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Microfinance Services: A Missing Product in Islamic Banks in Supporting Small and Medium Enterprises in Tanzania

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Abstract-*The study aimed to sensitize the Islamic banking in Tanzania in initiating Islamic microfinance which is a missing tool in boosting small and medium business ventures in Tanzania. The study employed descriptive corelational research design whereby data collection was done through both probability and non probability sampling design. Data were collected in three banks (National Bank of Commerce, Kenya Commercial Bank, and Akiba Commercial Bank) which are Islamic Bank windows, and in Amana Bank which is a fully fledged Islamic Bank. The findings of the study revealed that Islamic microfinance is concerned with the provision of financial and non financial services to the poor who desire to embark in entrepreneurship based on Islamic values for the aim promoting development and welfare of the entire society. Based on those findings, the study recommends that Islamic microfinance should be established in those carrying out Islamic banking in Tanzania because these interest free financial institutions often support Small and Medium Enterprises with small loans for the purpose of improving their business operations*.

Keywords- *Islamic Microfinance, Small and Medium Enterprises.*

1. BACKGROUND OF THE STUDY

1.1 An Overview of Islamic Banking

Islamic banking has grown significantly over the past 30 years, with estimated deposits surpassing $180 billion in more than 55 countries. Annual turnover is currently estimated at $70 billion and is projected to pass $100 billion by 2020 (O'Sullivan 2013). More than 100 Islamic banking institutions in the world are in operation, ranging from pure Islamic banks to smaller *sharia* banking units in conventional banks and investment houses. As one of the fastest growing segments of the financial services market in the Islamic world for the past five years, the annual growth has averaged 15 percent. Thus, these Islamic financial institutions have attracted a lot of attention for researchers and academicians in the world (O'Sullivan, 2013). This argument has been supported also by Chalu (2012), and Ariss (2010) who have noted that Islamic banking is a product that has gained popularity worldwide for the last three decades in the banking industry worldwide. Since the introduction of the first Islamic bank in 1975 in the world, Islamic banking has been growing at a rate of 10 to 15 percent per year with persistent growth in the future (Ariss, 2010; Ćihák and Hesse, 2008; Eagle, 2009; Tayyebi, 2008, and Chalu, 2012). According to Ariss (2010) and Chalu (2012), currently Islamic banks have spread in more than 55 countries, with more than 270 institutions including banks, mutual funds, mortgage companies and insurance firms (also known as Takaful). Therefore, as noted, Islamic banking is a fast growing sector in Middle Eastern financial markets and other Islamic parts of the world especially in Indonesia, Malaysia, and Egypt. Its growth and roles are also increasing in the West especially in the United Kingdom and United States of America. According to Lughod (2011), Islamic Banking has been growing worldwide significantly in the past three decades and is developing remarkably in the Southeast Asia, Middle East and even in Europe and in North America as there are several International financial Institutions in Europe and the United States which have adopted some Islamic Instruments to attract investors who prefer the use of Islamic credit instruments, such as Murabaha, Mudaraba, Musharaka and Ijara. Also, Islamic banking is expanding not only in nations with majority Muslim populations, but also in other countries where Muslims are a minority, such as China and Japan (Solé, 2007; Lughod, 2011).Moreover, this growth has not been limited to a particular sector of the banking industry (Dhumala and Sapcanin, 2001), but it has been spreading across many sectors in the world.

As observed by Eagle (2009) and Chalu (2012), there are several reasons for the growth of Islamic banking worldwide. First, there is a large population of Muslims worldwide. As Eagle (2009) has clarified the point by stating that the population of Muslims worldwide is estimated to be over 1 billion, hence creating a wide market segment for Islamic banks. According to El-Hawary, Grais and Iqbal (2007), Islamic finance may attract about 40 percent of the total savings of the Muslim population worldwide. As such, this makes Islamic banking one of the fastest growing segments of the financial industry in the world (Eagle, 2009). Second, the emergence and growth of Islamic bonds (sukuk instruments) have provided momentum and opportunities for the development of secondary debt markets (Tayyebi, 2008). Third, the recent global economic crisis caused by greedy and selfishness managers in the USA has also renewed the growth of Islamic banking worldwide (Tayyebi, 2008) due to the fact that many bank customers in the world contrary to conventional banks, they believe that Islamic financial practices are founded on the core belief that money is not an earning asset in and of itself, there is more to the system's underlying tenets.[1] Thus, Islamic financial Instruments do not consider money as an earning asset by itself; but it is used to evaluate commodities.

