

The key players' perception on the role of Islamic microfinance in poverty alleviation

The case of Pakistan

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Abstract

Purpose – This study aims to know the present structure and move of the Islamic banks of Pakistan as well as current issues and challenges for Islamic microfinance. However, this is based on perceptions of the Islamic bankers, regulators and micro-entrepreneurs and petty traders, as they are the key players in the credit market.

Design/methodology/approach – The study gathered relevant information through conducting field survey. Two questionnaires were designed for the survey. One questionnaire was administered to survey 270 micro-entrepreneurs and petty traders in three major cities of Pakistan. Another survey deals with the perceptions of Islamic bankers. In total, 100 people from middle and top management were surveyed from five full-fledged Islamic banks of Pakistan. The SPSS software, version 16, was used for questionnaire reliability and descriptive analysis to analyse the data.

Findings – In general, the study found the strong opinions of the respondents speak in favour of Islamic microfinance under a system of profit and loss sharing. Conversely, the majority of the clients also feel that Islamic banks do not encourage lower-income micro-entrepreneurs. In addition, the study found that Islamic microfinance is constrained by lack of knowledge, experience and professionalism of the supporting staff; however, Islamic bankers have shown great consensus that Islamic banks should offer Islamic microfinance products and instruments to respond to the needs of the poor for poverty alleviation.

Research limitations/implications – The first limitation of the study is the meagre interest of micro-entrepreneurs and petty traders to participate in the survey. The second limitation of this work concerns the extremely busy schedule of top management and administrative impediment to approach and fix an appointment. Despite these limitations, the findings of this study provide insights to Islamic banks in diversifying their products by offering Islamic microfinance to the low-income entrepreneurs but with proper guidelines and policies.

Practical implications – There is a need to educate the community towards the merits of Islamic banking system by developing a good information system using good visuals and professionally presented seminars, banners and arranging regular sessions with the business community. The growth and development of Islamic banking in the country largely depend on its customers' enhanced knowledge and awareness about its products and services.

Social implications – It is the responsibility of the community as well as of government to change the mindset of the poor that banks are meant to serve the interest of everybody, regardless of social, economic and political status.



Originality/value – Theoretically, this study contributes to the existing body of knowledge in the area of Islamic microfinance by examining the perceptions of Islamic bankers and micro-entrepreneurs. This can help Islamic banks of Pakistan to design and formulate new administrative as well as operational procedures to serve the interest of the poor with commitment towards Islamic values.

Keywords Pakistan, Perception, Islamic microfinance, Challenges, Islamic bankers, Micro-entrepreneurs

Paper type Case study

1. Introduction

In Pakistan, microfinance as a tool of social mobilisation and poverty reduction that has started gaining importance during the late-1990s. Indeed, International Financial Institutions encouraged both public and private sectors by providing funds for the development of the microfinance division in the country. The Government of Pakistan has accelerated its efforts to institute microfinance in formal sector based on an integrated approach between the informal sectors (NGOs) as well as Pakistan Poverty Alleviation Fund (PPAF). The Government of Pakistan has taken a significant step by launching the Microfinance Sector Development Programme (MSDP) in 2000. The major aspects of MSDP are to provide the financial services to the poor on sustainable basis and increase the access of females to financial services. Furthermore, the MFIs Ordinance 2001 was enacted by the Government of Pakistan to support the development of the microfinance sector. According to Ordinance 2001, people below taxable income are entitled for microfinance. In addition, the State Bank of Pakistan (SBP) issued guidelines for establishing Islamic Microfinance Banks, Islamic microfinance operation by Islamic banks, conventional banks and Microfinance Banks and the approach to provide Islamic financial products to the microfinance clients.

Microfinance is the provision of financial services such as loans, savings and insurance to micro-entrepreneurs and small businesses for raising their standards of living. For this reason, microfinance is also considered as a well-established poverty alleviating programme which gives people an opportunity to borrow, save, invest and protect their families through active participation and benefit from the development activities. However, the poor households need access to diverse financial services than formal bank credits. But banks do not consider them as attractive clients due to high risk and inadequate assets for collateral (Beck *et al.*, 2008). These households with limited or no access to financial services or high interest rates find it enormously difficult to take an advantage of economic opportunities. It is difficult to protect themselves from financial shocks. Thus, financial exclusion not only pushes them but also binds them into a vicious circle of poverty (Obaidullah, 2008a).

Likewise, Islamic financing method has moral, ethical and just characteristics that can efficiently encourage the participation of the poor and micro-entrepreneurs to succeed. Hence, Islamic microfinance has the potential to become one of the mechanisms of Islamic banking and accommodate liberally within the present structure of Islamic banking (Rahman, 2007). However, past studies have found that there are limited examples of actual microfinance institutions (MFIs) working in the field of Islamic finance and Islamic banks involved in microfinance. As observed by Muhammad and Shirazi (2010) that Islamic banks have not perceived microfinance as a viable

opportunity like conventional banks. [Rahman \(2007\)](#) observes that Islamic microfinance is still a missing component in Islamic banking industry. He further describes the wide recognition of Islamic banking worldwide but the concept of financing to the poor or broad range of products to micro and small-sized enterprises by Islamic banks is yet to be developed.

The current study reveals that there is no considerable development in Islamic microfinance research based on the perception and patronage studies of the key players in the market. Therefore, this study aims to provide in-depth analysis on the perceptions of micro-entrepreneurs and petty traders as [World Bank Group \(2011\)](#) report that, indeed, micro-entrepreneurs are a very important part of the Pakistan Economy. Approximately, 3.2 million businesses are in Pakistan of which an estimated 3 million are micro-entrepreneurs. The small and medium enterprises (SMEs) census shows that SMEs contributing nearly 30 per cent to the gross domestic product and more than 25 per cent to the country's total export earnings. SMEs utilise about 70 per cent of the labour force in manufacturing, trade and services. However, problems such as the absence of sufficient collateral, no credit history, irregular or uneasily verified sources of income of these low-income people pose difficulties in seeking financing from formal financial institutions. Consequently, they often rely on relatives or local moneylenders who charge exorbitantly high interest rates as [Hassan \(2008\)](#) also revealed this monetary victimization that is quite exploitative and rather brutal and the outcomes of this manipulation are multi-faceted. Thus, the easier access to formal financial services can protect the poor from unforeseen circumstances while microfinance can contribute to economic growth through formation of small entrepreneurship and businesses, reduction in inequality and poverty ([Ravallion, 2001](#)).

