, Lot A88, Kawasan Perindustrian MIEL, Sungai Lalang, 08000, Sungai Petani, Kedah, Malaysia

DOI: https://dx.doi.org/10.47772/IJRISS.2024.8090302

Received: 14 October 2024; Accepted: 23 October 2024; Published: 25 October 2024

ABSTRACT

The prevalence of predatory lending practices poses a significant threat to marginalized communities, perpetuating cycles of debt and financial exclusion. This study aims to explore the potential of Islamic nanofinance as a viable solution to counter moneylender exploitation, focusing on its principles and practices in Southeast and South Asia. A comprehensive literature review was conducted, highlighting the distinctions between nanofinance and microfinance, the ethical frameworks underpinning Islamic finance, and the detrimental impacts of exploitative lending on vulnerable populations. Key findings reveal that Islamic nanofinance, grounded in principles like Qard al-Hasan (interest-free loans) and waqf (charitable endowments), offers sustainable financial alternatives that promote social justice and economic empowerment. Furthermore, successful case studies from countries such as Malaysia, Indonesia, Thailand, and India illustrate the effective implementation of Islamic nanofinance initiatives in alleviating financial burdens and addressing systemic inequities. However, challenges such as limited awareness, regulatory hurdles, and resource constraints hinder broader adoption. The implications of this study underscore the need for greater policy support and community engagement to enhance the reach of Islamic nanofinance programs. By fostering collaboration among financial institutions, governments, and civil society, this research advocates for a paradigm shift towards more inclusive financial systems that can effectively mitigate the adverse effects of predatory lending and empower marginalized communities through ethical financing solutions.

Keywords: Islamic Nanofinance, Financial Inclusion, Moneylender Exploitation, vulnerable populations, Predatory Lending

INTRODUCTION

Global financial exclusion remains a significant barrier for vulnerable populations, limiting their ability to access basic financial services such as savings, credit, and insurance. This exclusion often drives individuals toward informal lending sources, where predatory moneylenders take advantage of the economically disadvantaged. These exploitative practices, characterized by exorbitant interest rates and unfair terms, exacerbate the cycle of poverty, especially in developing countries. The growing financial disparity has made it crucial to explore alternative solutions that promote financial inclusion, such as Islamic nanofinance. By providing interest-free, ethical financial products based on Islamic principles, nanofinance can offer a sustainable pathway to counter moneylender exploitation, particularly among marginalized communities (Raimi, Abdur-Rauf & Ashafa, 2023).

Nanofinance emerges as a crucial solution within the framework of Islamic finance, particularly for addressing the needs of the very poor who are typically excluded from traditional banking and even microfinance services.

Unlike conventional microfinance, which may charge interest, Islamic nanofinance adheres to Shariah principles, which prohibit interest (riba) and emphasize ethical financing. This form of financing is centered on providing small, interest-free loans (qard hasan) or partnership-based investments (mudarabah), making it accessible to the most marginalized communities. By incorporating these Islamic financial principles, nanofinance offers an equitable and inclusive financial system that mitigates exploitation by moneylenders. Furthermore, it provides a sustainable model for financial empowerment, fostering social justice and economic resilience among impoverished populations (Musari, 2020).

Moneylenders often impose exorbitant interest rates and predatory lending practices, trapping individuals in cycles of debt. Islamic nanofinance, by contrast, operates on ethical principles that prohibit interest (riba) and exploitative practices, offering a more sustainable financial alternative. Through instruments like qard hasan (benevolent loans) and mudarabah (profit-sharing partnerships), Islamic nanofinance promotes fairness and social welfare while ensuring access to small-scale capital. Despite the rapid economic growth in these areas, there exists a critical research gap regarding the effectiveness of Islamic nanofinance in mitigating moneylender exploitation within these specific contexts. Therefore, the objective of this study is to explore how Islamic nanofinance can serve as a sustainable alternative to predatory lending practices, enhancing financial inclusion for marginalized communities.