Lughod (2011) has added two more reasons for the rapid growth of the Islamic banking. According to Lughod (2011), Islamic banks are less exposed to liquidity risk contrary to conventional or western banks, also; Islamic banks do not depend much on external liabilities compared to conventional banks. Due to those rationale provided in relation to Islamic banking, many people in the world have been drawn attention and interest in using Islamic banking products.

1.2 Islamic Financial Instruments

Islamic banking is a system of banks which is governed and guided by Islamic laws (Sharia).Thus, for any bank to be considered to be offering Islamic services it must conform to Islamic rules and norms; in other words, it is required to make Islamic religious features integral to its daily operations (Algaoud and Lewis, 2001; Adebayo and Hassan, 2013; Garas, 2012). However, the most important distinguishing features of Islamic banks compared to conventional banks are their credit instruments, famous among which are riba, Mudarabah, Murabaha , Musharaka, and Ijara.

The first Islamic financial instrument is the prohibition of interest (*riba*) in all transactions. Thus, all business and investments are undertaken on the basis of *halal* (legal/permitted) activities because the Holy Quran treats receiving, paying interest in all transactions as *haraam*, and there are some consequences for those who do that (Zamir, 2007). As such the implementation of prohibition of interest from financial transactions forms part of the Islamic vision of moral economy (Bjorvatn, 1998) and those who disregard the ban on interest are at war with God[2]. Thus, the justification of prohibition of *riba* is based on social, economic and religious rationale (Zamir, 2007).

The second Islamic financial instrument is called *Mudarabah (interpreted as trust-financing):* A *Mudaraba* is part of the profit sharing model whereby there is a contract between two parties. One party provides the funds and the other party provides the labour or entrepreneurial abilities. Thus, under this mode of financing an Islamic bank, as a limited partner, provides cash (capital requirements) to a borrower or an entrepreneur who is free to use the funds in pursuit of the partnership's goal. In the Mudarabah, the share of each party in the profits and losses must be in percentages, and all expenses related to the partnership are deductible before profit distribution (Algaoud and Lewis, 2001; Olson and Zoubi, 2008; Khan, 2010, Chalu, 2012).The third Islamic financial instrument is called *Murabaha (interpreted as cost-plus trade financing):* under this model of profit sharing, an Islamic bank, as a partner, finances the purchase of commodities in return for a share in the profits realized when the goods are sold. Payment of such financing can be deferred or made in installments (Khan, 2010). The fourth Islamic financial instrument is called *Musharaka (interpreted as participation in financing)*: under this mode an Islamic bank provides a part of the equity plus working capital of a project and shares in profits and/or losses. Under *Musharaka*, on the other hand, the entrepreneur may add some of her/his own capital to what is provided by the Islamic bank. In the case of *Musharak*a, the profit shared is based on an agreement between the two parties and any gain or loss is divided in proportional to each party's capital contribution based on their contributions (Khan, 2010). *Finally,* Ijara (interpreted as rental financing or leasing): this activity has provided the bulk of the operating income of Islamic banks, it covers both long-term leasing/lease financing and short-term hire-purchase. (Zamir and Mirakhor, 1999,Olson and Zoubi, 2008).