In addition, it is the primary study that explores the micro-entrepreneurs and petty traders' awareness level, their intention and motivation to use Islamic microfinance and the related issues and challenges in Pakistan. On the other hand, to record the perception of Islamic bankers and regulators in identifying the problems of current microfinance practices and offering alternatives could contribute to better microfinance practices for poverty alleviation in Pakistan, with possible improvements and important insights in the field of microfinance. Therefore, this study aims to contribute towards bridging the gap between Islamic banks and small entrepreneurs. The paper is organized into six sections. The following section presents the literature review. Section 3 deals with research methods adapted for the paper. Sections 4 and 5 explain the data analysis and findings. The last section concludes and offers recommendations.

2. Literature review

Microfinance is considered as an economic development tool which addresses issues such as, poverty alleviation, gender and socio-political empowerment including the increase of financial services to the poor. According to [Engler \(2009\)](#) Yunus established the execution of joint liability groups as an alternative to tangible collaterals and particularly highlighted the key role of women in managing credit, social acceptability and organizing micro enterprises. He developed a model to extend loans to those entrepreneurs who have no sufficient credit history to meet the criteria for traditional bank loans. He put his model to exertion by creating Grameen Bank – Banking for the Poor.

However, efforts to extend the financial services to the poor and low-income people have received enormous attention and discussion in many major conferences and summits worldwide such as, the Millennium Development Goals and [Microcredit Summit \(2006\)](#). Nonetheless, there is an enormous unmet demand for microfinance worldwide. [Hickson \(2001\)](#) claims that mostly MFIs are far behind from reaching the extremely poor households. [Swain \(2004\)](#) also finds that microfinance programmes are still not very prevalent as may be required given that the sustainable and cost-effective microfinance programmes to help the poorest are limited. However, according to [Islam \(2007\)](#), providing finance for poverty alleviation, for instance, through microfinance is not just about the number of clients reached. It is also about providing the quality and range of financial services related to the needs and desires of the poor. The concept of microfinance is the idea that poverty can be effectively and permanently reduced or eliminated within a reasonable period. It can be done through the access to financial services by the poor ([Getubig et al., 2000](#)).

On the other hand, a study by [Coleman \(2004\)](#) found that the existing programs are not getting the poor as much as they reach moderately more well-off. The poor are reluctant to go to these conventional banks for taking loans because they are likely to be ineligible to, for instance, provide the collateral demanded as the security requirements of the banks ([Ahmed, 2002](#)). Moreover, even if the poor are successful in getting microfinance it is still often hard for them to pay the required interest on the principle amount. [Milford \(2010\)](#) argues more generally that microfinance disseminates rather than removes poverty and that its commercialization merely exacerbates this failure. [Rulindo \(2012\)](#) explains this phenomenon by stating that due to lack of access to credit from formal financial institutions, the poor and micro-entrepreneurs pay higher interest rates. Thus, if the financial system fails to provide the opportunities to the poor and micro-entrepreneurs, they may not be able to come out of prudential problems which are created by MFIs. This brings us to the problems experienced by conventional microfinance.

Thus, the conventional microfinance methods and functions based on interest (*riba*) are prohibited in Islam as stated by [Anwar \(2005\)](#) that conventional banks offer debt finance on the basis of interest which is believed to be *riba*. Islamic scholars and reformers have been criticizing conventional banking and struggling to replace interest income with some sort of Shari'ah-compliant form of lending. Consequently, therefore, this study supports the argument that these conventional practices do not effectively alleviate poverty as the micro-entrepreneurs remain into an unending debt cycle which will not only perpetuate poverty but also ultimately worsen the social tensions and unrest ([Chapra, 2008](#) cited in [Sharma, 2002](#)). Furthermore, the experiences of conventional microfinance have been criticised not only in the Islamic world but also in non-Islamic countries because of high interest rates. These interest rates are quite prohibitive and the low-income people cannot afford to bear the burden of high cost of borrowing. [Mizanur \(2010\)](#) describes that the interest rates for institutional sources vary from 15-20 per cent and the interest rate is even much higher in case of non-institutional sources varying from 33 to 140 per cent. Thus, on the grounds of equity and justice, Islamic microfinance seems to provide a much needed alternative to the poor because the Islamic system is guided by justice and compassion.

The Qur'an says:

We sent our Messengers with clear confirmation (to support their truthfulness), and sent with them the Book and the Balance (criteria of right and wrong) so that people would uphold justice (Surah al-Hadid, 57:25).

A study by [Karim et al. \(2008\)](#) found that large numbers of poor Muslims in many countries reject all forms of loans, including Grameen-style micro-loans on religious grounds. Some surveys ([CGAP, 2008](#)) proved that there is a high demand for Islamic microfinance, particularly among low- and middle-income groups in predominantly Muslim societies. However, it has been reported by International Finance Corporation (IFC) commissioned that approximately 20 to 40 per cent of the poor demand Shari'ah-compliant products and not seeking conventional microfinance because of religious reasons. In Algeria and Jordan, the demand for such products varies in the range of 20 per cent compared to 40 per cent for Yemen and Syria. Similar trend exists in Indonesia, Pakistan, Afghanistan, the Palestinian territories and also in Muslim mainstream areas of India, Brunei, Sri Lanka, Cambodia and the Philippines[1]. According to [FINCON \(2009\)](#) (Report, for Ministry of Finance & State Bank of Pakistan) both microfinance NGO's and commercial financial institutions envisage great demand for Islamic microfinance in the country. There is a strong tendency to borrow from family members and friends to avoid extra payment and *riba*. The report claims that 80 per cent of the population tries to avoid interest/*riba*. Results of the survey report concluded that time has come for Islamic banks to expand their products in microfinance directly or through intermediaries, whereas offering equity participation and *Ijara* modes may build confidence of the poor through risk sharing and improve economic lives of the poor.

So, there is a need to establish institutions that can accomplish the goals of Islam using both conventional conceptions and newer tools and methods ([Ahmed, 2007](#)). Therefore, presently, debate is going on that Islamic microfinance programs can improve the economic conditions of the poor and can prove to be an excellent source of poverty alleviation than conventional MFIs. It is hoped that Islamic microfinance as a best way to increase the income and employment of the poor will contribute to improving the socio-economic status. Today, the major consensus of Islamic finance centres is to develop and implement Islamic microfinance programs. [Alam and Molla \(2013\)](#) investigate the potentials and prospects of the Islamic microcredit in Bangladesh. They explain that Islamic microfinance has a special appeal because of its religious stance. There is a great need and scope for increasing the outreach of the Islamic microcredit. Therefore, Islamic Development Bank (IDB) has a plan to set up an Islamic microfinance institutions (IMFIs) with collaboration of local banks for serving the hardcore poor and poverty alleviation in the country.

