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Role of Islamic Social Finance in Reducing Households' Over-Indebtedness in Malaysia

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ABSTRACT : Credit market research generally focuses on business loans, while households are generally viewed as providers of funds rather than debtors. However, the household credit market transfers resources from households in temporary surplus to those in temporary deficit. Generally, young people are burdened with student loans during their studies and after graduation. Once they started working, their needs for transportation and independent housing increases, leading to more loan commitments and increasing the possibility of over-indebtedness. Some households have accumulated too much debt as they are unaware of the consequences of their own financial choices, while others have been forced into debt due to unfortunate life events. According to the literature, an excessive level of indebtedness leads households to fall into poverty. Hence, this study aims to highlight the severity of household over-indebtedness in Malaysia and to propose a model based on a crowdfunding platform combining Cash-waqf and Qard Hasan to reduce this phenomenon. This study adopts a qualitative research approach, by undertaking a meta-analysis of comprehensive secondary data obtained from reports of the relevant agency, namely the Credit Counseling and Debt Management Agency (AKPK) and literature. Several recommendations and suggestions have been put forward in efforts to raise awareness among households and encourage Islamic social finance actors to include this social issue in their development programs.

KEYWORDS: Households, Over-Indebtedness, Cash Waqf, Qard Hassan, Islamic social finance

I. INTRODUCTION

1.1. Background

Over the years, there has been an increasing trend in the level of indebtedness of individuals, stimulated by a "culture of consumption" bring about by a massive growth of consumer goods coupled with the "democratization of credit" which has facilitated access to credit in many countries around the world (Kus 2015). In fact, debt plays an important role in modern society. It helps people to smooth their consumption and therefore to maintain a stable lifestyle when incomes are lower than expenses. It also allows people to react to unexpected events such as illness, job loss and emergencies. Conceptually, household debt or credit market transfers resources from households in temporary surplus to deficit units, thus boosting and promoting economic activities enabled by availability of funding to support the productive activities. These funds collected through indebtedness will be injected into the economy whether via consumption, saving or investment. Some households will be able to pay all the installments in time, but others will struggle to reimburse. However, those households will have to borrow again but only to repay the previous debt. By doing so, they will be stuck in the vicious circle of debt. This phase is called over-indebtedness. Recently, debt has become a persistent feature of households' balance sheets throughout their life cycle (Lusardi and Tufano 2015). Households are considered to be over-indebted if their net resources constantly do not enable them to meet essential subsistence expenses and to repay their debts when they fall due. In fact, researchers argue that excessive use of debt, particularly unsecured debt, threatens the financial stability of households (Ntsalaze and Ikhide 2016).

In Malaysia, recent official statistics show that households are facing an increase of over-indebtedness, an increasing trend in consumer loan demand, a high household debt-to-GDP ratio, as well as a high number of bankruptcies. According to the central bank Bank Negara Malaysia (BNM), Malaysian household debt reached $ 294.3 billion in December 2018, compared with $ 263.8 billion the previous year, representing 82% of the nominal GDP. In the same year, household credit represents more than 60% of total bank and non-bank loans, exceeding corporate credit since 2004 (Aziz, Zahari, and Nordin 2018). While households' nonperforming loans, were reported at $ 6.752 billion in January 2020, recording an increase compared to the previous number of $ 6.476 billion for December 2019 (BNM, 2019). In addition, according to the Malaysian Department of Insolvency (MDI), most of the bankruptcy cases for the year 2008 to 2017 come from the younger group age from 25 to 40 years old. Moreover, a study had shown that in Malaysia more than half of the civil servants' monthly income is used to repay debts (Aziz et al. 2018).

1.2. Objective

Islamic social finance (ISF)has an important role in improving social welfare in the society mainly by launching projects for the needy people (Center of Strategic Studies and Zakat 2019; Obaidullah and Shirazi 2017; Suprayitno, Aslam, and Harun 2017), and improving financial inclusion (Obaidullah and Shirazi 2015). But, ISF instruments had been channeled to a specific segment of social issues while giving less important to others. Through this study, we try to highlight the severity of households' indebtedness in Malaysia and propose a model based on cash waqf to help those in financial burdens. However, this study is one of the pioneering studies that combine Cash-waqf and Qard-Hassan to reduce this social issue.

In achieving the research objective, this study adopts a qualitative research approach by exploring the literature and analyzing secondary data issued by the Credit Counseling and Debt Management Agency (AKPK).

This study intends to increase awareness among households of the seriousness of the debt trap. By understanding the harmful impact of over-indebtedness, households and consumers in general must manage properly their expenses and take control of their finances. The results should also encourage cash-waqf institutions to take into consideration this social issue and raise funds dedicated to supporting those who suffer from this issue.