Therefore, under the Shari'a legal code, business transactions should be fair, transparent and contractual between partners. Moreover, business transactions must be halal and free from riba (usury), gharar (uncertainty), maisir (gambling). Shari'a law does not only restrict interest rate but supports socially responsibility for the wellbeing of the society and set up rules to highlight ethics in business transactions (Ariss, (2010)). Though it is generally visualized that the prohibition of interest rate is conflicting the time value of money concept, however, the prohibition of interest on loans is common to all Abrahamic faiths. According to Muhammad et al (2013) whether in Christianity, Islam or Judaism, every community wants to borrow money without being bugged down with multi layer interest structure. *Riba*, interest or usury literally means to grow, to increase. Technically, it denotes the amount that a lender receives from a borrower

[1]Islamic religious law, that is, sharia emphasizes ethical, moral, social, and religious factors that promote equality and fairness for the good of society as a whole. However, it is surprisingly to note that although Islamic financial practices are established the on the basis of Islamic ethical and moral standards, some Islamic banks in Dubai, Turkey, Egypt and South Africa experienced financial scandals similar to what happened in conventional banks due to poor corporate governance, weak internal controls and poor regulatory framework (Hasan, 2010; Chalu,2012).

[2] See the Holy Quran sections which ban riba and the consequences of receiving and paying riba (al-Faatih'a 2:275-279; al-Imran 3:130; An-Nissai 4:161 and ar-Rum 30:39).

at a fixed rate in excess of the principal. Islamic banking is involved with the activities that are consistent with the principles of sharia/Islamic law and its practical application through the development of Islamic economics. Based on these grounds, Islamic law prohibits the fixed or floating payment or acceptance of specific interest (known as riba or usury) for loans of money. Investing in businesses that provide goods or services contrary to Islamic principle is prohibited.

1.3 Islamic Banking and Islamic Microfinance Services

We have seen that the guiding principles of Islamic finance draw curiosity from Muslims and non-Muslims alike as they try to understand how a system that prohibits the receipt and payment of interest has become so widespread. Islamic financial principles is encouraging risk sharing, individual rights and duties, property rights, and the sanctity of contracts are all part of the Islamic code underlying the banking system. In this light, many elements of microfinance which are operating helping entrepreneurs can be considered consistent with the broader goals of Islamic banking. Both systems strongly advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. At a very basic level, the disbursement of collateral-free loans in microfinance operations in certain instances is an example of how Islamic banking and microfinance share common aims.

Thus, Islamic banking and microcredit programs may complement one another in both ideological and practical terms. This close relationship would not only provide obvious benefits and relief for poor entrepreneurs who would otherwise be left out of credit markets, but investing in microenterprises would also give investors in Islamic banks an opportunity to diversify and earn solid returns. Thus, Islamic banking and microcredit programs may complement one another in both ideological and practical terms.

Islam financial principles regard profit, rather than interest so as to be closer to its sense of morality and equity because earning profits inherently involves sharing risks and rewards. In Islamic financial principles making profits addresses the Islamic ideals of social justice because both the entrepreneur and the lender bear the risk of the investment.

Again, the profit- and loss-sharing schemes advocated under the Islamic principle of cooperation (*shirakat*) allow all parties including investors, savers, and financial institutions to play an active role in the economic process and avoid credit-rationing problems. In fact, given the increased risks from investment returns based solely on profits, an argument can sometimes be made for banks to play a more active role in project management to oversee their investments. In Islamic finance the technical term for a transaction between an entrepreneur and the suppliers of funds is *mudaraba*. Two of the conditions for a mudaraba-type venture show the level of partnership implicit in Islamic contracts whereby the gross or net return on capital or entrepreneurship are not be predetermined. Also, partners not only share profits but also share losses in proportion to their shares in the enterprise. The bargaining terms between the two parties involved in the transaction can vary substantially and are determined by contracts. In a business based on mudaraba, each partner shares an agreed portion of the profits, which may or may not be predetermined, according to the contract.

Under a mudaraba contract the bank provides the capital needed for a project while the entrepreneur offers labor and expertise. The profits (or losses) from the project are shared between the bank and the entrepreneur at a fixed ratio. Financial losses are assumed entirely by the bank; the liability of entrepreneurs is limited to their time and effort. In cases of proven negligence or mismanagement by entrepreneurs, however, they may be held responsible for the financial losses.

