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Community Development Financial Institutions: Lessons in Social Banking for the Islamic Financial Industry

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1. Introduction

New forms of financial intermediaries have emerged since the 1990s to provide social and community finance to socially vulnerable groups and reinforce social cohesion. These financial institutions take different forms and structures and have spread largely in Europe and the United States and are also expanding worldwide. They have been classified under the label "*social banking*" such that they are said to "*take a positive interest in the social outcomes and effects of their activities*" while at the same time are driven by financial returns [Mayo and Guene 2001: 1]. One such provider of community development finance is Community Development Financial Institutions (CDFIs). This paper focuses on these financial intermediaries which have evolved as the financing of economic development has followed the new thinking on development that is people-centred and focuses on local capacity building by empowering the poor, encouraging local sustainable enterprises, and overcoming financial and social exclusion. By so doing, these financial institutions help in improving individual lives and enable more individuals to be involved in the dynamics of economic development. This micro-economic development paradigm has also been promoted by the World Bank under the umbrella term "*Community Based Development*" or "*Community Driven Development*", where projects run include the beneficiaries in their design, decision making and management of investment funds [Mansuri and Rao 2003]. Overall, these measures are expected to deliver better social, economic and environmental progress and assist in alleviating poverty in underdeveloped areas.

In this paper a link between CDFIs and Islamic banking and finance is established, particularly in view of the high importance attributed to social development and human well-being within the Islamic worldview. Indeed, the concept of community development is well reflected in the Islamic economics literature and in the establishment of distinctively Islamic pro-development modes of financing. However, despite this emphasis, the real life experiences of Islamic banking indicate the lesser concern placed on community development. In this respect Asutay [2007] states that neither the growth in the operations of Islamic financial institutions nor the expansion in the modes of financing have had significant impact on the lives of Muslim individuals. Similarly, El-Gamal [2006: xii] criticises the current state of Islamic finance for failing to internalise the social dimension and social justice into its operational functions.

In an attempt to align the practice of Islamic finance with the socially responsible objectives of Islamic economics, this paper seeks to draw lessons in social banking from the community development finance movement for the Islamic financial industry. Based on the content analysis of published materials of some CDFIs located primarily in the UK and the USA, this paper examines the community development initiatives of these institutions and learns lessons from their experiences

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on capacity building in local communities and their social impacts through poverty alleviation. The question posed is whether there is a role for specialised Islamic financial institutions – in the form of Islamic CDFIs that would focus on not only the double objectives of profit and Islamic ethics but also on the social mission – to more effectively empower Muslim communities and enhance socio-economic development.

2. Islamic Economics, Banking and Finance and the Social Aspirations of Community Development

The Islamic economics literature promotes the social aspiration of the discipline by emphasising socio-economic goals such as social justice, equity, poverty alleviation and human well-being. One of the leading Islamic economists, Siddiqi [1980: 202], summarized the socio-economic objectives of the Islamic economic system as follows: (i) the promotion of economic well-being; (ii) attainment of sufficiency and peace, eradication of hunger and fear in society; (iii) fulfilment of basic human needs; (iv) provision of ease and convenience in life, optimisation in the utilisation of natural resources; (v) fulfilment of spiritual needs; (vi) establishment of economic and social justice, equality of opportunity and cooperation; (vii) promotion of universal brotherhood and justice, equitable distribution of income and freedom of the individual within the context of social welfare [Abu Sa’ud 1967; Baqir al Sadr 1968; Mawdudi 1969; Chapra 1970; Qutb 1970; Kahf 1973; Al-Tahawi 1974]. These goals inevitably have recourse to and are meant to further the *maqasid al-Shari’ah* (objectives of Islamic law) which provides a framework encapsulating the concept of human well-being and seeking its improvement.

For the fulfilment of these socio-economic goals, the early Islamic economics literature has attributed a socially responsible role to members of the society. Muslim individuals and Islamic banks are thus expected to care for the social good and act in the social interest. Unlike the individual who is guided by self-interest motives under the *homo economicus* principle in the neo-classical literature, the individual guided by the philosophical and behavioural norms of Islam is expected to exhibit altruism, humanism, and social responsibility. He is accordingly given the special name of *homo islamicus* [Kuran 1983]. Other philosophical notions of human accountability before God, the role of man as a vicegerent on earth, and the ethical axioms of unity (*tawhid*), equilibrium (*al-adl wa’l-ihsan*), free will (*ikhtiyar*) and responsibility (*fard*) are further assumed to be the drivers which restrain self interested behaviour, motivate individuals to make careful use of limited resources, care for the environment and fulfill their social obligations [Ahmad 1980: 178; Naqvi 1981].