II. LITERATURE REVIEW

2.1. Theoretical Foundation

The Life cycle theory is based on the idea that people make smart choices about how much they want to spend at each age, limited only by the resources available during their lifetime. They adapt their consumption patterns to their needs at different stages of life, regardless of their income at each age. Generally, the very young have little wealth, the middle-aged have more while the peak of wealth is reached just before retirement. The life cycle hypothesis assumes that individuals' incomes will increase throughout their lives. On this basis, the expecta ion of future income growth will lead individuals to consume more than their capacity in their early lives. The increase in expenditures that comes with the presence of children postpones savings. Therefore, the youngest individuals and families are more likely to borrow. This overconsumption is mainly financed by debt. The theory predicts that there would be dissaving at the beginning and the end of the life cycle, financed by savings during the middle age. Modigliani (1963) argues through the life cycle and permanent income hypothesis that younger groups will spend more in contrast to an older group. They explain that they have a large burden such as children's expenses, buying homes for family and having a vehicle for the necessity. While for the older generation, most of the requirements are already available (Ando and Modigliani, 1963).

Furthermore, the life cycle hypothesis explains that consumption needs and incomes are often unequal at different stages of the life cycle. Young people generally have consumption needs greater than their income. Unlike the elderly, their consumption is very low compared to their income (Modigliani and Brumberg 2005). However, household's spending and savings depend on the stage of their life cycle. Although income will increase during the working years and decrease during retirement, consumption should remain relatively stable. In addition, young people tend to borrow more to cover multiple expenses.

2.2. Indebtedness and over-indebtedness of households

Nowadays, credit is used to meet the needs related to almost all areas of life, including, among other things, housing, transportation, education, and health. Banks and other financial institutions facilitate meeting needs with different types of debt instruments. In fact, debt is seen as a mechanism to fill the gap between income and expenditures. Households borrow to mitigate transient income fluctuations (Jappelli, Pagano, and Maggio 2008). They also borrow to smooth consumption throughout their life cycle (Lusardi and Tufano 2015). However, unnecessary debt should be avoided as it has negative consequences for individuals and for society.

Household debt is measured as the value of debt relative to disposable income. An acceptable level of debt is not a problem, but it becomes an issue when the debt turns out to be a burden for them and, therefore, they do not fulfill their financial obligations. An irresponsible loan could result in default and even bankruptcy. Although indebtedness and over-indebtedness are distinct concepts, they are related.

The lack of a worldwide definition of over-indebtedness and a standard benchmark beyond which a household is considered burdened by debt makes it difficult to identify the level of indebtedness that we can consider as over-indebtedness. While some researchers see it as a self- reporting measure (Lusardi and Tufano 2015), others, have established a scale to measure the debt levels(Idris et al. 2018). The measurements for individual debt status are as follows:

- Low debt: using less than 20% of income for debt repayments.
- Moderate debt (MD): using between 21%- 30% of income for debt repayments.
- High debt (HD): using between 31% - 49% of income for debt repayments.
- Over-indebted (OID): more than 50% of income for debt repayments.

In addition, a person is considered as over-indebted if he borrows to repay another debt, he does not want to borrow because of too much outstanding debt, he had loan application turned down due to too much debt, he restructured his debt, he defaulted on a debt obligation, and has been subject to foreclosure (Mutsonziwa and Fanta 2019).

For other researchers, a household is regarded to be over-indebted when its income, despite decreasing its standard of living, is insufficient to discharge all its payment obligations over a longer period (Haas, 2006). Also, it is regarded to be over-indebted when its members are unable, although willing, of fulfilling their non-professional debt obligations (D'Alessio and Iezzi 2013).

2.3. Cash waqf: definition and potential

Waqf is one of the most important components of the Islamic social finance and a clear manifestation of the objectives (Maqassid) of Shariah. It is a powerful instrument that, if managed properly, makes it easier for ISF to solve modern socio-economic problems in society. When a person donates his assets to a waqf institution, he no longer remains the owner of those assets. The assets are considered to belong to Allah. But, the recipients of waqf are very broad. In fact, the restrictions that apply on zakat recipients do not apply on waqf recipients. Meanwhile, the job of the waqf trustee is to manage the waqf properties honestly. However, one of the biggest misconceptions about using the Waqf is its use for building mosques, cemeteries, or schools. Although nothing in the Qur'an or Sunnah prohibits a wider use of waqf to meet the needs of the community.

In the past, donations to waqf institutions have been restricted to wealthy people that are able to donate their assets. But recently, with the integration of cash waqf, the donor base has been expanded. The concept of cash waqf has widened the scope of waqf since it allows the acceptance of donations of waqf in the form of money and other movable property. In addition, contributions are no longer limited to the wealthy since donations can be made in cash at any amount.