If Islamic banking and microcredit programs may complement one another in both ideological and practical terms in helping small and medium entrepreneurs in boosting their business ventures, Islamic banks in Tanzania may establish microfinance service as a tool in supporting small and medium entrepreneurs in Tanzania because conventional microfinance and conventional banks are exploiting the poor instead of helping them to be out of poverty. Islamic banking and Islamic microfinance are following Islamic principles of finance in terms of compliance with Islamic principles, selection of customers according to Islamic principles, structuring of banks to follow the Islamic distinguishing features of Islamic banking. Up to this moment, Islamic banking in Tanzania is operating in Kenya Commercial Bank (Islamic window), National Bank of Commerce (Islamic window), Stambic Bank (Islamic window), Akiba Commercial Bank (Islamic window), Peoples Bank of Zanzibar (Subsidiary Islamic bank), City Bank (Islamic window), Azania Bank (Islamic window), and Amana Bank (fully fledged Islamic bank). These banks have established Sharia Supervisory Board (SSB) to guide banks in implementing Islamic banking.

Therefore, the general objective of this research is to sensitize the Islamic banking in Tanzania in establishing microfinance service which is a missing product in helping small and medium entrepreneurs in boosting their business ventures. Thus, this study has been built on the hypothesis that Islamic microfinance is a potential tool in helping small and medium entrepreneurs in Tanzania. Despite the wide acceptance of Islamic banking worldwide, the concept of financing for the poor or microfinance by Islamic banks has been not well developed. Most Islamic banks, as in the case of conventional commercial banks, do not provide easy access to financing to the poor although historically, Prophet Muhammad was among the poor and later became a successful trader for many years before he became a prophet. This was mainly due to the microfinance capital for his ventures that was provided on a PLS based on *mudarabah* by a wealthy widow, Khadijah, who later became his wife (Rahman, 2007). The World Bank report (2011) has stated that the majority of the population of Tanzania is living below the poverty line, despite of the availability of various conventional microfinance institutions in the country. Dahiru and Zubair (2012) also have noted that the major challenge of conventional microfinance in the world is that the microfinance institutions and programs have not achieved their objectives of reaching a greater number of people living in poverty. With the apparent failure of conventional microfinance, Islamic microfinance has been advanced as an alternative to conventional microfinance (Frasca,2012). Thus, this study has been built on the hypothesis that Islamic microfinance can be used to alleviate poverty and maintain sustainable development in Nigeria.

This study on the other hand acknowledges the existence of other studies done on Islamic banking in Tanzania such as Chalu (2012) whereby this study was conducted to assess the distinguishing features between Islamic banks and conventional banks in Tanzania, Pastory, Xuezhi and Ndiege (2013) whereby this study addressed the efficiency of Islamic banks in Tanzania, and Beatus, Tripathi and Kasongwa (2013) whereby this study analyzed customers' and service providers' view on different issues related to Islamic banking service in Tanzania. However, there are no studies in Tanzania done on Islamic microfinance as a tool in helping small and medium entrepreneurs. Thus, this study aims to sensitize the Islamic banking in Tanzania in initiating Islamic microfinance which is a missing tool in boosting small and medium business ventures in Tanzania. The variables which were tested include microfinance and opportunities, microfinance and capability of the poor improvement, microfinance and reduction of vulnerability for the poor, and microfinance in relation to empowerment. In this case, Islamic microfinance can be used to alleviate poverty and maintain sustainable development in Tanzania. The advocacy for an alternative form of finance is based on the need to effectively address the financial needs of the poor and low-income earners, hitherto neglected by the conventional banks. Khan (2008) explains that microfinance refers to making small loans available to the poor with a focus on those not served by traditional institutions through programs designed specifically to meet their needs and circumstance. The rest of the paper is organized as follows: the literature review that covers the concept of evolution of microfinance in the world, Islamic microfinance, microfinance policies in Tanzania, and microfinance and poverty reduction, the methodology applied in this study, analysis and interpretation of the study findings, discussion of the findings, conclusion and implication of the study.