Moreover, Islamic microfinance is a solemn assignment to move forward with fairness, equity, transparency, socio-economic justice and principles of risk-sharing. This explains why Islamic microfinance is concerned with a lot more than just abstaining from charging interest. Besides, Shari'ah-based microfinance programmes can effectively be manifested as best approach and strategies to poverty alleviation. In fact, Islamic microfinance is a convergence of microfinance and Islamic banking as both have similar considerable characteristics such as, social development programs for the betterment of society, to motivate clients, risk sharing and responsibility to insisting the poor to participate in development process. But there is a main difference in the application of financing offered by conventional microfinance providers as charge higher interest rates, injustice and ambiguity, whereas the mode of Islamic finance is based on equity and assures stability than conventional microfinance. [Hassan \(2010\)](#) found that there is an opportunity for Islamic microfinance to develop by responding to

the needs of the deprived Muslim population. Moreover, he explains different approaches to anti-poverty programs while citing [Pramanik \(1998\)](#) that approach the underprivileged population with a required assistance to ensure them credit access, comprehending better health, increase literacy rate and eventually eradicate of poverty.

However, United Nations Human Settlements Programs ([UN-Habitat, 2005](#)) state that Islamic microfinance schemes are moderately limited at present while their potential is noteworthy. Islamic microfinance products are appropriate particularly for the poor. [Rulindo \(2012\)](#) contends that though Indonesia is well-known for its Islamic microfinance industry. Interestingly, he found only one study which assessed the impact of Islamic MFIs in Indonesia. He describes the findings of that study which was conducted by Widyanto and Abdul Ghaffar Ismail in 2006 as being very intriguing. For instance, the size of financing and other demographic variables such as, formal education, marital status and business experience have significant influence on the improvement of business asset, business income and improvement in productive assets. [Mizanur \(2011\)](#) uses ordinary least square (OLS) technique to measure the role and impact of Islamic microfinance on microfinance clients' income, expenditure, employment and productivity and ethics and moral. He selected 1,020 clients of 34 branches of Islami Bank Bangladesh Limited (IBBL) and 34 managers of sampled branch of IBBL. His findings suggest that the Islamic microfinance program benefited the clients. The clients were successful in bringing positive changes in their lives. Microfinance program has played a significant role in reducing poverty. The Rural Development Scheme (RDS) of IBBL is replicated in other rural regions of Bangladesh to speed up economic activities of the poor. In the light of above discussion, this indicates that Islamic finance has an imperative responsibility in support of supplementary socio-economic growth of the poor as well as micro-entrepreneurs without charging *riba*. This also shows that Islamic microfinance is able to reduce poverty and have positive influence on income-generating activities.

As hinted above, Islamic banks have not perceived microfinance as a viable opportunity like conventional banks. [El-Komi and Croson \(2012\)](#) also believe that limited research and innovation in Islamic microfinance, absence of subsidies and real motivations and commitments that Islamic banks have not characteristically been concerned in microfinance. Nonetheless, many studies have been conducted to understand the perception of customers towards Islamic banking ([Dusuki and Abdullah, 2007](#); [Haron *et al.*, 1994](#); [Tahir and Ismail, 2005](#)). However, the general perceptions of Islamic bankers, regulators, micro-entrepreneurs and petty traders towards Islamic and conventional microfinance system and related issues and challenges have not been examined so far in the context of Pakistan.

3. Research methodology

A quantitative method is used to describe and explain the perceptions of the key players comprising the Islamic bankers, regulators, micro-entrepreneurs and petty traders. The study gathered relevant information through conducting field survey by employing convenience and purposive sampling technique, the most common of all sampling techniques. According to [Bailey \(1982\)](#), purposive sampling as a technique whereby the researchers use their own decisions or judgements about which respondents to pick and choose merely those who superlative meet the purpose of the research. However, [Roscoe \(1975\)](#) suggested that sample sizes larger or greater than 30 and less than 500 are

suitable for general research. Hence, two questionnaires were designed for the survey. One questionnaire was administered to survey 270 micro-entrepreneurs and petty traders in 3 major cities of Pakistan including Rawalpindi, Lahore and Peshawar. The selection of these three cities was based on respondents' long-run businesses with small and bigger set-ups and these cities have become hubs of multiple businesses. Before conducting the survey, the respondents were asked about their approval or willingness for the data collection process. In addition to the necessary introduction and clarification of the purpose of the study, the actual process of data collection was commenced. The respondents were briefed on each section of the questionnaire as mostly respondent's preferred Urdu translation. The respondents were requested to fill the entire questionnaire and provide the correct information. Adequate completion time was given to the participants to fill the questionnaire. On the average, time taken was between 20 and 30 minutes. Five to ten micro-entrepreneurs and petty traders were approached per day and each time, briefing was done on introduction, clarification of the purpose of the study and on each section of the questionnaire. However, only 210 questionnaires were collected, these resulted in a response rate of 78 per cent. Out of 210 questionnaires, only 150 questionnaires were usable for further analysis, consequently, about 72 per cent was the adjusted response rate.

Another survey deals with the perceptions of Islamic bankers and regulators. The pilot study was performed for the second set of questionnaire. The questionnaires were given to three lecturers of the institute of Islamic banking and finance from international university of Malaysia (IIUM), two questionnaires were given to the lecturers of the department of Economic and Finance of IIUM and one Shari'ah Scholar from the department of Finance of IIUM. The purpose of the pilot study was to assess the overall contents, language, information sought, question sequence, wording and usage of the appropriate terms and concepts. Consequently, valuable feedback was attained and accordingly, minor modifications were made to carry out the actual study. In total, 100 people from middle and top management were surveyed from five full-fledged Islamic banks of Pakistan. Three of the sample banks including MB, UBLIB and BI were selected from Islamabad and two banks ALB and BB from Lahore. These are some of the well-established banks in these two cities of Pakistan. The bankers comprised top management who are involved in supervisory policies, standards, controls, transparency, disclosure, market discipline, risk management and customer protection. Others include directors and joint directors; branch managers of Islamic banks comprised middle management. Prior arrangements were made to collect the data from the senior management. The questionnaire was preceded with a cover letter to explain the purpose of the survey, outline the handling procedures of the survey results and the confidentiality concerned. However, the entire process was not without challenges, particularly because of the busy schedules of the officials. To deal with this, follow-up telephone calls and walk-ins were made to get back the questionnaires. Out of a total of 100 responses, only 50 responses were usable for further analysis. Data were collected during a period of three months, October to December 2011, from all the respondents of the study. SPSS version 16.0 was used to analyse the data.