The cash waqf is a waqf established with cash capital. It is managed by preserving and investing its corpus while the usufruct and the profits are devoted in perpetuity to the well-being of society (Chalabi and Moutahaddib 2020). Some jurisdictions only recognize immovable assets as valid contributions to waqf and exclude cash. This is mainly due to the perceived requirement for the perpetuity of the waqf assets and the perception that the cash may lose its value over time. But, the cash waqf allows practically all Muslims to contribute to the value of the waqf for the benefit and the development of society since very few people can afford to make endowments in real estate. However, if the cash waqf is managed properly, its value will not only be perpetual but will increase over the years (Aziz et al. 2019).

There is a consensus among the majority of Muslim jurists legalizing the cash waqf. In addition, the World Fiqh Council (*Majmaa 'al-Fiqfh*) issued a fatwa approving the use of Cash Waqf under certain conditions, in particular by preserving the corpus of waqf (Chalabi and Moutahaddib 2020). Moreover, due to its distinct advantages in fundraising besides its liquid and flexible nature, cash waqf has recently been integrated into several models that have been developed to improve socio-economic development and reduce poverty (Kachkar 2017).

III. METHODOLOGY

3.1. Data

Although the phenomenon of over-indebtedness among households has been studied, few are the solutions that have been proposed to reduce it. On this basis, it becomes necessary to build and promote models aiming for the reduction of this social issue.

For the purpose of this study, we have adopted a qualitative research design. The study is based on secondary data produced by the Credit Counseling and Debt Management Agency (AKPK) to highlight the phenomenon of excessive indebtedness among households in Malaysia. The survey conducted by the institution covers 1,083,970 individuals that have attended one of its programs since its inception in 2006. We note that AKPK offers three main programs (Financial education, Financial counselling, Dept management program). The focus of our study was the households that have attended the Debt management program (DMP) in order to be assisted in managing their debts. However, the 322,495 participants that have applied to enroll into the DMP are the subject of this study (Table1). Indeed, since the creation of the AKPK to date, DMP participants constitute more than 29% of the application to the three programs offered by the establishment. However, the approval rate for DMP applications varies from year to year. At the end of June 2020, the institution recorded a cumulative approval rate of 95.6%, that is, 308,306 approvals

(Table 2). It is important to note that AKPK offers individual borrowers the opportunity to improve financial discipline through financial education, financial counselling and debt management. Through these three programs, it aims to create a more resilient credit sector and to minimize the incidences of non-payment resulting from poor debt management.

Table 1. Overall number of cases received.

AT THE END OF	DMP APPLICATIONS	CUMULATIVE DMP APPLICATIONS	SHARE OF DMP IN ALL APPLICATIONS (%)
2007	8,172	8,172	25.4
2008	11,638	19,810	28.1
2009	15,837	35,647	43.0
2010	15,543	51,181	51.8
2011	16,811	67,992	53.0
2012	16,110	84,102	45.0
2013	16,769	100,871	41.4
2014	20,624	121,495	33.7
2015	22,208	143,703	26.2
2016	25,821	169,524	21.3
2017	41,290	210,814	24.6
2018	45,765	256,579	26.8
2019	50,892	307,471	28.7
JUN'20	15,024	322,495	28.6

Source: AKPK, 2020

Note: DMP refers to Debt Management Program

Table 2. Year to date approved Debt Management Program

During	No.	Approval Rate (in %)
2007	4,944	60.5
2008	9,043	77.7
2009	17,188	108.5
2010	15,281	98.4
2011	15,582	92.7
2012	14,923	92.6
2013	15,511	92.5
2014	19,336	93.8
2015	20,397	91.8
2016	27,084	104.9
2017	41,827	101.3
2018	44,925	98.2
2019	48,581	95.5
Jun'20	13,684	91.1

Source: AKPK, 2020

If we break down the applications received in the past 13 months, it can be seen that the credit counselling and debt management agency is constantly receiving thousands of applications every month. This number was affected by the unusual circumstances enforce during the MCO for the months of April and May 2020 (Figure 1). With a particular focus on the year 2019 and the first half of 2020, it can be seen that the Kuala Lumpur branch far exceeded the other branches by recording respectively 50.2% and 56.2% of all requests received by the AKPK across the country. followed by the branch of Johor Bahru that has registered 8.9% and 8.7% respectively (Table 3).