The Islamic modes of financing are also promoted as being intrinsically inclined towards growth and development as they finance real and asset backed transactions, encourage productive enterprises which are of value to mankind, promote entrepreneurship, shun interest, speculation and gambling, adopt a positive attitude towards profit maximisation and efficiency, and encourage risk sharing. These are practised in the positive and negative screening of investments as the core activity of the business is taken into consideration as well as quantitative factors such as the level of debt, the ratio of cash and interest bearing securities to assets, the extent to which a company’s

income is derived from interest, and the ratio of accounts receivable to assets [Wilson 2005]. The profit and loss sharing modes of *musharakah* and *mudarabah* have in particular been highlighted to be of high economic appeal in the Islamic economics, banking and finance literature (e.g. [Siddiqi 1983; 1996; 2000; Masood 1984; Chapra 1985; Tag el-Din 2002]. In addition, the concepts of *zakah* (religious tax), *sadaqah* (voluntary charity) and the *waqf* (endowment) system are said to have important roles to play in the promotion of welfare of Muslim communities.

Recently the new Islamic financial product, *Sukuk* (Islamic bonds), has been playing a key role in facilitating economic development. Its use is mainly being made for mobilising long term funds for financing large scale investment projects. The Governor of Bank Negara Malaysia, Dr. Zeti Akhtar Aziz, recently stated that Asia alone will require an estimated amount of $1 trillion for funding infrastructure projects over the next five years, while the figure stands at an estimate of $500 billion for the Middle East [Parker 2007]. The *Sukuk* market is thus being seen as an important avenue to mobilise the necessary funds for macro-economic development.

Above all, a socially responsible role has been assigned to Islamic banks by some contributors to the Islamic economics literature where the institutions are called upon to play the role of universal banks in promoting socio-economic development (e.g. [Chapra 1985; Siddiqi 1983; Warde 2000; Al-Zuhayli 2003; Hasan 2004]). Islamic banking and finance is itself perceived by a number of Muslims as a social enterprise whereby Islamic banks are expected to play a socially responsible role in the development process [Dar 2005: 50]. The socio-economic development role of Islamic banking and finance was in fact reflected in its early experimentations in the 1960s [Dar 2004; Kahf 2004]. In 1962, for instance, Tabung Haji Malaysia started its operations to help Muslims in Malaysia save for the performance of hajj while at the same time opening opportunities for their active participation in high profile investment activities such as industry, services, plantation, property and real estate. This early experiment reflected the ethical and indigenous form of Islamic banking and finance, especially the form of community banking that it proposed and its advantage of strengthening local economies and serving local communities [Khan 2007]. The idea of social and community banking was also institutionalised through the setting up of the Mit Ghamr savings houses (1963-67) in Egypt that replicated the model of the German Savings and Loans banks on the basis of Islamic tenets [Lewis and Algaoud 2001: 4-7]. Further developments took place with the establishment of the Nasser Social Bank (1971), a social lending institution assisting the poor and needy citizens and financing students and small-scale entrepreneurs. Another major milestone was the launch of the Islamic Development Bank (1973) which helps member OIC countries in development project funding.

Even though the early practices of Islamic finance and the emphasis in the Islamic economic theory is on economic development, the general perception felt is that Islamic banks are lacking in their involvement in community development. The explanation provided by Dar [2004] on this issue relates to the shift in emphasis from social banking to profit-and-loss sharing and profit motive as a result of the modelling of Islamic banking and finance. To this end, the emphasis is observed to be on such activities like product development, financial engineering, efficiency building, viability

and profitability and, if a social role is to be endorsed, it is only made peripheral to the activities of the institutions. There has also been heavy bias of *murabaha* and short-term trade-based financing transactions in the portfolio of Islamic banks relative to the use of profit-and-loss sharing arrangements as advocated in the literature. This has long subjected the practice of Islamic finance to various contentions. Islamic banks have, for instance, been claimed to (i) mirror conventional finance by adopting interest-like fixed return instruments [Warde 2000: 240]; (ii) choose financial products so that they are as closest as possible to the efficiency level of conventional financial products while they neglect the equity criteria of concern to Islamic jurists [El-Gamal 2000]; (iii) direct financial resources into consumption channels rather than into production [Hasan 2005a]; and (iv) direct the contribution of Islamic finance towards the growth of money by encouraging consumer indebtedness instead of the growth of the economy by linking financial services to the real and productive sector [Badawi 1996/1997: 20; Asutay 2007]. In short, the excessive use of fixed return modes has questioned the Islamic credentials of Islamic banking and finance which is perceived as a mere gimmick, with the products and services of Islamic financial institutions (IFIs) resembling those of their conventional counterparts except in name [Dusuki 2005]. The profit orientation of Islamic banks similar to their conventional counterparts has also raised criticisms about their social responsibility towards the development of Muslim communities. It is further believed that the mere replacement of *riba* with other fixed return modes of financing reflects an implied risk-averseness of Islamic banks which do not show their socio-economic commitment but rather indicates the downplay of their social identity.