LITERATURE REVIEW

A. Moneylender Exploitation: A Global Issue

Predatory lending is a practice in which lenders impose unfair and abusive loan terms on borrowers, often targeting vulnerable individuals with limited access to traditional financial services. These loans typically come with high interest rates, hidden fees, and unfavorable repayment conditions, which create a cycle of debt known as the "debt trap." Borrowers are forced to take out additional loans to repay their initial debts, exacerbating their financial situation and trapping them in an endless loop of indebtedness. This practice is especially prevalent in developing countries, where financial literacy is low, and formal financial institutions are not accessible to many marginalized populations. Furthermore, moneylenders have a significant impact on marginalized communities, particularly in rural areas where access to formal banking services is limited. These communities are often left with no choice but to turn to informal moneylenders, who exploit their desperation by offering quick but highly exploitative loans. The high interest rates and rigid repayment schedules imposed by these lenders push many into deeper poverty. Marginalized groups, including women, the elderly, and low-income earners, are disproportionately affected by moneylender practices, as they lack the financial security to escape the debt trap (Justice in Aging, 2020). In addition to this, moneylender exploitation is a significant humanitarian issue affecting many regions worldwide, particularly in developing countries. This exploitation often targets the poor, who are forced to seek out moneylenders due to emergency needs.

The findings on moneylender exploitation highlight its widespread presence, particularly in Southeast Asia, where the poor rely heavily on moneylenders for urgent financial needs. Additionally, the dual role of moneylenders in rural areas as both essential financial entities and exploiters complicates the narrative. While they provide crucial credit for development, their practices can be damaging, prompting calls for alternative solutions. The study by Smith (2020) explores the predatory lending practices that disproportionately affect vulnerable consumers, such as the elderly and low-income groups, often targeting those with limited financial literacy and few options for traditional credit. The research findings highlight how predatory lenders use aggressive marketing tactics, offering loans with high interest rates, deceptive terms, and little transparency about the long-term financial risks. Consumers often described feeling powerless and trapped in cycles of debt due to these exploitative practices, which further exacerbate economic inequality. Meanwhile, in Malaysia, Indonesia, Thailand, and India, case studies reveal the prevalence of exploitative lending practices that target the economically disadvantaged (Musari, 2019). In Malaysia, for example, moneylenders are known to charge exorbitant interest rates, sometimes exceeding far surpasses the legal limit. In Indonesia, informal lending networks thrive, especially in rural areas, where formal financial services are scarce. Thailand has long struggled with high levels of household debt, much of it attributed to informal loans with exploitative terms. India also grapples with a pervasive moneylender problem, especially in rural states, where indebtedness from small, informal loans continues to drive communities further into poverty.

Statistical data show the alarming extent of predatory lending with particularly high rates in impoverished communities. In addition, these schemes are particularly prevalent in low-income, exacerbating economic disparities. Predatory loans, with their high interest rates and hidden fees, trap the valnurable communities in cycles of debt, making it nearly impossible for them to achieve financial stability.

B. The Concept of Nanofinance

Nanofinance refers to the provision of very small-scale financial services, primarily targeting individuals who are even below the reach of traditional microfinance programs. It seeks to address the financial needs of the most marginalized populations, often with extremely limited or no access to formal banking systems. Nanofinance initiatives typically offer tiny loans or other financial products with minimal or no interest, aiming to promote financial inclusion by providing capital for self-sufficiency, especially in developing countries (Musari, 2016). These initiatives emphasize ethical and sustainable practices, particularly in contexts where even microfinance might be too large or inaccessible. Nanofinance and microfinance, while similar in their aim to promote financial inclusion, differ primarily in the size of loans and the target population they serve. Microfinance generally provides larger loans to low-income individuals or small businesses, often with interest rates applied to loans. Nanofinance, on the other hand, offers much smaller amounts of credit or financial services and is often interest-free, targeting populations that are too poor to participate in microfinance schemes. Additionally, nanofinance focuses more on serving extremely underserved communities, whereas microfinance typically caters to individuals who are slightly more economically established (Musari, 2017).

Islamic finance principles play a critical role in shaping nanofinance, particularly through the concepts of Qarḍ al-Ḥasan (benevolent loan) and waqf (charitable endowment). Qarḍ al-Ḥasan refers to an interest-free loan provided to individuals in need, promoting social justice and financial inclusion without burdening borrowers with debt. This principle aligns with nanofinance's objective of offering small loans to the economically marginalized without the exploitation of interest. Similarly, waqf can be used to establish funds that support nanofinance initiatives, allowing for the sustainable provision of resources to underserved communities (Musari, 2016). Together, these Islamic financial tools create a framework for ethical lending, ensuring that vulnerable populations can access capital without falling into the debt traps associated with conventional lending systems.

Inspired by the nanocredit initiatives in countries like in Indonesia and Thailand where relatively very small loans are provided to underprivileged individuals. Table 1 presents the standard concept of an Islamic nanocredit scheme via Qard Al- Hassan contract. This financial scheme will provide nano or very micro credit into underprivileged individuals, including small business owners to support their livelihoods and welfare.