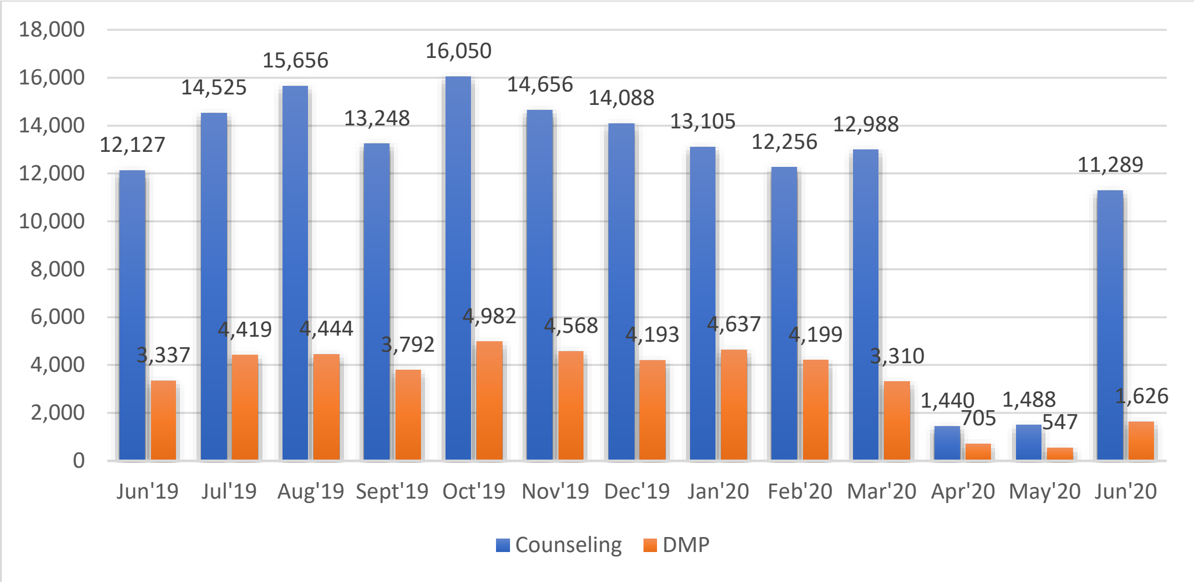


Figure 1. Counselling and Debt Management Program applications in the past 13 months
Source: AKPK, 2020

Table 3. Debt Management Program applications by branch / counselling office

Branch	2019		Jun'2020	
	NO.	%	No.	%
Kuala Lumpur	25,531	50,2	8,449	56,2
Penang	3,220	6,3	881	5,9
Johor Bahru	4,524	8,9	1,306	8,7
Perak	3,004	5,9	730	4,9
Pahang	2,003	3,9	576	3,8
Melaka	2,190	4,3	576	3,8
Sabah	2,740	5,4	730	4,9
Terengganu	1,214	2,4	288	1,9
Kedah	2,345	4,6	556	3,7
Sarawak	2,444	4,8	535	3,6
Kota Kinabalu	1,677	3,3	397	2,6

Source: AKPK, 2020

3.2. Model Development

Based on the above, we can understand clearly the seriousness of the over-indebtedness between households in Malaysia. Although the initiative taken by Bank negara Malaysia by creating the Credit Counseling and Debt Management Agency, many households still suffer from over-indebtedness. However, with this paper, we aim to propose a model that will target households trapped in the vicious cycle of debt.

The model is based on a Crowd-funding institution that will collect under a public authority Cash-waqf from the public with the final aim to allocate funds as Qard Hassan to householders that suffers from high levels of indebtedness. In order to preserve the corpus of Cash-waqf, it will be invested in low risk projects (Real estate as an example) and the benefice collected from this investment will be given as Qard with no interest to the beneficiaries. Qard Hassan's allowance will be a sort of debt rescheduling for the beneficiary since the amount received will cover all his overdue debt while the payment will extend on a longer period, with no interest and taking into account his income and his repayment capacity. This model will allow the financing of projects that will be chosen by the donors (Waqifs) among a variety of projects presented on the platform. That is, this platform will open applications for projects with financial need and after careful screening, low-risk projects will be subject to cash-waqf fundraising (Figure 2).