This failure of IFIs to develop more risk sharing mechanisms and to instead mirror conventional finance by adopting interest-like fixed return instruments is often seen as a failure of Islamic finance to deliver on its original promise of institutionalising an innovative financial system for bringing about social and economic benefits to the Islamic world [Warde 2000: 240]. Discussions by Islamic economists like El-Gamal [2000; 2006], Halim [2001], Siddiqi [2004] and Hasan [2005a] have labelled this “*gap between promise and performance*” [Warde 2000: 240] of Islamic finance as a divergence between the literature of Islamic economics and the contemporaneous practices of IFIs which is the operational aspect of the Islamic economic system. Siddiqi [2004] and El-Gamal [2006] add to the arguments by pointing out to the neglect of “*social engineering*” or “*social efficiency*” which is inspired by social goals and instead the greater emphasis placed on “*economic and financial efficiency*” or “*financial engineering*” by Islamic banks.

The tendency for Islamic banks to overlook the socio-economic agenda is commonly explained by the early stage of development that Islamic banks are at [Warde 2000; Haron and Hisham 2003]; the mixed banking systems environment in which they operate where their survival rests on how successfully they compete with their mainstream counterparts [Haron and Kamaruddin 2005: 65-66]; and the many challenges specifically faced by the banks in terms of the legal and regulatory framework, political and economic climate, and lack of human infrastructure. Hasan [2004: 23] in particular draws attention to the inadequate operational structure of Islamic banks and the common expectations attributed to them. He stated that Islamic banks “*have mostly been designed on the*

pattern of commercial banks ... But they are expected to undertake project financing, long-term risky ventures, and address the social aspirations for economic development [while] they hardly have the structure, aptitude, environment, or personnel to do what we think they must do".

Asutay's [2007] viewpoints can in fact explain the modelling of Islamic banks based on the structure of commercial banks. He [2007] in particular noted the pragmatic approach that the development of Islamic finance has adopted as a result of the realities of the financial markets where economic incentives are prioritised over religious behavioural norms and there is heterogenisation of the financial products and disregard of their value system. To remain in existence, Islamic banks are believed to have been forced to adopt the "*second best solution*" and thus become part of the international financial system.

3. The Call for Socially-Oriented Islamic Financial Institutions

If social goals are to be attributable to Islamic banks, Hasan [2004; 2005a; 2005b] contends that Islamic banks should be "*structurally enabled to fulfil their societal obligations*". To this end, a reconsideration of their organisational design has been suggested to facilitate the efficient performance of Islamic banks for their contribution towards growth and development. One way could be that Islamic banks adopt an explicit and conscious social mission so that these can be embedded into their operational activities and internalized into their working operations. For instance, Abdul Rahman [2007] argues that there are several elements of microfinance which are consistent with the broader goals of Islamic banking and hence calls upon Islamic banks to adapt the financial instruments used in Islamic banking into Islamic microfinancing schemes in order to better contribute towards the socio-economic development of the poor and small entrepreneurs.

The need for an appropriate set of operational institutions and instruments that work along Islamic financial principles in order to contribute towards growth and development has also been highlighted by Ahmed [2005]. He iterated that these are lacking within the current Islamic financial system because of the infancy stage it is in, despite the fact that theoretically, the Islamic financial system has great potential to meet different financial needs that will bring about growth. Within this argument, instead of expecting Islamic banks to conduct socially oriented activities beyond their legal obligations, a new set of social-financial institutions is called for to alleviate economic development issues in poor and disadvantaged regions.

The latest document published by professionals in the Islamic financial services industry [IDB/IRTI/IFSB 2007], for instance, highlights the need to develop such socially-oriented financial institutions that can complement the activities of banks by providing various services that banks may not find profitable to offer – for example, social services, venture capital, financing the under-privileged. The IDB/IRTI/IFSB report [2007] mentions the lack of such institutions – classified under the category of Islamic non-bank and microfinance institutions – given the infant stage of the Islamic financial services industry which is yet to develop a comprehensive set of operational Islamic institutions and instruments similar to the wide variety available in the conventional systems.

Likewise, Dar [2005: 50] stated that "*there is need to develop new institutions that could*

operate on the principles of Islamic finance and which emphasize equitable growth with an ultimate objective of poverty elimination". To this end, he advocates a model of Islamic banking that combines the efficiency of modern banking with the passion of charity to provide financing for development. He uses the Islamic concepts of *waqf* and *zakah* to combine with the principles of modern banking for this purpose.