2. THEORETICAL BACKGROUND OF MICROFINANCE IN THE WORLD

Microfinance has received the world's attention in the last two decades as a powerful means for poverty reduction in developing countries (Kandker, 1998; Hulmes, 2000; Kiiru, 2007). This had been the result of success stories over the impact of Microfinance Institutions (MFIs) on the Development of Small and Medium enterprises (SMEs) in Bangladesh (Weiss and Montgomery, 2005) following an intervention put forth by Yunus Mohammed in 1976. He guaranteed the poor to get access to loan from commercial banks, despite their thought un-creditworthiness they repaid by one hundred percent, later on he opened the Grameen Bank (Village bank) which was a microfinance bank, this bank has been very successful (Mohammed, 2011). As result of this success of microfinance institutions in Bangladesh as a development strategy has been replicated almost in all developing countries as a strategic way in reducing poverty (Weiss & Montgomery, 2005; Hermes and Lensink, 2007 and, Brewer , 2007;). For example worldwide by December, 2005 MFIs have been increased from 618 to a record of 3,133 with the number of beneficiaries rising from 13.5 million people to 113.5 million (Harris, 2006; Hermes and Lensink, 2007). Due to the rapid growth of the microfinance industry the United Nation in its millennium Development goals (MDGs) is suggesting microfinance institutions to be the engines towards halving the world's poverty by 2015 (Radhhawa and Gallardo, 2003).

On the other hand, academicians also suggest that financial institutions should support Small and Medium Enterprises with small loans (Fhandker, 1998) for the purpose of improving their business operations (Kereta, 2007). Microfinance institutions are integral in accessing the poor to productive assets (Radhhawa and Gallardo, 2003). These productive assets include the Small and Medium Enterprises from which the poor can improve their living through the income generated from these businesses. The majority of the developing economies/countries are characterized by poor families whose major economic activities are subsistence farming Small and Medium enterprise (Chijoriga, 2000). Also, the research conducted in the last two decades shows that there is a link between microfinance institutions Small and Medium businesses development (Chijoriga, 2000). Thus, if the micro-credits can be directed towards financing Small and Medium enterprises can be instrumental in poverty reduction (Kessy and Urio, 2006). Microfinance institutions are said to be efficient in supporting Small and Medium enterprises (SMEs) in this regard due to their ability to mitigate the information asymmetry which exists between the clients and the lenders (Ana, 2001) hence improving the access of financial services to the poor people who lack formal collateral required by commercial banks.

The contribution of MFIs on the development of Small and Medium Enterprises (SMEs) has been evidenced in Asian and Latin American countries; in these countries Small and Medium enterprises (SMEs) have contributed to the growth of national income, provide more employment opportunities and improve the living standard of low income carder (Meyer, 2002; Kereta, 2007; CIDA, 2006; Atieno, 2009; Santen, 2010).

Also empirical evidence shows that a dynamic and growing Small and Medium Enterprises (SMEs) sector through the boost of MFIs in Tanzania, has contributed to the achievement of a wide range of development objectives, including: the attainment of income distribution and poverty reduction (DFID, 2000); creation of employment (Daniels and Ngwira, 1993); savings mobilization (Beck et al, 2005); and production of goods and services that meet the basic needs of the poor (Cook and Nixson , 2000). While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 per cent of employment in developing countries and Tanzania alike is generated by the informal economy, while an additional 18 per cent is provided by (formal) small and medium enterprises. Together these two groups contribute 63 per cent of the GDP (Ayyagari et al, 2003).

3. ISLAMIC MICROFINANCE SERVICES

The Grameen Bank is an outstanding example of a successful microfinance institution. The
award of the Nobel Prize in 2006 to the founder of the Grameen Bank, Muhammad Yunus, brought microfinance to international attention. Although Bangladesh is a predominantly Muslim country, The Grameen Bank is not a *shari'ah* compliant financial institution as it charges interest on loans, and pays interest to depositors. Even though Grameen Bank calculates its rates of interest in simple rather than in compounded terms, it does not mitigate the *riba'* transactions [Wilson 2007].

There are also wider concerns with conventional microfinance from a Muslim perspective.