4. Findings of the study from entrepreneurs' perspective

This study categorises the respondents into two categories. The first category consists of micro-entrepreneurs and petty traders. Because both are involved in small-scale

trading, therefore, we are merging them into one group/category that has the same importance and meaning of their opinions. The second category is the Islamic bankers and regulators. However, the discussion of Section 4 is based on the respondents of first category.

4.1 Profile of the respondents

Table I, summarises the demographic information about the respondents. Expectedly, the number of male clients is overwhelming large (81.0 per cent) relative to the number of female clients (19 per cent). This is because, traditionally, the big or small business industry of Pakistan has always been dominated by male. Unlike other countries such as, Indonesia and Malaysia, females in Pakistan suffer from moral or religious prejudices.

The result of the survey shows that most micro-entrepreneurs and petty traders are married (Row 2, vide Col 2), while nearly one-third respondents are single. Non-married respondents are supposed to have the better economic position compared to those who have been married. Perhaps, as the married respondents are relatively required to support more non-earning members of the family.

The age of the respondents among other socio-demographic factors is also very significant because age distribution offers an initial indication of the capabilities set, human capital stock and earning potentials of a household (Abideen, 2010). The findings of Table I seem to suggest nearly half of the respondents belonging to the age group of 31-40 years (Row 3, vide Col 2) and slightly less than one-third belonging to the age group of 20-30 years. Below 20 and above 50 indicate clients' involvements in business are considered low. However, the demographic information suggests that our respondents mostly comprise economically active labour force. This indicates that relatively young people are doing a very good job of managing their businesses and taking responsibilities at early age. As Pramanik *et al.* (2008) observed that the middle age was considered the best period of one's life and this dynamic age group could make decisions for even risky ventures for positively contributing to the family income.

By far, the religious faith of the respondents is overwhelmingly predominated by Islam with only 1.4 per cent being non-Muslims (Table I; vide Col 2, Row 4). It might suggest that the religious belief other than Islam has no implications for our findings on perception.

In terms of the respondents' educational level, it appears that a significant majority (70 per cent) have access to education for 10 to 14 years. (Vide Col 2, Row 5). The rest, however, possess diplomas or merely graduated from primary school. However, Pramanik *et al.* (2008) suggest that the greater the number of years spent on education the better for future potential to qualifying for better-paid jobs. It is further interesting to observe that our respondents despite having bachelor or master degree prefer to engage in self-employed economic activities apparently due to lack of adequately paid jobs in the cities.

Moreover, 80.0 per cent of the respondents have 1-10 years or more working experience with different nature of businesses. As shown in Table I, few of the respondents were engaged in mentioned professions like, poultry shop, fruit and vegetable, tea shop and tailoring (vide Col 2, Row 7), while 82 per cent of the respondents categorized them as "Others" were engaged in different nature of business such as, beauty parlours, tuition centres, day care centres, ice-cream parlours, fresh juice corner,

No.	Demographic variables	Col 1	Research sample for first category (<i>n</i> = 150)	
			Col 2	Frequency (%)
1	Gender	Male	122	81.3
		Female	28	18.7
2	Marital status	Single	49	32.7
		Married	99	66.0
		Divorced	1	0.7
		Widow	1	0.7
3	Age (years)	Below 20	7	4.7
		20-30	39	26.0
		31-40	68	45.3
		41-50	30	20.0
		More than 50	6	4.0
4	Religion	Islam	148	98.6
		Others	2	1.4
5	Current qualification	Master	1	1.0
		Bachelor	48	31.6
		Matriculation	58	38.8
		Primary	14	9.2
		Certificate/Diploma	14	9.2
		Others	15	10.2
6	Working experience	Less than 1 year	6	4.0
		1-5 years	55	36.4
		6-10 years	67	44.4
		11-20 years	13	9.1
		Above 20 years	9	6.1
7	Nature of business	Poultry shop	7	5.0
		Fruit and vegetable	5	3.0
		Tea shop	6	4.0
		Tailoring	9	6.0
		Others	123	82.0
8	Usual working hours	Less than 8	23	15.0
		8-10	55	37.0
		More than 10	72	48.0
9	Working spouse	Yes	20	13.0
		No	130	87.0
10	Number of dependent (children below 18 year old)	0	50	33.0
		1	5	3.4
		2	27	18.0
		3	30	20.0
		4 or more	38	25.6
11	Number of dependent (adults)	1	7	4.8
		2	67	44.4
		3 or more	76	50.8
12	Monthly income (for single) in Pakistan currency \$ 1 = 92 Rs	RS 9,000-20,000	90	60.0
		RS 20,001-40,000	38	25.0
		RS 40,001-60,000	13	9.0
		RS 60,001 and above	9	6.0

Table I.
Demographic profile
of the respondents

Source: Survey data, 2012

ladies boutiques, small-auto workshops, fast food joints, pastries, traditional catering, electrical wiring, masonry and barber shops. Nearly half of all the respondents (48 per cent) used to work more than 10 hours a day and 37 per cent work 8-10 hours per day (vide Col 2, Row 8). Nevertheless, a vast majority (87 per cent) of our respondents' spouses do not work, while only 13 per cent of them work (Table I, vide Cols 1-2 Row 9). However, males are found to be dominant over females as far doing business is concerned. It is quite expected that in conservative society as that of Pakistan, mostly males do not allow their women to work outside or do business in a male-dominated society. Hence, they are supposed to stay at home to take care of children or other household chores. As evident from the success stories of Grameen Bank Model of Bangladesh, empowering women in terms of provision of small credit for small businesses can help increase household income thereby reducing the vulnerability of the poor families.