In the same way, Asutay [2007] does not require Islamic banks to be restructured to incorporate the principles of social justice and ethics as expected in the Islamic economics literature. Instead, like El-Gamal [2006], he argues for the establishment of new institutions as a new project for creating an ethically-oriented practice of Islamic finance where "*the brand name of Islamic finance [would] emphasize issues of community banking, microfinance, socially responsible investment, and the like*" [El-Gamal 2006: xii]. These new financial institutions could arguably follow the form of social banks and social investment institutions and could be considered as the next stage in the development process of Islamic banking and finance [Asutay 2007].

In line with the above argument, it asked if the model of community development finance – which is a form of social banking and has been working successfully in the West – could be combined with the principles of Islamic finance to foster economic development and improve the plight of Muslims in underprivileged regions. In particular, it is questioned whether Islamic financial institutions can learn from the experiences as well as the institutional and managerial structure of CDFIs in fulfilling their socio-economic objectives.

4. Community Development Financial Institutions: Their Role in Fostering Socio-Economic Development

CDFIs are financial service providers involved in the mainstream social banking sector with the primary mission of promoting community development. They serve principally underserved markets which can not access mainstream finance. As such, they target socially-disadvantaged communities and particularly niche market groups like women, ethnic minorities, and low income people who can not find finance from conventional sources because of adequate collateral, sufficient capacity or resources to borrow. Their predominant business activity is to make loans or development investments as well as provide development services such as counselling and technical assistance. In sum, CDFI is the general term used to describe "*private sector*" "*locally controlled*" "*market driven*" "*specialised financial institutions*" "*with community development as their primary mission*". The Community Development Finance Association defines CDFIs as "*sustainable independent financial institution providing capital and support to individuals or organisations to develop and create wealth in disadvantaged communities or under-served markets*" [Community Development Finance Association 2003-2005]. Along with having a social mission, they therefore have financial objectives as their aim.

CDFIs have a variety of structures and development lending goals [Dewees, 2004; Coalition of CDFIs (a)]. Six basic types of CDFIs have been noted in the literature: (i) community development banks, (ii) community development credit unions, (iii) community development

loan funds, (iv) community development venture capital funds, (v) micro-enterprise development loan funds, and (vi) community development corporation-based lenders and investors [Coalition of CDFIs (a)] ・Table I in the Appendix summarises the aims of each of the CDFI types, their governance and ownership structure, target groups, financial products and services, and the technical assistance provided.

The concept of CDFI is reported to have its origins in the history of self-help finance which resulted out of the financial exclusion of some communities by mainstream financial institutions [Coalition of CDFIs (a)]. The formative years of the current CDFI industry are reported to be the late 1960s and early 1970s when the CDFI industry began taking shape in the USA from the initiatives of government to establish development-oriented organisations to address poverty and racial discrimination (Coalition of CDFIs, www.cdfi.org). However, it was in the 1990s that the CDFI industry registered a dramatic boost in the USA and, based on its successes, the CDFI sector in the UK was modelled in the years 2000s [1].

The number of CDFIs in the USA is reported to be between 800 and 1000, operating in every state and serving both urban and rural communities [Opportunity Faith Network 2006-2007]. These institutions comprise more than 500 community development loan funds, 80 venture capital funds, 275 community development credit unions and 100 community development banks [Opportunity Faith Network 2006-2007]. Based on a survey of 496 CDFIs in 2005, it was reported that total financing provided by CDFIs total about $4.3 billion, financing about 55,242 housing units, 9,074 businesses, 613 community service organisations and creating 39,151 jobs.

In the UK, the community development finance sector is said to have a capital base of £450 million as at end 2005 and to have financed over 18,000 businesses and individuals in under-invested communities, thus creating 11,000 jobs and sustaining an additional 88,000 employment positions [McGeehan 2006]. It is reported that there are about 62 CDFIs that form part of the Community Development Finance Association (cdfa) in the UK [McGeehan 2006].

The key role of CDFIs is to serve in the social, economic and physical renewal of under invested communities. They help by creating jobs, economically empowering individuals, building

1) The boost of the CDFI sector in the USA was led by the following contributing factors [Coalition of CDFIs (a)]:
• The creation of the CDFI Fund in 1994 to provide both funding and technical assistance to CDFIs.
• The revision of the Community Reinvestment Act (CRA) regulations in 1995 which encouraged mainstream financial institutions to invest in CDFIs.
• The building of confidence in the CDFI industry as a result of its growing record of success, which directed new sources of support and funding to CDFIs.
The CDFI sector in the UK grew out of the five recommendations made by the Social Investment Task Force to government in February 2000 (UK Social Investment Forum, 1998-2003):
• To introduce the Community Investment Tax Relief (CITR) to encourage private investment in under-invested communities via CDFIs. (The CITR legislation was enacted in the Finance Act 2002)
• To help set up Community Development Venture Capital Funds. (Bridges Community Development Venture Fund, the first of such funds, was launched in May 2002)
• To encourage disclosure by mainstream banks of their lending activities in under-invested areas. (A number of banks have started disclosing such information e.g. Barclays (February 2001); Unity Trust Bank (May 2003); Natwest (November 2003); and HSBC (June 2004))
• To provide greater latitude and encouragement for charitable trusts and foundations to invest in community development initiatives. (The Charity Commission published a guide on social investment in May 2001)
• To set up a trade association to provide support to CDFIs and the CDFI sector. (The Community Development Finance Association (cdfa) was established in April 2002)