Although the provision of alternatives to exploitative lending is applauded, there is issue of whether these are sustainable if they conflict with the values and beliefs of local Muslim communities. As interestingly pointed by Wilson (2007), simply extending materialism and consumerism into rural poor communities and urban shanty town settlements could actually undermine social cohesion, by raising false expectations which could not be fulfilled, resulting in long term frustration and possible discontent or even economic crime. Supporters of Islamic alternatives to conventional microfinance have as their aim the enhancement of the society, rather than with the promotion of values that might be contrary to *shari'ah*. Comprehensive Islamic microfinance services are involved not only on credit through debt finance, but rather it is involved in the provision of equity financing via *mudarabah* and *musharakah*, savings schemes via *wadiah* and *mudarabah* deposits, money transfers such as through *zakat* and *sadaqah*, and insurance via *takaful* concept. Thus, Islamic microfinance offers more feasible solution by offering not debt based approached, but rather assets based approach.

Islamic microfinance is concerned with the provision of financial and non financial services to small and medium entrepreneurs based on Islamic values with aim to promote justice for all. Considering that Islam prefers community-based activities Islamic principles shape the nature of microfinance institutions as they operate under a group-based approach and joint liability. It can, therefore, be argued that the above characteristics seem to cover almost all aspects required by the poor. In addition, conventional microfinance has been criticized because it is likely to charge its clients high interest rates; this is known as the debt-based approach, as they are dragged into debt (Asutay, 2010). Islamic finance, hence, offers a moral approach through a profit and loss-sharing approach in the form of *musharakah* and *mudarabah* modes of financing (Asutay, 2010) to prevent individual borrowers to be dragged into further debt. As IMF is based on asset-based approach as opposed to a debt-based approach, it is more appropriate for the needs of microenterprises, since their profits from their businesses can be hard to predict.

The performance of Islamic microfinance has been quite promising in the world. Obaidullah (2008) argues that the performance of RDS (Rural Development Scheme) of IBBL was better in terms of growth (12.5%), dropout rate (5%), and operational efficiency as compared to three conventional leaders in microfinance; Grameen Bank, ASA (Association for Social Advancement), BRAC (Bangladesh Rural Advancement Committee). Having lower rate of return charged (10% with 2.5% rebate for on time payment) than other microfinance (16% to 22.5% of interest), this offers advantage for the poor (Obaidullah, 2008). The Islamic microfinance also offers an active spiritual development program with the purpose to improve members' awareness of social right and responsibility in order to improve better relationship with others (Obaidullah, 2008), the program which has not been provided by conventional microfinance.

3.1 The Microfinance Policy of Tanzania

The Microfinance Policy of Tanzania is envisaged to provide regulatory framework to financial institutions in the country. The policy regulates financial organizations engaged in providing financial services to the households, small holder farmers and small and micro enterprises both in the rural and urban areas. Amount others, the policy is aimed at regulating the provision of financial services including savings, credit, payments and money transfers to mention but a few which are provided by the Microfinance Institutions. Therefore the policy itself is meant to provide operational framework for Microfinance Institutions providing micro credits to poor families and their enterprises (URT, 2000).

This microfinance policy is envisaged towards achievement of widespread access of microfinance all over the country that the microfinance services be made possible. And the policy requires that the provision of the services be made on commercial principles. Further to that, the policy stipulates that the setting of interest (pricing) be made by the microfinance institutions themselves who are well informed over the cost inherent in credit provision. And that, neither the government nor the

Bank of Tanzania (BoT) and donors should interfere the setting of the interest rates, in essence this likely lead the Microfinance Institutions moving away from the core objective of serving the poor and may lead into mission drift.

This suggests that the usury laws do not exist in Tanzania which requires setting ceiling rate. The policy therefore gives room to operators of Microfinance Institutions to operate freely. If this is the case, there is a major question to be answered in particular; if there are no usury laws how microfinance services can by a means to eradicating poverty while providing financial services in commercial basis?