Pertaining to their monthly income, most of them (60 per cent) earned a monthly income in the range of RS 9,000-20,000/- (US\$97-US\$217), 25 per cent indicated in the range of RS 20,001-40000/- (US\$217-US\$434), 9 per cent earned in the range of RS 40,001-60000/- (US\$444-US\$652), while 6 per cent of the respondents earned more than RS 60,000/- (US\$652), which can be classified as somehow better income earners. Pramanik *et al.* (2008) found that higher monthly income might not automatically imply lower incidence of poverty, as age, family composition together with eating habits are also important in explaining poverty incidence. However, majority of the respondents revealed that they are unable to meet expenses or other needs as they spend a greater portion of their income on food only. Additionally, the respondents revealed their slow and uneven progress since they are unable to access any formal and bigger size of financing schemes which are planned for the low income entrepreneurs.

4.2 Reliability: attributes of the questionnaire

A Cronbach's alpha value was found to be 0.872 as shown in Table II.

4.3 Respondents' perception on conventional microfinance

The study also intends to explore the general information and awareness about conventional microfinance using the frequency tests. The results as presented in Table III show that majority of the respondents state that conventional microfinance cannot help the needy because the primary mission of microfinance seems to make profit only by exploiting the needs of the needy. Subsequently, as shown in Table III (vide Col 1, Row-2), majority of the respondents (89 per cent) were discontented to agree with the statement that "the establishment of conventional microfinance is in accordance with the well-being of the society (the poor)". The respondents consider the factor of fixed high interest rate is not consistent with improving the well-being of the society. Hence, this negative perception on conventional microfinance is indicative of a positive future of Islamic microfinance in Pakistan.

Cronbach's alpha	Cronbach's alpha based on sitandardized items	No. of items
0.872	0.815	39

Source: Survey data, 2012

Table II.
Reliability statistics

Table III.
Distribution of the respondents' perception on conventional microfinance

Perception	Disagree (%) Col 1	Uncertain (%) Col 2	Agree (%) Col 3	Mean Col 4	SD Col 5
1- Conventional microfinance can help the needy	64.5	27.5	8.1	2.15	0.950
2- The establishment of conventional microfinance is in accordance with the well-being of the society (poor/needy)	88.5	10.8	0.7	1.72	0.681
3- Microfinance cannot function without the high interest rates	26.8	47.7	25.5	2.95	0.899
4- It is easier to obtain financing without collateral in conventional microfinance	70.5	27.5	2	1.94	0.879

Source: Survey data, 2012

This above finding is consistent with prior studies, such as *Akhtar et al. (2009)*, who mentioned that, in the Muslim world, the conventional microfinance could not be productive because of the Islamic social principles and that most people prefer Islamic microfinance over conventional microfinance. This brings us to know respondents' perception on Islamic microfinance.

4.4 Respondents' perception on Islamic microfinance

This section examines the respondents' perception on Islamic microfinance by using the descriptive tests. As evidently shown in the *Table IV* that the majority (75 per cent, vide Row 1, Col 3) of the respondents agree with the statement that Islamic microfinance can help the needy and is better than conventional microfinance. According to them, the concept of Islamic microfinance embraces the principles of Islam. They might have

Table IV.
Distribution of the respondents based on their awareness about Islamic microfinance

Perception	Disagree (%) Col 1	Uncertain (%) Col 2	Agree (%) Col 3	Mean Col 4	SD Col 5
1- Islamic microfinance can help the needy and is better than conventional microfinance	1.4	23.6	75.0	3.91	0.709
2- In Islamic microfinance, the extra charge on initial capital (borrowed) is lower than that of the conventional microfinance	6.7	59.1	34.2	3.32	0.689
3- I can obtain financing without worrying about usury (riba)	18.2	61.7	20.2	3.01	0.923
4- I can obtain Islamic microfinance without collateral, such as, witness/guarantor	53.1	41.6	5.4	2.29	0.910

Source: Survey date, 2012

given this opinion based on their associations with friends and relatives who have taken financing facility from Islamic or commercial banks or NGOs.

Furthermore, [Table IV](#) also shows that most (59 per cent, vide Row 2, Col 2) of the respondents are uncertain about the extra charge on initial Islamic financing whether it is lower or higher as compared to conventional microfinance. This is because overwhelming majority of the respondents (98.6 per cent, [Table V](#)) is not found to be involved in any financing facility from either Islamic or conventional banks. Their experience with Islamic banks is elaborated in the section below Section 4.5. However, about less than two-thirds of the respondents (vide Row 3, Col 2) expressed the great concerns that it seems difficult to get financing without collateral even from the Islamic banks. Thus, the most consistent answer from the respondents is that the mechanism of lending with respect to charging interest in Islamic finance and handling with the low-income entrepreneurs might be the same as that of conventional microfinance.

4.5 The involvement of the respondents with Islamic banks (some experiences)

The results as presented in [Table VI](#) show that 85 per cent (vide Row 1, Col 3) of the respondents have applied to Islamic banks for the small financing. Although 15 per cent (vide Row 1, Col 3) of them did not apply for the loan, as a notable reason, they state that banks might not have considered their applications because of absence of guarantee and low-income entrepreneurs. Those who applied to Islamic banks for the microloan did not succeed, even not getting any satisfactory response for the rejection of their loan applications.

Moreover, the respondents were also asked whether they applied again for finance after sometimes. In total, 79 per cent (vide Row 3, Col 3) showed their disappointment

Involvement in any financing facility recently	Frequency	(%)
Yes	2	1.4
No	148	98.6
Total	150	100.0

Table V.
Distribution of the respondents based on their involvement in any financing facility

Source: Survey data, 2012

Experience with Islamic bank	Col 1	Frequency	
		Col 2	(%) Col 3
1- Recently, have you applied to Islamic banks for the microfinance?	Yes	128	85.0
	No	22	15.0
	Total	150	100.0
2- Were the applications for the credit accepted?	Yes	–	–
	No	128	85.0
	Total		
3- Have you applied again after sometimes in case of rejected the prior application?	Yes	27	21.0
	No	101	79.0
	Total	128	100.0

Table VI.
Distribution of the respondents based on their experiences with Islamic bank

Source: Survey data, 2012

and did not apply for the second time. It might be the reason that overwhelming majority of the respondents were not satisfied with the present services provided by Islamic banks to the micro-entrepreneurs and petty traders (vide Row 1, Col-1, Table VI).