local businesses, developing entrepreneurial initiative, developing small businesses and micro-enterprises, constructing affordable housing, providing essential community services like child care, health and education, serving women, ethnic minorities and other economically disadvantaged groups [Social Investment Forum 2006: 4]. Importantly, they seek to help people out of poverty by encouraging self-sufficiency through enterprising and individual initiatives instead of depending on grants [Social Investment Task Force 2005: 10]. They therefore work with the local people and motivate them to positively change their economic and financial situations. They are thus perceived as "*a vital tool for boosting enterprise and wealth creation*" [Social Investment Task Force 2003: 12]. The World Bank equally shares this view as it reports some of the benefits brought about by the community development projects that it finances. Mansuri and Rao [2003: 2] reported that the projects assist in the development of more informed and involved citizens who are capable of undertaking self-initiated development activities and thus, the projects help in reversing existing power relations as they provide a voice for the poor. It is noted that the World Bank's lending for community development projects amounted to some US$2 billion in 2003.

In general, CDFIs may affect the macro economy in a positive way by changing the economic growth of a specific region or sector; they may also affect the political-economic status of a particular sector, for instance, by shifting the rural sector from barter to a monetized economy; and they are equally expected to entail psychological effects on individuals, households and communities by giving them access to financial services [Ledgerwood 1999: 47-48].

The socio-economic effects of CDFIs are generally aided by some of their characteristics:

- They have an explicit aim of revitalizing local communities by providing finance or equity participation to low-income individuals, entrepreneurs, businesses and voluntary non-profit organisations. The setting of explicit social goals can be said to impact positively on the organisational design of the financial institutions such that management's vision and mission, the uses of funds, financing methods, training of staff, managerial system, governance structure, reporting procedures, and products and services are directed along appropriate lines to facilitate efficient performance. As pointed out by Hasan [2004; 2005a; 2005b], an organisational structure which explicitly recognises the institution's societal obligations enables the latter to consciously work towards its goals and perform better.
- CDFIs have a long term objective of assisting local communities and also have a strong focus on sustainability of their operations [Joseph Rowntree Foundation 2005]. In this way, they are in existence as long as needed and involve a diverse range of local stakeholders to establish support and trust of the community.
- They have specialized knowledge about the needs of the communities with whom they do business and for which they seek financial solutions [Dewees 2004]. This is usually helped by having community members on the board of the financial institutions. At other times, financial institutions like the community development credit unions are owned, governed, and benefited by local community members who are aware of community problems and needs.

- They are able to establish strong relationships with the local communities which help in gaining their moral and financial commitment and reduce the risk of default [Dewees, 2004].
- CDFIs provide funding for meaningful purposes – for example, for building financial assets, working capital, purchase of equipment, start up capital, home improvements, financing of affordable housing, consumer financial products for personal development. Along with funding, they also offer technical assistance to businesses in the form of credit counselling, business planning and development, marketing, financial literacy training, and building business networks [Coalition of CDFIs (c)]. Such assistance is at times outsourced by involving sub-contractors or separate subsidiaries like in the case of Community development banks (see Table I in Appendix).
- They are project-based and often give more importance to the viability of a project or such factors like social solidarity over the credit worthiness of the individual [Guene and Mayo 2001: 5]. The financing of short term projects also makes monitoring easy, which is in turn helped by having technical experts represented as board members in the project committee.
- They advocate a bottom-up, participative, and people-centred approach to financing with their commitment to the social agenda geared towards a genuine transformation of societies.

5. Case Studies of CDFIs and their Social Impacts

In an effort to understand the scope and activities of CDFIs and provide an overview of their social impacts, this section researches the community development initiatives of some CDFIs located in the UK and the USA. A content analysis of the published and electronic materials of three institutions was therefore carried out. Discourse analysis of the published texts and documents and use of the method of interpretivism were made to give meaning to the texts.