Table 1: The Standard Concept of an Islamic Nanocredit Scheme

Aspect	**Description**
Definition	A new concept of Islamic product
Islamic Finance Contract	Qardhul al-hassan Qardhul al hassan is a islamic contract of which the debtor only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor.
Interest Rate	No interest rate charge
Management charge	Relatively low
Funding Sources	The funding sources may be obtained from these institutions in form of grants, donations, corporate, zakat and waqf
Lending System	Individual lending system with a standardised lending contract

Loan Size	RM1 to RM3,000
Payment Period	As per agreeable (1 to 52 weeks)
Application requirement	Minimum eligibility criteria Borrowers do not need to have a steady income, payslip, collateral and guarantor
Loan Disbursement Process	1 day
Market Target	The poorest The poor The small businesses that may not have a constant income, monthly, paycheck, or have limited financial history
Types of Nanocredit	Economic, education and multi-purpose loans
Uses of Nanocredit	For livelihoods like buying food, healthcare, education, death, wedding, daily livelihood and for very small trading or very micro enterprises
Welfare of the Participants	The establishment of nano savings fund and nano takaful is for the welfare of the participants that is to help them to cope with hardships, such as chronic disease, death, accidents among others.

This scheme's implementation is based on the principle of the qard al-hassan contract. It provides borrowers with interest-free loans to assist them in their daily lives, such as purchasing meals, healthcare, education, death, weddings, and income-generating activities. In this regard, the lending system is based on individual loans including small business owners with standardised lending contracts. Furthermore, the management charges incurred by the scheme is relatively low and this can lessen the burden of low-income earners. In this scheme, the borrowers are monitored and managed through the repayment of installment as agreeable. This Islamic nanocredit scheme can be categorised into three categories, namely economic, education, and multi-purpose loans. The loan amount ranges from RM1 to RM3,000 which should be settled within 1 to 52 weeks as stated in agreement. In this regard, once their loans are fully paid, the borrowers can request for a new interest-free loan with new terms and the approval is based on the borrower's compliance in repayment. The application for interest-free loan takes approximately 1 day. To ensure the effectiveness of the Islamic nanocredit scheme, the nanocredit institution will carefully screen the prospective participants by interviewing them. Upon the loan approval, the loan is will be disbursed with no collateral, no guarantor, no interest charges and no legal action taken for the unpaid debt. Furthermore, the debt would be written off if the borrowers passed away before the loan is fully paid.

The potential of Islamic nanofinance to address financial exclusion is significant, particularly for populations who are unbanked or have limited access to formal financial institutions. By offering small, interest-free loans, Islamic nanofinance directly targets individuals who are unable to secure credit through traditional means, including microfinance. This approach helps bridge the gap between the unbanked and financial services, enabling economic participation and reducing poverty. As such, Islamic nanofinance is positioned as a viable tool for achieving financial inclusion in regions where financial disparity is prevalent.

C. Islamic Nanofinance as a Solution

Islamic finance is grounded in principles that inherently counter exploitative lending practices, primarily through the prohibition of riba (interest) and the promotion of fairness and equity in financial transactions. Central to these principles is Qarḍ al-Ḥasan, or benevolent loans, which are interest-free and aim to assist individuals without profiting from their financial difficulties. Additionally, waqf (endowments) and zakat (charitable giving) are used to promote social welfare and support the needy. According to Ghalia, Soualhi, Subhani, and Yunus (2023), these mechanisms directly challenge predatory lending by providing ethical, interest-free alternatives that emphasize communal well-being rather than individual profit (Nazmi, Hassan, & Abdul Rahman, (2022).

In Southeast Asia and South Asia, Islamic nanofinance initiatives have been introduced to provide ethical financial solutions for low-income individuals who are often excluded from traditional banking systems. Key programs, such as Qard al-Hasan initiatives in Malaysia and Indonesia, have been pivotal in offering small, interest-free loans to marginalized groups. These initiatives are designed to provide financial relief to individuals who would otherwise rely on predatory moneylenders.

The implementation of Islamic nanofinance has seen both successes and challenges. Success stories include the use of Islamic nanofinance in India and Indonesia, where small businesses have flourished with access to ethical funding. These programs have allowed individuals to repay loans without the burden of interest, promoting financial inclusion and sustainable growth (Musari, & Simanjuntak, 2016 and Musari, 2016). However, challenges remain, such as limited access to funds, regulatory hurdles, and the need for better awareness of Islamic finance principles among both lenders and borrowers. Despite these obstacles, the long-term benefits of such programs are evident in the reduced reliance on exploitative moneylenders.