Additionally, about 80 per cent of the respondents (Table VII, Row 1, Col 1) state that Islamic banks are not encouraging low-income micro-entrepreneurs in terms of providing financing facility. Even the majority (83 per cent, vide Row 2, Col 1) of the respondents disagree with the statement that the government supports the establishment of Islamic microfinance to lower-income people. However, most of the respondents feel that banks might have considered them less trustworthy and unbankable. Quite contrary to this finding, many other studies suggest that the poor are creditworthy as Oke *et al.* (2007) observed about 90 per cent members of different MFIs same as MFs' NGOs, fulfilled their repayment obligation as at when due. Despite all the limitations, clients are still optimistic and have a demand for the development of Islamic microfinance in the country. Therefore, the following section presents respondents' motivation as a preferred choice to IM.

4.6 Islamic microfinance as a preferred choice

The results of Table VIII, (vide Row 1, Col 3) also reveal that the most important motivational factor of Islamic microfinance to micro-entrepreneurs and petty traders is religion (mean = 3.96). This is followed by the nature of products and services (mean = 3.54). Respondents were more likely to state that their preferred choice to available

Table VII.
Distribution of the respondents based on their observation to support Islamic microfinance by government and Islamic banks

Perception	Disagree (%) Col 1	Uncertain (%) Col 2	Agree (%) Col 3	Mean Col 4	SD Col 5
1- Islamic banks encourage lower income micro-entrepreneurs by offering Islamic microfinance without collateral such as witness/guarantor	80.4	13.3	6.3	2.56	0.918
2- Government of Pakistan supports the establishment of Islamic microfinance to lower income micro-entrepreneurs	83.1	16.9	–	1.72	0.641

Source: Survey data, 2012

Table VIII.
Distribution of the respondents based on their motivation to Islamic microfinance

Perception	Disagree (%) Col 1	Uncertain (%) Col 2	Agree (%) Col 3	Mean Col 4	SD Col 5
1- The most motivational factor of Islamic microfinance is religion	4.7	22.8	72.5	3.96	0.884
2- The most motivational factor of Islamic microfinance is the nature of its products	9.4	40.9	49.7	3.54	0.874

Source: Survey data, 2012

micro-financing would not only be based on religious reasons but some other reasons that motivate them to adopt Islamic banking system for Islamic microfinance such as, quality of products and services in terms of low transaction costs, easy excess, staff's dealings and proper communication. This leads us to conclude that micro-entrepreneurs and petty traders are significantly eager to do business with Islamic microfinance as a preferred choice than conventional microfinance.

4.7 Financing priorities of the micro-entrepreneurs and petty traders

The study also explores the financing priorities of the respondents. It is, therefore, significant to know their financial priorities as many studies mentioned that demand for Islamic finance is high and microfinance system should be supported with zakat, sadaqat, qard-hasan and awqaf. However, the overwhelming majority (94 per cent, Table IX, vide Col 2) of the respondents have preference for profit and loss Islamic modes to expand their business activities. This indicates the adequacy in support of PLS. Thus, Islamic banks may come out of this perception that low-income people always need zakat or awqaf funds and may stop considering microfinance (Islamic or otherwise) as a philanthropic activity merely for them. Rahman (2007) also mentioned that charity is not an effective tool in eradicating poverty because it will lead to dependency and lack of initiative among the poor. Mizanur (2011) recommends that bank foundation, donation and Zakat money may be utilized for some other purposes such as, the establishment of school, health care and training facilities. He articulates that infrastructure development is a very important component for rural development and poverty alleviation.

Nevertheless, Obaidullah (2008a) also highlights that Islamic microfinance does not need to limit “not-for-profit modes” merely but Islam permits “for-profit trade” and creation of wealth as well. He further defines that providing finance (for-profit modes) to economically active category could generate income and wealth.

On the other hand, if Islamic banks might be considering that micro-entrepreneurs and petty traders are risk-averse and often viewed them as non-creditworthy, then the confidence level of the clients will never be enhanced to overcome these risks. In this regard, Pramanik (2006, p. 263) asserts that:

The basis of cooperation between capital and enterprise which Islam cherishes, is equitable sharing of the risk and gains between them which is possible under a system of profit and loss sharing.

Priorities	What type of product will you be interested in?	
	Frequency Col 1	(%) Col 2
Zakat	—	—
Sadaqat	—	—
Qard hassan	6	4.0
Awqaf	3	2.0
PLS	141	94.0
Total	150	100.0

Table IX.
Distribution of the
respondents based on
their financial
priorities for doing
business

Source: Survey data, 2012

Thus, already established and small businesses of the respondents might come to an end just because of having low or no access to the financial services. Therefore, there is a need to fulfil the primary mission of microfinance, to financially assist them to become economically independent.

5. Findings of the study from Islamic bankers' perspective

This section deals with the perception of Islamic bankers and regulators to know the potential of Islamic microfinance, Islamic bank's approach and issues and challenges for Islamic microfinance. This relates to the adoption of an appropriate instrument to Islamic microfinance as an alternative to the conventional model of microfinance for poverty alleviation.

5.1 Profile of the respondents

This section discusses the information on profiles of the respondents. The frequency of the respondents was based on their demographic details such as, gender, age, current qualification area of specialization, professional status and working experience.

As shown in [Table X](#), the overwhelming majority (94 per cent) of the bankers surveyed are male and only 6 per cent are female. About 42 per cent of respondents are in the age group of 41-50 years and 26 per cent are in the age group between 31 to 40 years. Furthermore, 4 per cent of the respondents hold a doctoral degree, about 76 per cent holding master degree and 18 per cent holding a bachelor degree. Almost all of them have specializations in conventional economics and finance but some of them are also having the knowledge of Islamic finance, while others 6 per cent were holding Shari'ah diplomas. In addition, 36 per cent of the professionals were holding senior positions, namely, Executive Vice President, Head of Product Development, Deputy Head Islamic banking and Shari'ah advisors with more than 15-20 years of working experience in banking sector. In total, 60 per cent of them are holding middle management positions, specifically director, joint director and branch managers with more than 10-15 years of working experience in the banking sector.

5.2 Reliability: attributes of the questionnaire

A Cronbach's alpha value was found 0.87.

5.3 Potential of Islamic microfinance in poverty alleviation

Although, Islamic microfinance is a new concept in banking but somehow a majority of respondents (86 per cent, vide Row 1, Col 3, [Table XI](#)) have a strong understanding of this concept that Islamic microfinance can be a powerful tool against poverty. The opinions of the respondents are sought out with respect to their understandings, level of education and extensive banking experiences. This indicates a strong agreement amongst the Islamic bankers and regulators on operationalization of Islamic microfinance. [Akhtar et al. \(2009\)](#) have also acknowledged this statement. Having made a critical financial analysis of Akhuwat, an Islamic microfinance organization operating in Pakistan, they indicated that it provides interest free small loans to the poor and helps them start a business and come out of poverty. Thus, they suggest that interest-free loans can be used as a powerful tool against poverty.