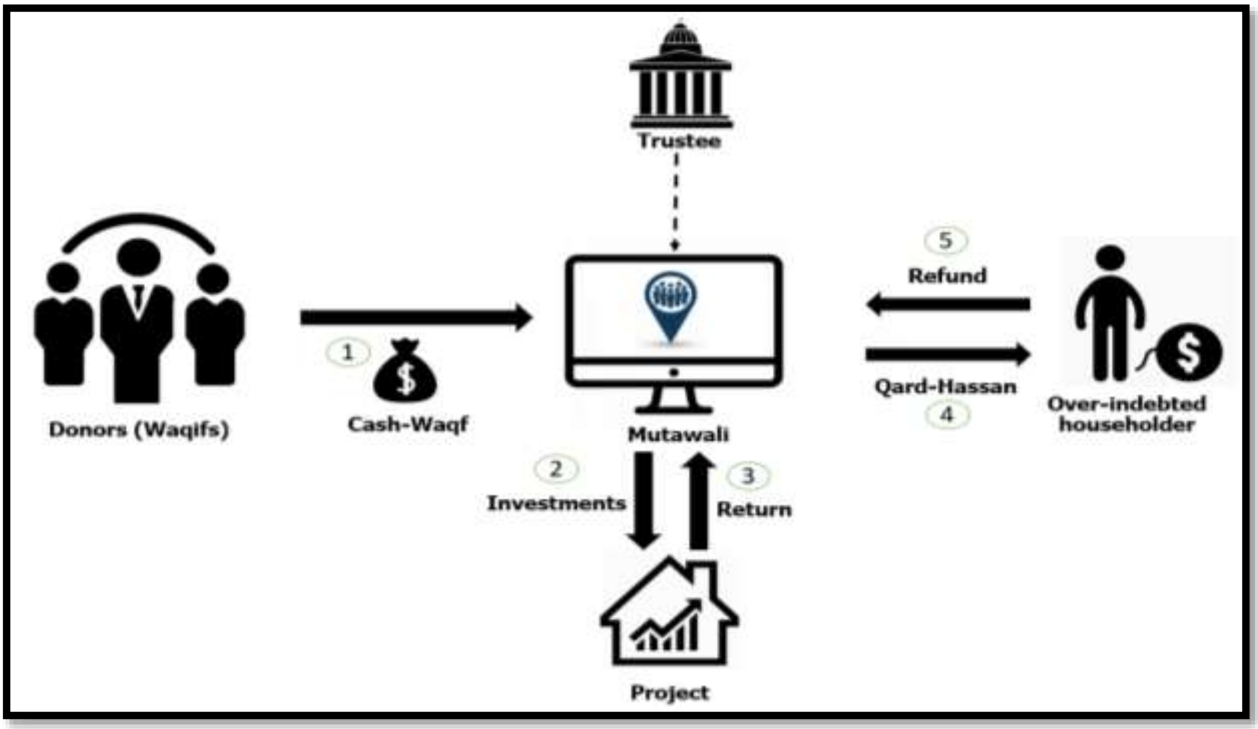


Figure 2. Proposed model

Source: Authors, 2020

IV. RESULTS AND ANALYSIS

4.1. itsResults

Statistics covering candidate profiles start in 2011. Since then, male applicants far exceeded women with a rate that does not fall below 64%. Accordingly, married applicants made up more than two-thirds of applicants over the past 10 years, followed by applicants who were single, divorced and then widowed (Table 4). As for the age group, it became clearer after 2013 since the statistics were more detailed by breaking down the category "over 40". Applicants aged 30-39 was the highest, followed by the 40-49, 20-29, 50-59, and then over 60s (Table 5). Regarding annual income, households with a salary below Rm 24,000 per year are those who have the most difficulty in meeting their debts, followed by households with incomes varying between Rm 24,000 and Rm 36,000, and households with incomes ranging between Rm 36,000 and Rm 48,000. In fact, during the past three years, the first and the second range were almost equal. In addition, households from all the income ranges have approached the institution for the debt management program (Table 6). This is interesting and we can conclude that the poor are not the only ones struggling to pay off their debts and that this issue concerns all social classes.

Table 4. Profile of approved Debt Management Program (by Gender and Marital status)

	Gender (%)		**Marital status (%)**			
At the end of	**Male**	**Female**	**Married**	**Single**	**Divorced**	**Widow/ Widower**
2011	67.5	32.5	72.1	16.6	4.5	6.8
2012	67.4	32.6	77.3	16.3	4.3	2.1
2013	67.1	32.9	77.5	15.9	4.7	1.9
2014	66.8	33.2	78	15.5	4.4	2.1
2015	66.5	33.5	77.3	16.1	4.6	2

2016	65.3	34.7	77.3	15.9	4.8	2
2017	64.5	35.5	77.9	15.3	4.8	2
2018	64.2	35.8	78.1	14.9	4.8	2.2
2019	64.1	35.9	78.1	14.9	5.2	1.8
Jun'20	64.1	35.9	77.9	15	5.2	1.9

Source: AKPK, 2020

Table 5. Profile of approved Debt Management Program (by Age range)

	Age range				
At the end of	**Between 20 and 29**	**Between 30 and 39**	**More than 40**		
2011	20.8	39.9	39.3		
2012	19.2	40	40.8		
2013	17.7	39.9	42.4		
-	**Between 20 and 29**	**Between 30 and 39**	**Between 40 and 49**	**Between 50 and 59**	**Between than 60**
2014	16.3	39.6	28.7	12.7	2.7
2015	15.6	39.2	29.1	13.1	3
2016	15	39.2	29.2	13.4	3.2
2017	14.5	40.1	28.9	13.3	3.2
2018	14.1	40.9	28.6	13.1	3.3
2019	13.8	41.4	28.5	13	3.3
Jun'20	13.7	41.4	28.5	13	3.4