3.2 Microfinance and Poverty Reduction in Tanzania

According to the national Microfinance Policy of 2000 people with small incomes once they get access to micro-credits, it is argued that they can efficiently provide for the basic needs of the their families as well a running their enterprises. Likewise with access to financial resources they can take advantage of emerging business opportunities. The national Microfinance Policy further provides that, access to microfinance provides avenue for the businesses growth. Kereta, (2007 argue that, one of the causes for the poor to fail to come out of poverty it is lack of access to credits. Yunus, (1984) as cited by Kessy and Urio (2000) provide that, poor families may come out of poverty by becoming entrepreneurs and that microfinance institutions should provide them with micro credits.

According to the research by Chijoringa (1997) Chijoriga and Cassimon (1999) the impact of Microfinance Institutions to the contribution of SMEs towards poverty reduction has been felt. It was found that about 12% to 34% of both urban and rural employment in Tanzania is contributed by SMEs. Also the research by Wangwe and Semboja, (1997); Toroka and Wenga, (1997) conducted in Tanzania show that MSEs contributed about 32% of the Tanzania's GDP.

With that growth in employment, contribution to the GDP, the researcher is puzzled as to why Tanzania is still ranked third from bottom of poor countries in the world with its people living below one US dollar per day. It seems the kind of employment reported in these researches does not assist the employees to sustain their families together with their businesses.

Research has shown that in Tanzania, 18.7% of the population is living below the food poverty lines where 35.7 percent living below basic needs poverty line. In 2001 Tanzania established its National Strategy for Growth and Reduction of Poverty (NSGRP). The objective of this strategy is to reduce both urban and rural poverty. Under this strategy, the goal is to reduce the food poverty line from 25.8 percent in 2001 to 12.9 percent by 2010 whereby for the case of basic need the aim is to reduce it from 13.2 percent in 2001 to 6.6 percent by 2010.

4. RESEARCH METHODOLOGY

The study employed descriptive -correlational research design whereby the researcher gathered information through both probability and non probability sampling design. Data were collected in three banks (National Bank of Commerce, Kenya Commercial Bank, and Akiba Commercial Bank) established Islamic Bank window, and in Amana Bank which is the only bank having fully fledged Islamic Banking. . Based on this research design, the study employed a quantitative research approach in explaining the contribution of Islamic microfinance in enhancing small and Mediums enterprises to transform their business activities. The study used a sample size of 100 which was characterized of bank employees and customers consuming Islamic banking products. The study employed both structured closed and open ended questionnaire as a method of data collection. A five point scale ranging from 5-stronly agree, 4-agree, 3-Neutral, 2-Disagree, and 1-Strongly disagree was used to assess the contribution of Islamic microfinance in supporting Small and Medium Enterprises (SMEs) and consequently reducing poverty in Tanzania. Data collected was analyzed by using one way-ANOVA and regression through the help of SPSS version 20.

5. ANALYSIS AND INTERPRETATION OF THE FINDINGS

This study tested four related variables so as to achieve the objective of the study. These related variables are Islamic microfinance and opportunities in increasing income and fixed income, Islamic microfinance and improvement of capabilities to improve the living standard, Islamic microfinance and reduction of vulnerability for the poor and Islamic microfinance and empowerment for the poor.

				Sum of Squares	Mean Square	F	Sig.
Islamic Microfinance increases opportunities to increase income, and fixed assets	Between Groups	(Combined)		6.017	1.504	7.692	.001
		Linear Term	Unweighted	1.689	1.689	8.639	.010
			Weighted	1.541	1.541	7.878	.013
			Deviation	4.476	1.492	7.630	.003
	Within Groups			2.933	.196		
	Total			8.950			
Islamic microfinance improves capabilities for the poor to improve the standard of	Between Groups	(Combined)		3.367	.842	3.677	.000
		Linear	Unweighted	1.689	1.689	7.381	.016

living		Term	Weighted	1.101	1.101	4.812	.044
			Deviation	2.265	.755	3.299	.050
	Within Groups			3.433	.229		
	Total			6.800			
Islamic microfinance reduces vulnerability for the poor	Between Groups	(Combined)		3.117	.779	1.572	.000
		Linear Term	Unweighted	.156	.156	.316	.582
			Weighted	.843	.843	1.702	.212
			Deviation	2.273	.758	1.529	.248
	Within Groups			7.433	.496		
	Total			10.550			
Islamic microfinance creates empowerment for the poor to live better life	Between Groups	(Combined)		1.950	.487	.850	.003
		Linear Term	Unweighted	.352	.352	.614	.445
			Weighted	.012	.012	.021	.885
			Deviation	1.938	.646	1.127	.370
	Within Groups			8.600	.573		
	Total			10.550			