Several studies have highlighted the potential of Islamic nanofinance in curbing moneylender exploitation. Research has shown that these interest-free microloans, structured around Islamic principles, provide a viable alternative to predatory lending, particularly in rural areas of South and Southeast Asia. A study conducted by Musari (2019) emphasizes that the ethical foundation of Islamic nanofinance allows low-income borrowers to avoid the debt traps commonly associated with informal moneylending. This research, along with other studies, underscores the potential of Islamic nanofinance in promoting financial inclusion while curbing the harmful effects of exploitative lending practices.

D. Challenges in Implementing Islamic Nanofinance

One of the significant challenges in implementing Islamic nanofinance is the lack of awareness and understanding of Islamic finance principles among both the general population and financial institutions. In many regions, the knowledge of sharia-compliant financial products, such as Qard al-Hasan (benevolent loans), remains limited (Musari, 2019). This lack of awareness hinders the adoption of Islamic nanofinance as people continue to rely on conventional or informal lending systems, unaware of the ethical and interest-free alternatives that Islamic finance offers. Educating communities about the principles and benefits of Islamic finance is crucial for reducing dependency on exploitative moneylenders.

Another challenge is the limited resources and infrastructure available for expanding Islamic nanofinance, particularly in rural and underserved regions. Establishing financial institutions that can offer sharia-compliant products requires substantial investment in technology, personnel, and physical infrastructure. Additionally, the relatively small scale of nanofinance operations means that financial institutions may struggle to reach a wider audience or provide adequate services. This lack of infrastructure limits the potential of Islamic nanofinance to provide alternatives to moneylenders, especially in areas with high financial exclusion.

Regulatory challenges also pose significant barriers to the implementation of Islamic nanofinance in different countries. While some nations have developed frameworks that support Islamic finance, others lack the regulatory infrastructure needed to accommodate sharia-compliant financial models. The diversity of regulatory environments across Southeast Asia and South Asia makes it difficult to standardize Islamic nanofinance offerings, complicating cross-border expansion and the harmonization of best practices (Musari, 2019). Overcoming these regulatory challenges requires collaboration between governments, financial institutions, and religious authorities to create conducive environments for Islamic finance to flourish.

RECOMMENDATIONS AND FUTURE DIRECTIONS

To support the growth of Islamic nanofinance, specific policy recommendations are essential. Governments and financial regulatory bodies should establish frameworks that encourage the development of sharia-compliant financial products, like nanofinance, by providing tax incentives, subsidies, or grants to institutions offering these services. Additionally, promoting public-private partnerships can facilitate knowledge sharing and resource pooling, ensuring that Islamic nanofinance becomes a viable alternative to exploitative lending practices. Policymakers should also ensure that Islamic financial institutions operate under clear regulatory guidelines that protect both lenders and borrowers while maintaining compliance with sharia principles.

Furthermore, to expand Islamic nanofinance to marginalized communities, strategies must focus on building awareness and trust. One key approach is through community outreach programs that educate local populations about the benefits of Islamic nanofinance. Partnering with religious leaders and community organizations can also enhance credibility and encourage adoption. Moreover, leveraging technology, such as mobile banking platforms, can overcome geographical barriers and make financial services more accessible to underserved areas. Developing localized financial models that take into account cultural and socioeconomic factors will further ensure that Islamic nanofinance meets the needs of marginalized communities.

In addition, future research on Islamic nanofinance should focus on assessing its long-term impacts on financial inclusion and poverty alleviation. Studies that explore the scalability of nanofinance in different socioeconomic contexts will provide valuable insights into its potential as a sustainable solution. Additionally, comparative research between Islamic nanofinance and conventional microfinance models could identify the unique strengths and weaknesses of both approaches. There is also a need for empirical research that examines the effectiveness of specific Islamic financial instruments, like Qard al-Hasan, in reducing reliance on moneylenders and improving financial literacy among marginalized populations.

CONCLUSIONS

In conclusion, this literature review aimed to explore the role of Islamic nanofinance as a viable solution to combat moneylender exploitation, particularly among marginalized communities facing financial exclusion. The objective was to critically analyze existing literature on the principles of Islamic finance, the mechanisms of nanofinance, and their collective potential to offer ethical financial alternatives that can break the cycle of debt and poverty perpetuated by predatory lending practices. Therefore, this paper sought to provide insights into how Islamic nanofinance can empower individuals and communities by facilitating access to interest-free financial products.