Moreover, the top and middle management (94 per cent vide Row 3, Col 3, [Table XI](#)) agreed that Islamic microfinance has a strong potential to overcome poverty. This has been equally corroborated by the equally favourable opinions of the micro

Demographic variables	Research sample (<i>n</i> = 50) Frequency (%)
<i>Gender</i>	
Male	47 (94.0)
Female	3 (6.0)
<i>Age (years)</i>	
20-30	14 (28.0)
31-40	13 (26.0)
41-50	21 (42.0)
More than 50	2 (4.0)
<i>Current qualification</i>	
PhD	2 (4.0)
Master	38 (76.0)
Bachelor	9 (18.0)
Others	1 (2.0)
<i>Area of specialization</i>	
Economics	2 (4.0)
Finance	41 (82.0)
Islamic finance	4 (8.0)
Others	3 (6.0)
<i>Professional status</i>	
Top management	18 (36.0)
Middle management	30 (60.0)
Others	2 (4.0)
<i>Working experience</i>	
<i>Less than 1 year</i>	
1-5 years	15 (30.0)
6-10 years	13 (26.0)
11-20 years	13 (26.0)
Above 20 years	9 (18.0)

Source: Survey data, 2012

Table X.
Profile of the
respondents

entrepreneurs as well (vide Row 1, Col 3, Table IV). As Karim *et al.* (2008) also described, the potential of Islamic microfinance is expanding access to unprecedented levels throughout the Muslim world. However, 86 per cent of the Islamic bankers (vide Row 4, Col 3, Table XI) agree that it should be available to the weaker sections of the society.

From the above, it is clear that the importance of the religious and social objectives of Islamic microfinance is somewhat unique and these must be considered in any attempt to build a comprehensive financial plan for the poor. Therefore, the next section discusses the Islamic bank's approach towards Islamic microfinance perception on Islamic microfinance followed by the challenges for Islamic microfinance in Section 5.4.

5.4 Islamic bank's approach towards Islamic microfinance

The aim of this section is to examine the approach of Islamic banks towards Islamic microfinance in Pakistan. The results as presented in Table XII show that majority of

Table XI.
Distribution of the
respondents based on
operationalization of
Islamic microfinance

Operational criteria of IM	Disagree (%) Col 1	Uncertain (%) Col 2	Agree (%) Col 3	Mean Col 4	SD Col 5
1- Islamic microfinance can be a powerful tool against poverty	–	14.0	86.0	4.56	0.733
2- Islamic microfinance programmes can have a positive impact on the economic status of the poor	–	4.0	96.0	4.68	0.551
3- Islamic microfinance consists of providing financial help to low-income families or individuals who lack access to interest-based banking services	–	6.0	94.0	4.66	0.593
4- Islamic microfinance services should be made available for all living below the poverty line income	2.0	12.0	86.0	4.42	0.785

Source: Survey data, 2012

Table XII.
Distribution of the
respondents based on
the criteria of
performing IB

Criteria of performing IB	Disagree (%)	Uncertain (%)	Agree (%)	Mean	SD
1- Islamic banks should supervise separately Islamic microfinance from other products	1.5	5.0	93.5	4.21	0.480
2- Islamic banking is not addressing the financing needs particularly of those poor and micro-entrepreneurs that generally have preference for Shari'ah-compliant finance	10.0	14.0	76.0	3.76	0.981
3- Islamic banks may require collateral to offer Islamic micro finance to petty traders and micro-entrepreneurs to cover the possibility of losses from defaulters	4.0	12.0	84.0	4.32	0.913
4- There is a need to design microfinance programmes based on Islamic financing principles to promote justice	2.0	4.0	94.0	4.62	0.667

Source: Survey data, 2012

the bankers (93 per cent, vide Row 1, Col 3) agree that Islamic banks should separately supervise Islamic microfinance from other products. This indicates that there is nothing wrong in managing Islamic microfinance separately from other products. It shows the solidarity of Islamic banks in terms of recognizing the significance of Islamic microfinance. It is important to observe that most of the respondents accept their limitations of not being able to deliver up to the expectation of its low-income clients (vide Row 2, Table XII).

In response to the question related to collateral, 84 per cent of the key players (vide Row 3, Col 3, Table XII) agree that Islamic banks may require collateral to offer Islamic microfinance to petty traders and micro-entrepreneurs to cover the possibility of losses from defaults. Meanwhile, the bankers constituting 94 per cent of the key players felt that there is also a need to design microfinance programmes based on Islamic financing principles to promote justice (vide Row 4, Table XII). Nevertheless, they might be quite aware of the inability of the poor borrower/clients to show collateral. According to Abdouli (1991), Islamic banking institutions could lose their importance if they keep the tangibility of assets, as a requisite for access to finance. He further suggested that granting of credit to an educated, yet financially poor person could even be more beneficial on both social justice and long-run growth.

Another study by Tsukada *et al.* (2010) confirms that households' demand of new small-scale loans without collateral is growing and households prefer formal credit. They concluded that the poorest households might not be able to exploit new credit opportunities if available for them, even if the size of credit is very small, as compared to that is available to the richer households. Johnstone and Morduch (2008) also analysed the creditworthiness of the poor households through direct judgments of credit officers of Bank Rakyat Indonesia (BRI) and found that majority of the poor households were creditworthy.