5.1 The Local Alchemy Project: Promoting Development by the People, for the People

One of the projects run by the New Economics Foundation (NEF) entitled '*Local Alchemy*' is particularly of interest to this research in terms of its approach and the supported programme of project implementation it offers towards economic regeneration. At the outset, it should be highlighted that the NEF is not a CDFI *per se*. It is however a think-and-do tank in the area of community development finance such that this London-based organisation (i) analyses CDFIs activities, (ii) initiates policy measures to support the growth of community development finance, (iii) promotes performance measurement, quality standards and good practices among CDFIs, (iv) innovates new CDFIs models and financial products (such as the London Rebuilding Society and the Adventure Capital Fund), and (v) seeks funding for individuals, businesses and social enterprises involved in community development (www.neweconomics.org).

Local Alchemy is described by NEF as being "*about helping areas experiencing economic disadvantage to overcome these challenges and 'get back in the economic loop' by making their local economy stronger and more robust*". Ten pilot areas showed interest in participating in this project in the East Midlands, UK. Some of its key characteristics that contribute to the success of the scheme are as follows:

- It brings together residents in one area – individuals, businesses, organisations, and public agencies – to understand what is going on or going wrong in their local economy and to think of ways to reverse economic decline. As a helping tool, it uses simple, easy-to-understand and practical concepts to teach complex economic issues. A practical demonstration of the concept of a 'leaking bucket' is for example utilised to find out how money is spent in the local area and where it is leaking out. Other toolkits used are board games, the mapping of local assets, networking events, undertaking workshops to develop a local economic vision.
- Seed capital funding is provided to kick start economic ideas and projects. More importantly, local projects are identified, planned and acted upon with the help of a Local Alchemy coach who facilitates workshops and provides technical assistance in the form of advice on practical business and project development, and offers training on special areas like how to conduct feasibility studies, access funding, and make funding applications.
- The Local Alchemy places emphasis on three key areas to create an enterprising community framework: Assets, Attitude and Action. With respect to assets, it recognises the need to access high quality assets (like business advice, finance, availability of premises) and the need to use local assets wisely to ensure sustainability. A positive and proactive attitude is secondly a prerequisite for participating in the project. Importance is given to such values like optimism, creativity, persistence, patience, confidence, commitment, working for the social good, and passion – such that individuals are encouraged to find out what they love, develop their skills and work towards their goals. Local Alchemy further encourages local communities to act to create a positive social impact.

Therefore, more than the provision of project funding, the Local Alchemy scheme helps local communities to identify local assets and development handicaps, plan to regenerate their local economies, and work skilfully towards the implementation of the community renewal projects with a positive attitude and with the aim of improving social good. It encourages local projects development by the people and for the people.

5.2 The Aston Reinvestment Trust: Financing Viable Projects of Social Benefit

The Aston Reinvestment Trust (ART) is a leading British CDFI established in 1997 as a result of community initiatives involving local groups, voluntary sector organisations and businesses at a time when the CDFI concept was being introduced in the UK. Its primary activity is to provide loans to existing and start-up businesses and social enterprises which have been turned down by mainstream banks in the Birmingham and North Solihull areas in the UK. The other conditions for securing finance from the CDFI relate to the viability of the project and the social benefit of the project. To this end, loans ranging from £2,000 to a maximum of £50,000 are dispensed to local enterprises which are believed to have an impact on the lives of local people by making available useful local services in the disadvantaged areas, by creating new employment, and by safeguarding jobs. It is reported that since 1997, ART has lent a total of £5 million to over 250 borrowers, enabling them to create or protect more than 2,300 local jobs (www.reinvest.co.uk/art/about).

Although Aston Reinvestment Trust appeals to socially-motivated investors, who in fact provided the necessary funds for its establishment, its successful operations also make it attractive to mainstream companies (like, Jaguar and Severn Trent) and banks (like, Barclays and Natwest) who have invested in the CDFI. It thus works in collaboration with mainstream banks to achieve its purpose of being socially beneficial. In fact, ART believes that it is in a unique position to make loans where banks cannot. This is on account of its small scale operations, the acceptability of a lower rate of return by its investors who regard their investment as a social investment rather than as investment made for personal gain, and the support it receives from volunteers (ART Annual Report 2004). In this way, the CDFI complements other banking models which are unable to serve small local and more risky communities. To this end, ART is commended for tackling the problem of financial exclusion faced by socially disadvantaged communities.

5.3 ShoreBank: A Mission to Create Economic Equity and a Healthy Environment

ShoreBank is the oldest and largest community development bank in the United States, headquartered in Chicago. Since its inception in 1973, it has been increasing economic opportunities in underserved communities in about 30 neighbourhoods in the USA through community development investments. Its services include the provision of non-traditional and more flexible loans to individuals and small local businesses, loans for the renovation or purchase of affordable housing, financial and homebuyer education, workforce development and employment services, consulting and advisory services for businesses, and provision of conservation loans to protect the environment and conserve natural resources. ShoreBank also operates a number of non-bank companies to support its mission of building sustainable communities, protect the environment and help its customers to build wealth. ShoreBank and its subsidiaries therefore share the triple bottom line objectives of social, economic, and environmental sustainability.