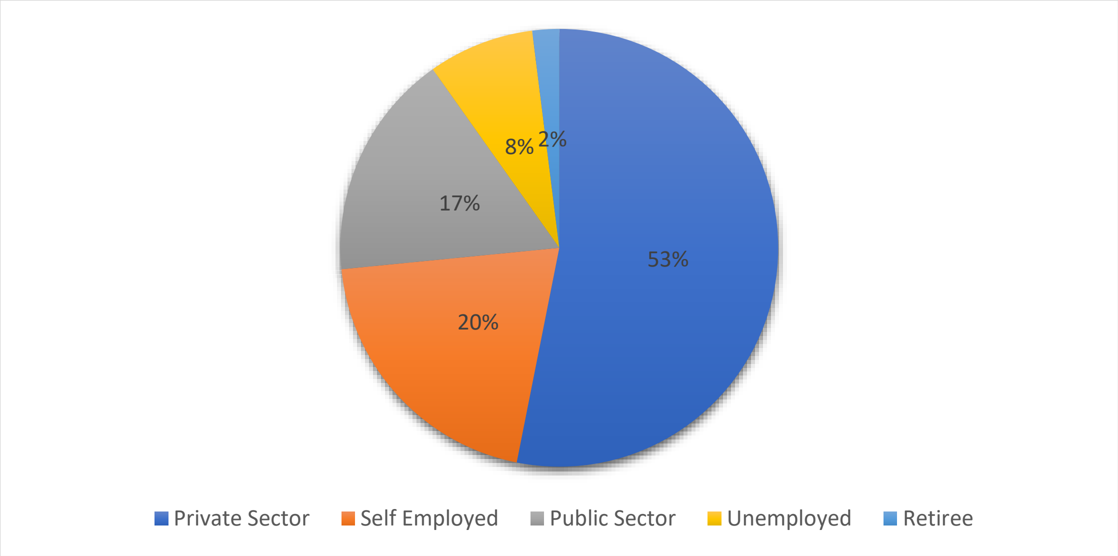
Source: AKPK, 2020

Most DMP applicants are employed in the private sector (53.6%), followed by the self-employed (20.5%), the public sector workers (16.9%), the unemployed (7%), then retirees with only 2% (Chart1). Credit card facility is the one with highest default (55.3%), followed by personal loan (31.8%), hire-purchase (4.3%), housing loan (4%), and others (Chart 2). The main driver of a Malaysian household to an unmanageable level of debt is poor financial planning (36.7%) followed by the high cost of living (34.7%), business failure (12.3%), the loss of a job (8.8%), high medical expenses (6%), and others (1.5%) (Chart 3).

Table 6. Profile of approved Debt Management Program (by Annual Income)

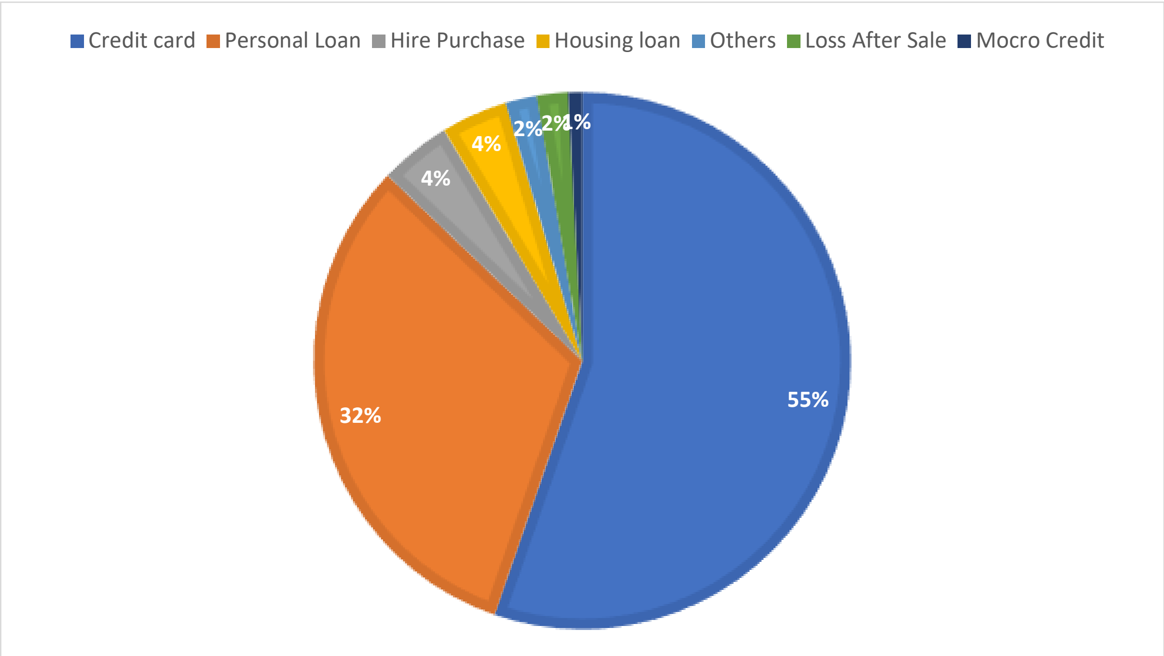
	Annual Income (1000Rm)							
At the end of	**Less than 24**	**Between 24 and 35,9**	**Between 36 and 47,9**	**More than 48**				
2011	64.8	14.8	9.8	10.6				
2012	57.6	17.5	11.7	13.2				
2013	52.6	18.8	13	15.6				
-	**Less than 24**	**Between 24 and 35,9**	**Between 36 and 47,9**	**Between 48 and 59,9**	**Between 60 and 71,9**	**Between 72 and 95,9**	**Between 96 and 119,9**	**More than 120**
2014	47.8	19.3	14	7.5	4.5	3.8	1.5	1.6
2015	44.3	19.6	14.6	8.2	5.2	4.4	1.8	1.9
2016	40.9	19.9	15.1	9.1	4.5	3.6	4.7	2.2
2017	37	20.3	15.8	9.7	4	2.9	7.8	2.5
2018	35.1	20.7	16	10.2	3.3	2.4	9.7	2.6
2019	33.8	20.8	16.1	10.6	2.8	2	11.2	2.7
Jun'20	33.4	20.8	16.1	10.7	2.6	1.9	11.6	2.9