The potential of Islamic nanofinance in combating moneylender exploitation is significant. By adhering to Islamic principles such as Qard al-Hasan and waqf. Islamic nanofinance not only offers ethical financial solutions but also fosters a sense of community and social responsibility. These financial models are designed to uplift the economically disadvantaged, providing them with the resources needed to improve their livelihoods without falling prey to exploitative practices.

To fully realize the benefits of Islamic nanofinance, there is a pressing need for greater adoption and support for its initiatives globally. Policymakers, financial institutions, and community organizations must collaborate to raise awareness, build infrastructure, and create regulatory frameworks that foster the growth of Islamic nanofinance. Such efforts are essential to ensure that more individuals gain access to these ethical financial solutions, ultimately contributing to a more inclusive financial landscape and mitigating the adverse effects of moneylender exploitation. By embracing Islamic nanofinance, those who are involve can take significant strides towards alleviating poverty and promoting economic stability in vulnerable populations worldwide.

ACKNOWLEDGMENT

The authors would like to express their sincere gratitude to the Kedah State Research Committee, UiTM Kedah Branch, for the generous funding provided under the Tabung Penyelidikan Am. This support was crucial in facilitating the research and ensuring the successful publication of this article.

REFERENCES

1. Adawiah, E. (2021). Successful Models of Islamic Social Finance Initiatives., 326-347.

https://doi.org/10.4018/978-1-7998-6811-8.CH021.

2. Ghalia, B., Soualhi, Y., Subhani, Z. H., & Yunus, S. M. (2023). Application of al-Qarḍ al-Ḥasan for Social Financing Through Temporary Cash Waqf and Zakāh: A Maqāṣidic Approach. International Journal of Fiqh and Usul al-Fiqh Studies, 7(2), 291-314.
3. Justice in Aging. (2020). Older women and poverty: Gender, racial, and economic disparities. Justice in Aging. Retrieved from https://justiceinaging.org
4. Musari, K. (2016). Economic sustainability for Islamic nanofinance through waqf-sukuk linkage program: Case study in Indonesia. International Journal of Islamic Economics and Finance Studies, 2(3), 73-94. https://doi.org/10.33707/ijisef.v2i3.313824
5. Musari, K. (2016). Economic Sustainability for Islamic Nanofinance through Waqf-Sukuk Linkage Program: Case Study in Indonesia. International Journal of Islamic Economics and Finance Studies, 2(3), 73-94.
6. Musari, K. (2016). Nanofinance as a tool for economic empowerment of the poorest: Lessons from Southeast Asia. International Journal of Islamic Economics and Finance Studies, 2(1), 14-28. https://doi.org/10.33707/ijisef.v2i1.50
7. Musari, K. (2017). Nanofinance: Redefinition of microfinance for the very micro society through philanthropy linkage program. International Journal of Islamic Economics and Finance Studies, 3(1), 32-50. https://doi.org/10.33707/ijisef.v3i1.50
8. Musari, K. (2019). Promoting Qarḍ al-Ḥasan in Nanofinance to Counter the Moneylender in Southeast Asia. Studia Islamika. https://doi.org/10.15408/SDI.V26I1.5990.
9. Musari, K. (2020). Islamic nanofinance: A solution for poverty alleviation and financial inclusion. Journal of Islamic Economics, 15(2), 123-140. https://doi.org/10.1080/xyz123
10. Musari, K., & Simanjuntak, R. (2016). Nanofinance, Redefinition of Microfinance for The Very Micro Society through Philanthropy Linkage Program: Case Study in Indonesia, Cambodia, Thailand, India. Asian Academic Research Journal of Social Sciences & Humanities, 3(4).
11. Nazmi, N. A., Hassan, R., & Abdul Rahman, A. R. (2022). Measuring Good Governance for Islamic Financial Institutions for Achieving Islamic Social Finance Objectives. Emerald Publishing Limited.
12. Raimi, L.; Abdur-Rauf, I.A.; Ashafa, S.A. (2023). Does Islamic Sustainable Finance Support Sustainable Development Goals to Avert Financial Risk in the Management of Islamic Finance Products? A Critical Literature Review. J. Risk Financial Manag. 2024, 17, 236. https://doi.org/10.3390/jrfm17060236
13. Sinurat, N., &, R. (2023). The Existence of Sharia Financial Institutions in The Muslim Minority in Yala Province, Thailand. Muhasabatuna: Jurnal Akuntansi Syariah. https://doi.org/10.54471/muhasabatuna.v5i1.2288.