The first hypothesis (Ha1): There is a significant relationship between Islamic Microfinance and increase of opportunities to increase income, and fixed assets. This hypothesis shows positive significance because the significance value is 0.001 at (P≤0.000) at 95% confident level.Islamic microfinance are said to have an influence in expanding opportunities at both household level and enterprise level and that this is attained through raise in income, increase in fixed assets, diversification of income sources, increasing employment opportunities as Gobezie, (2004) and Latifee (2003) noted. It is assumed that once the poor takes credits they will fix assets, opening of new businesses and increasing employment opportunities. However, Gobezie (2004) outlines some of the practical challenges in achieving these opportunities, these include low outreach, problems of group lending and the one fits all terms and conditions, clients, low absorptive capacity, the poor market infrastructure and road networks.

The second hypothesis (Ha2): There is a significant relationship between Islamic Microfinance and improvement of capabilities of the poor to improve their standard of living. This hypothesis shows positive significance because the significance value is 0.000 at (P≤0.000) at 95% confident level. Capabilities can be looked in terms of parents sending their children to school, ability of the poor to access hospital services also their ability to get nutritious food. There is an assumption that a client is rational and will use the credit for the sought reason, but this is not always the case. Islamic microfinance including other microfinance institutions are therefore expected to address these problems if at all the micro credits are to have impact in the lives of borrowers (Nghem, 2006).

The third hypothesis (Ha3): There is a significant relationship between Islamic Microfinance and reduction of vulnerability for the poor. This hypothesis shows positive significance because the significance value is 0.000 at (P≤0.000) at 95% confident level. It has been argued that microfinance stands a better position to assist micro and small enterprises owners in diversifying their income, increasing savings, expand their credit options and small enterprises owners in diversifying their income, increasing savings, expand their credit options and house hold management (Gobezie, 2004) By so doing will assist the microfinance institutions to positively impact the lives of micro – entrepreneurs. Presence of business development services to clients will have a positive influence on the impact of MFIs on the lives micro and small entrepreneurs at both household and enterprise levels.

The fourth hypothesis (Ha4): There is a significant relationship between Islamic Microfinance and empowerment of the poor to live better life. With access to Islamic microfinance services the poor can be empowered (Gobezie, 2004) through supporting their economic activities. Empowerment can be looked in areas of increase in control over resources, increase in savings, increased recognition and their future orientation. These are some of the important indicators of the successfulness of an MFI in empowering the poor. These are capability base indicators and should include other standard health indicator such as longevity, malaria incidence and infant mortality rate.

Based on those findings, the study concludes that Islamic microfinance is concerned with the provision of financial and non financial services to the poor who desire to embark in entrepreneurship based on Islamic values for the aim promoting development and welfare of the entire society. Considering that Islam prefers community-based activities, thus, Islamic principles shape the nature of microfinance institutions as they operate under a group-based approach and joint liability. It can, therefore, be argued that the above characteristics seem to cover almost all aspects required by the poor to be transformed from an umbrella of poverty. In this regard, the study recommends that Islamic microfinance should be established in those carrying out Islamic banking in Tanzania because these interest free financial institutions often support Small and Medium Enterprises with small loans for the purpose of improving their business operations. On the other hand, Islamic microfinance and other conventional microfinance institutions are integral in accessing the poor to productive assets because majority of the developing countries are characterized by poor families whose major economic activities are subsistence farming Small and Medium enterprise. These productive assets can improve their living through the income generated from these businesses. In addition, the study recommends further research in this new but potential area because Islamic microfinance are said to be efficient in supporting Small and Medium enterprises (SMEs) in Tanzania and elsewhere in developing countries.

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