Source: AKPK, 2020



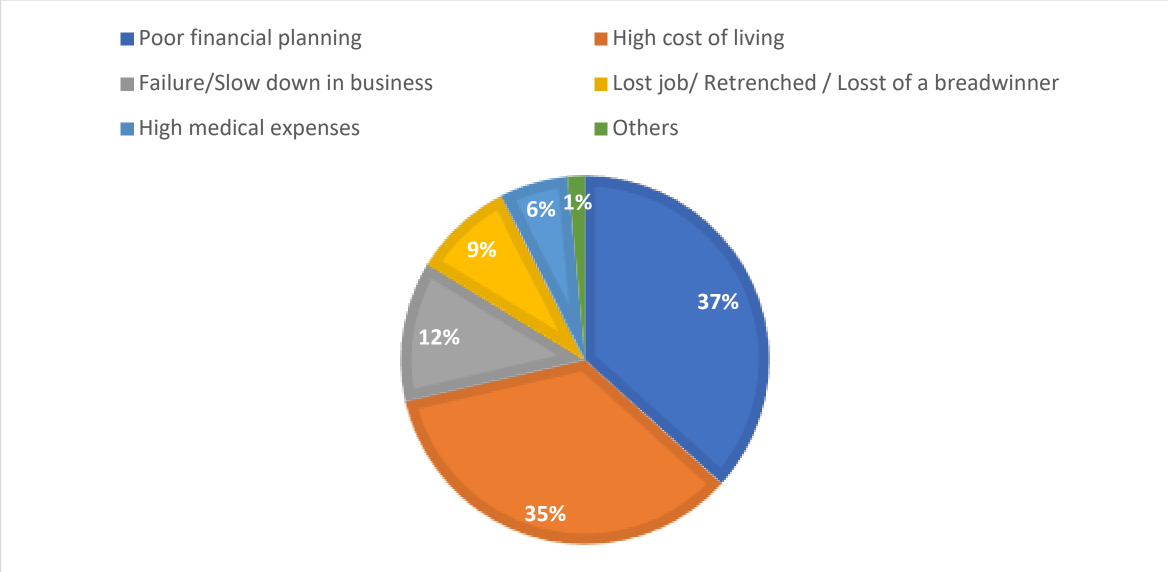
Source: AKPK, 2020

Chart1. Debt Management Program application by employment



Source: AKPK, 2020

Chart2. Debt Management Program application by credit facility



Source: AKPK, 2020

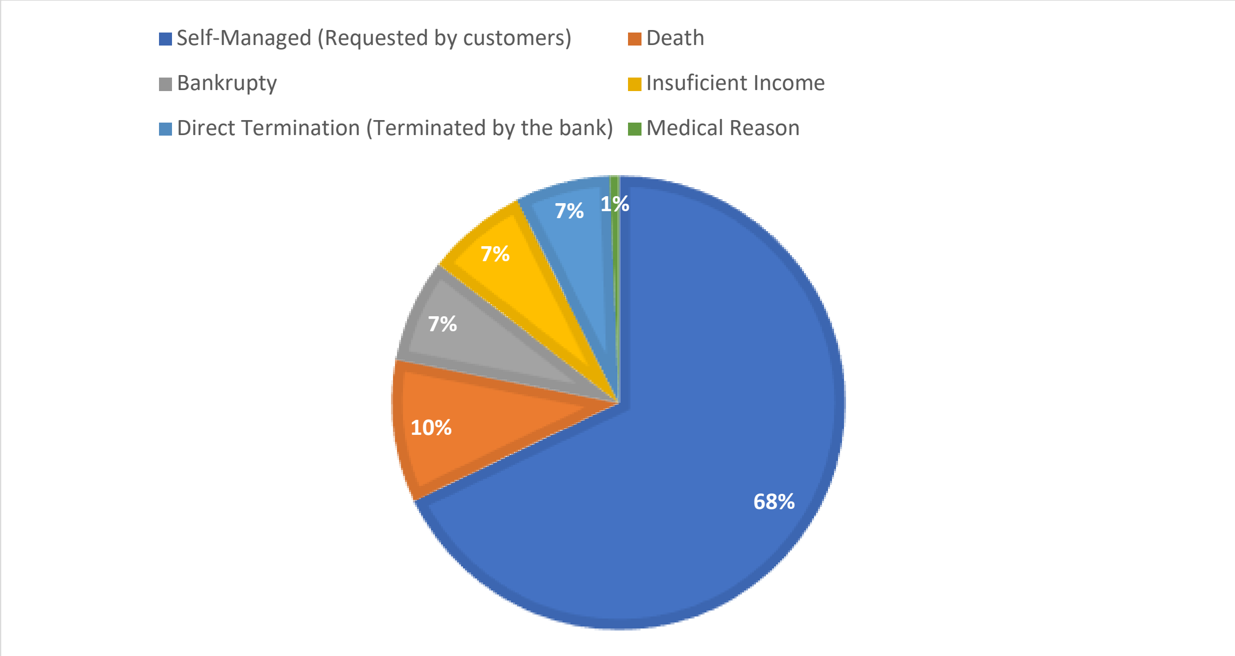
Chart3. Debt Management Program application by reason of default / debt problem