One of the distinctive measures adopted by the bank for improving the economic situation of local communities was the setting up of Development Deposits and EcoDeposits by the bank to direct the savings of depositors into community and sustainable development projects. In this way it attracts needed capital to the neighbourhood. At the same time depositors earn the double satisfaction of creating positive change by supporting community development and of earning a competitive rate on their investments.

6. The Significance of CDFIs to the Islamic Financial Services Industry

The aim to bridge the gap between the rich and the poor is equally shared by the Islamic finance paradigm. Socio-economic justice and equitable distribution of income are particularly highlighted to be the key goals of an Islamic economy. These were reflected in the 1960s practices of Islamic banking in the landmark experiences of the Tabung Haji Pilgrim's Fund, the Mit Ghamr Savings Houses and the Nasser Social Bank. These institutions were notably Islamic non-bank financial institutions (NBFIs) which focused on socio-economic objectives.

In principle, NBFIs are meant to complement the activities of banks by providing various services that banks may not find profitable to offer [IDB/IRTI/IFSB 2007: 29]. They include

different kinds of specialised financial institutions, sector-specific financial companies, leasing and factoring companies, cooperatives, building societies, credit unions, micro-finance institutions, and venture capital funds; and they would exclude commercial and investment banks. CDFIs would also form part of NBFIs.

Given that the Islamic financial services industry is still developing, it is observed that it lacks a comprehensive set of operational institutions and instruments compared to the conventional systems [IDB/IRTI/IFSB 2007: 30]. Nonetheless, Islamic alternatives exist for a number of the mainstream NBFIs. Some examples are micro-finance institutions, cooperatives, credit unions, leasing companies, venture capital funds and factoring companies. Also, within the Islamic financial system, some unique NBFIs have developed which do not have their mainstream counterparts, notably, *zakah* funds, *hajj* funds, *qard hassan* funds, *modaraba* companies, and *waqf* foundations.

Yet, the development of Islamic CDFIs has been found to be missing in the practice of Islamic banking and finance. It is recalled that CDFIs take the form of community development banks, community development credit unions, community development loan funds, community development venture capital funds, and micro-enterprise development loan funds. While it may be observed that Islamic alternatives to some of these institutions prevail (e.g. credit unions, venture capital funds, micro-finance institutions), no emphasis appears to be placed on the objective of community development, either within the appellation of the institutions or in their mission statements. It is likely that by explicitly including the prefixes ‘community development’ within the names of the institutions, as in the case of CDFIs, their community development objective and social mission would be naturally enhanced.

The transformation of conventional CDFIs into their Islamic alternatives would necessarily involve the elimination of interest (*riba*) and other non-Islamic elements from their transactions. Indeed, Islamic CDFIs would operate on a *Shari’ah* compliant basis. While the institutional structure of CDFIs could further be retained, the contracts used would have to be adapted to Islamic principles.

One of the major advantages of the Islamic CDFIs is that they would be able to offer social services which for-profit Islamic commercial banks might not be willing to offer. Just like their mainstream counterparts, Islamic commercial banks might not find the financing of underprivileged communities profitable or might not be adequately equipped to fulfil the specific needs of the community. In a survey conducted by the author based on a sample of 48 Islamic banks, it was found that about 69.5% of the respondents (who constituted Islamic financial practitioners) related the concept of the ‘social responsibility’ of Islamic banks with such key terms as “*responsive to social needs*”, “*community development*”, “*civic awareness*”, “*social obligation to the public and themselves*”, “*community oriented*”, “*social justice*”, “*against financial exploitation*”, “*concern of the haves for the have-nots*”. Nonetheless, it was noted that about 47.2% of the respondents stated that their financial institutions spend only about 0-2% of their annual profits on community developing activities. This showed that the financial practitioners who were

surveyed were highly socially responsible in their views. This, however, did not correspond with a high percentage of profits being disbursed on community development issues by the financial institutions. Furthermore, it was noted that the 0-2% of the profits spent on community activities mostly related to donations-like activities (e.g. donations to charities, sponsorship of community events) instead on the financing of any specific projects. Hence, the setting up of Islamic CDFIs with clear goals of community development would help meet the social responsibility function generally expected of Islamic financial institutions.

Furthermore, unlike retail banks which tend to offer financing packages geared towards a broader customer market or high-net-worth investment funds which target the wealthy, Islamic CDFIs would be more responsive to the customers' financing needs which are unsatisfied by the market and would focus on offering alternative solutions to the socio-economic development problems of local communities. Their key advantages will be their operation at the grass root level whilst maintaining financial professionalism and efficient standards.