Up to the end of June 2020, the cumulative total of approved DMPs was 308,306 cases for a total amount of RM 43,032.8 million. Of these cases, only 28,224 cases were resolved (RM 1,249.3 million) while 100,736 cases were withdrawn or terminated (making an amount of RM 9,481.8 million). However, an amount of RM 32,301.7 million, shared between more than 179,000 active cases, is now being managed by the institution (Table7). Withdrawal from the program may be due to several reasons. In the best case, the client requests it when he can manage his debts himself (68.1%). But other reasons further exclude the client from the program. In addition to his death, the client is withdrawn from the program due to bankruptcy (7.4%), insufficient income (7.2%) and for medical reasons (Chart4).

Table7. Approved Debt Management Program status

	2019		Jun'2020	
Branch	**NO.**	**RM mil.**	**No.**	**RM mil.**
Total cumulative approved DMP	294,622	40,467.5	308,306	43,032.8
Active	171,477	30,385.3	179,337	32,301.7
Settled	25,844	1,122.3	28,224	1,249.3
Withdrawn	11,788	1,226.7	13,098	1,441.6
Terminated	85,513	7,760.2	87,647	8,040.2

Source: AKPK, 2020



Source: AKPK, 2020

Chart 4. Debt Management Program application by reasons for withdrawal

4.2. Analysis

These results corroborate the life cycle and permanent income theory established by Ando and Modigliani (1963) which asserts that consumption needs and income are often unequal at different stages of a household's life cycle. It argues that younger groups spend more compared to an older group, which might explain their need to take on more debt. However, an excessive level of debts might have a harmful impact on the life cycle of the household.

Although the important role played by the Credit Counseling and Debt Management Agency, there is more to be done. In fact, the success rate of debt management services rendered by the insttion since its start in 2006 is as low as 11%. Moreover, it only accepts individuals struggling with debts approved by the BNM. In other words, non-formal and non-structured loans are not subject to the DMP despite their prevalence.

Therefore, there is an urgent need for the establishment of a platform that targets directly this social issue using the appropriate financial products. We believe that a combination of cash-waqf and Qard-Hassan will be a good solution to provide over-indebted individuals with liquidity to settle their debts given the flexibility of the products. However, the establishment of such a platform will be subject to a variety of legal and regulatory challenges.

V. CONCLUSION AND RECOMMENDATION

5.1. Conclusion

Households' over-indebtedness is one of the pressing social issues in Malaysia and around the world and, until now, the measures taken are not yet sufficient to reduce it. However, Islamic social finance has focused on reducing poverty while overlooking one of the main drivers of household poverty.

It is evident that Islamic social finance is effective in reducing poverty. Although there are a lot of researches on innovative methods for the reduction of poverty, as far as we know, there is no research on the impact of Islamic social finance on preventing households from falling into it. Realizing the vulnerability of over-indebted households and the crucial need to provide alternative financing to them, this study aimed to develop a model directly targeting this overlooked social range.

5.2. Recommendation

In view of the above, this study is unique and innovative, as it proposes a new model based on a crowdfunding platform combining Cash-waqf and Qard Hasan offering a financing solution to Malaysian households burdened by debt. This study aims to raise awareness of the public on the importance of the effective management of their finances in the hope of curbing financial related issues faced by many Malaysian households. It makes also households more aware of the consequences of over-indebtedness. This study is also an invitation to actors of Islamic social finance to mobilize their resources towards this social range and to legislators to facilitate legal procedures and incentivize investors to contribute to reducing this social issue.

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