7. Conclusion

This paper discussed the positive contributions of CDFIs in enhancing community development and considers combining the Western model of community development finance with the principles of Islamic finance for maximisation of social well-being in Muslim communities. This is submitted on basis of the observed low response of commercially-oriented Islamic banks towards community development, which have been commonly criticised to be focusing on financial engineering, contract mechanics, Shari'ah compliance, efficiency building and increasing their profits rather than emphasising Shari'ah objectives, building social capacity and empowering individuals. Instead of calling upon existing Islamic banks to show more social commitment, academicians like Tag El-Din [2004], El-Gamal [2006] and Asutay [2007] are of the view that these may well continue to provide the invaluable service of meeting the financial needs of consumers and producers. Alternatively, they propose a new model of financial institutions that would have a greater role in the promotion of economic development in Muslim communities. These new institutions, according to El-Gamal [2006], should emphasise such concepts like community banking, micro finance, and socially responsible investment.

This paper therefore calls for the establishment of Islamic CDFIs which would add another layer of institutions to the Islamic financial system and thus complement Islamic banks by providing financial services not offered by the banking sector. Islamic CDFIs will combine the efficiency of modern banking with the provision of technical assistance and support services to improve community welfare whilst they operate in line with the Shari'ah. They will also internalise the elements of Islamic ethics, social justice and community banking to the working of Islamic financial institutions. In this way, Islamic CDFIs would be perceived as a valuable back up to the Islamic financial services industry, providing specialised financial services to serve the specific needs of communities. They will hence revive the principles of Islamic social banking which represents the initial and authentic practice of Islamic banking.

APPENDIX Table I: CDFI Types and Their Characteristics

CDFI Types	*Aims*	*Borrowers*	*Financial Products and Services Offered*	*Technical Assistance*	*Capital Sources*	*Governance and Ownership*
Community Development Bank	To provide capital to rebuild lower-income communities through targeted lending and investment	Non-profit community organizations, individual entrepreneurs, small businesses, housing developers	Mortgage financing; home improvement; commercial business; non profit and student loans; consumer banking services	Usually sub-contractors or separate subsidiaries offer credit counselling, business planning	Deposits (often below market investments) from individuals, institutions and the government	For profit corporation; stock ownership; community representation on board
Community Development Credit Union	To promote community ownership of assets and savings, provide affordable credit card and retail financial services to lower-income people with special outreach to minority communities, take deposits and make loans only to members	Members of the credit union (usually individuals)	Consumer banking services (e.g. savings accounts, check cashing, personal loans , home rehabilitation loans)	Credit counselling, business planning	Member deposits and limited non-member deposits from social investors, the government	Non-profit financial cooperatives owned and operated by lower-income persons who are members
Community Development Loan Fund	To aggregate capital from individuals and institutional social investors at below-market rates and re-lend this money primarily to non-profit housing and business developers in urban and rural lower-income communities	Non-profit community organizations, social service provider facilities and small businesses	Construction; pre-development; facilities and business start-up and expansion loans	Extensive guidance before, during and after the loan transaction	Foundations, banks, religious organizations, corporations, the government, insurance companies and individuals	Non-profit, democratic; community investors, borrowers and technical experts serve on the board and loan committees

CDFI Types	*Aims*	*Borrowers*	*Financial Products and Services Offered*	*Technical Assistance*	*Capital Sources*	*Governance and Ownership*
Community Development Venture Capital Fund	To provide equity and debt with equity features for medium-sized businesses to create jobs, entrepreneurial capacity and wealth that benefit low-income people and communities	Invests in small to medium-sized businesses in distressed communities that hold the promise of rapid growth	Commercial equity investments and loans with equity features	Extensive technical assistance to portfolio companies, including taking seats on their board of directors	Foundations, corporations, individuals, the government	For profit or non-profit; varied community representation.
Micro-enterprise Development Loan Fund	To foster social and business development through loans and technical assistance to low-income people involved in very small businesses or self-employed and unable to access conventional credit	Low-income individuals and entrepreneurs	Micro-business start-up and expansion	Substantial training and technical assistance in social and business development	Foundations, the government	Non-profit, democratic; in peer lending model, borrower groups make loan decisions
Community Development Corporations	To revitalize neighbourhoods by producing affordable housing, creating jobs, and providing social services to low-income communities	Entrepreneurs, homeowners, business owners, consortia of community residents	Equity Investments, mortgage lending, debt financing, linked deposits, Individual Development Accounts	Marketing, business planning, flexible manufacturing networks, business improvement	Banks, foundations, corporations, other private support, the government	Non-profit; formed by local community residents; operated by a volunteer board, community residents are board members

Source: Coalition of CDFIs (c), Comparing Different Types of CDFIs, Available at <URL: http://www.cdfi.org/compare.asp>

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