The results as presented in Table XIII show that most of the Islamic bankers viewed *Murabahah* (cost-plus financing), *Dimishing musharakah* (reducing partnership) and *Ijara* (leasing) as "Somewhat applicable and Most applicable" for Islamic microfinance (vide Rows 3-4, Cols 3-4). Perhaps, top management decides to train its staff for Islamic microfinance's programmes based on these above-discussed financing modes. In addition, this finding also supports previous studies by Rahman (2010), Dhumale and Sapcanin (1999) that *Murabahah* and *Ijarah* instruments can be advanced and modified for the drive of microfinance. These schemes even with the low applicability for the latter are moderately easy to manage and monitor (vide Rows 3&5, Cols 3-4). *Dimishing musharakah* concept appeared to be mostly applicable (59 per cent vide Col 4) was also supported by Rosly (2005) and Meera and Abdul Razak (2005). According to them, equity financing can contribute to a better achievement of socioeconomic justice. According to another empirical study by Mizanur (2011), *Musharaka* mode may be practiced with some selective good clients. In case, it does not work properly or generate

Instruments of IM	Not much applicable Col 1	Undecided Col 2	Somewhat applicable Col 3	Most applicable Col 4	Total (%) Col 5
1- Musharakah (partnership)	70.5	25.0	4.5	–	100
2- Mudarabah (trust financing)	66.7	25.6	5.1	2.6	100
3- Murabahah (cost-plus financing)	14.3	7.1	50.0	28.6	100
4- Dimishing musharakah (reducing partnership)	11.1	25.9	3.7	59.3	100
5- Ijara (leasing)	7.7	30.7	23.1	38.5	100
6- Qard Hassan (beneficence loans)	3.7	70.4	25.9	–	100

Table XIII.
Distribution of the
respondents based on
their perception on
the prevailing
instruments of IM

Source: Survey data, 2012, the degree to which an individual's responses (i.e. their scores) on a survey (i.e. 1 = not much applicable to 4 = most applicable)

profit to any person then this practice will provide a clear understanding about the essence of Musharaka mode.

Hence, Islamic banks may be more appropriate institutions to get involved with microfinance. In fact, all of these instruments (*profit and loss sharing modes, Murabahah, Ijarah and Istisna*) can be structured for microfinance operations (Wilson, 2007).

Interestingly, [Rulindo \(2012\)](#) examines the impact of Islamic micro-financing on clients' income and poverty status in Jakarta, Indonesia. He collected information from 400 micro-entrepreneurs, in which 360 of them were clients of Islamic microfinance institutions (IMF). He finds that Islamic microfinance, as reflected by length and size of financing, is able to generate positive impact on clients' income and poverty status. He further asserts that positive impact may not be felt in the short-term. The impact on poverty status can be significant if poverty status is measured by using local poverty standards as endorsed by Government Agency. His findings indicate that those clients who obtain *Mudharabah and Musharakah financing* live a better life compared to those who receive *Murabahah* financing. This finding also speaks in favour of *Mudharabah and Musharakah*. But whatever be the benefits of IMF, this institution is not without challenges as the next section presents the challenges confronted by IM.

5.5 Challenges for Islamic microfinance

This section presents the perception of the Islamic bankers towards the main challenges confronted by Islamic microfinance. To analyse this purpose, the respondents were asked to rank the eight assigned problems as 1 to 5 (with 1 the most serious and ending with 5, the least serious). [Mohd. Ariffin and Adnan \(2010\)](#) also used ranking method to deal the perception of Islamic bankers towards the main challenges in offering qardhul hasan by the Malaysian Islamic banks.

From [Table XIV](#) above, majority of the key players comprising Islamic bankers and regulators assign the highest rank to the statement that "Islamic microfinance is constrained by lack of knowledge of supporting staff, experience and professionalism

Challenges	Rank
1- Islamic microfinance is constrained by lack of knowledge of supporting staff, experience, Shari'ah advisory and professionalism	1
2- Compared to conventional microfinance, Islamic microfinance is less popular due to lack of risk management tools to handle the cases of defaulters	1
3- Moral hazard is a serious problem to the growth of Islamic microfinance, in general	2
4- Islamic microfinance is constrained by lack of adequate loanable funds based on profit and loss sharing system	2
5- Islamic microfinance is less popular because of easier access to other sources of conventional financing	3
6- Lack of supervision by central bank is another serious dilemma for expansion of Islamic microfinance	3
7- Islamic microfinance is constrained by lack of knowledge (awareness), in general, among the people	4
8- Operations in Islamic microfinance are constrained by lack of supporting institutions such as, life insurance etc.	5

Table XIV.
Distribution of the Islamic bankers based on challenges facing Islamic microfinance

Source: Survey data, 2012

(technical capacity of the staff) and Shari'ah advisory warranted by IMFIs (vide Row 1). They also consider that the Islamic microfinance is less popular due to lack of risk management tools to handle the cases of defaulters (vide Row 2). Moral hazard likewise as adequacy of loanable fund also poses a constraint.

Furthermore, "Islamic microfinance is less popular in terms of easier access compared to other sources. Lack of supervision by central bank and lack of supporting institutions, such as life insurance", were perceived as least serious issues in offering Islamic microfinance. This indicates that the majority of the Islamic bankers and regulators are not satisfied with the present organizational structure to deal with Islamic microfinance. However, this research also indicates that the implementation of Islamic microfinance would help to understand its Shari'ah requirements and undertake a closer examination on the practical issues that need to be addressed, whilst maintaining a balance of function socially. Promoting the image of Islamic banks through Islamic microfinance is in line with the true spirit of Islam which will contribute positively to the equitable distribution of wealth and income. This argument also supports the views of [Obaidullah and Khan \(2008, p. 5\)](#) that "microfinance works best when it measures and discloses its performance".

6. Conclusion and recommendations

This section provides the summary of the major findings of the study.

6.1 Summary of the major findings of the first category

This section provides the summary of the major findings of the first category – micro-entrepreneurs and petty traders with regard to their economic position, awareness, general information on conventional and Islamic microfinance and major issues faced by the micro-entrepreneurs and petty traders.

The result revealed that majority of the entrepreneurs' income is found inadequate to assist them to live above the poverty line. The reasons are having more dependents, lack of better sources of income, such as income from other family members comprising spouse and adult children. Unfortunately, the results of this study suggest that micro entrepreneurs have no formal access to micro financing either from conventional or Islamic banks.

The results of the research explain clear opinion by micro-entrepreneurs and petty traders that conventional microfinance cannot help the needy. Rather, the conventional microfinance is perceived as being motivated by profit maximisation through exploiting the desperate condition of the needy. The strong opinions of the respondents speak in favour of Islamic microfinance under a system of PLS. Despite all the limitations, the clients of this study generally feel that their preferred choice for Islamic microfinance is also guided by the motivational factors.

The majority of the respondents also feel that Islamic banks are not found to be encouraging lower income micro-entrepreneurs. Likewise, the majority of micro-entrepreneurs and petty traders also believe that the government of Pakistan does not fully encourage the establishment of Islamic microfinance to serve the interest of people belonging to the low-income class.

6.2 Summary of the major findings of the second category

Although, Islamic microfinance is a new concept in banking, but, somehow, majority of the Islamic bankers and regulators have a good understanding of this concept. They think it can be a powerful tool against poverty. Furthermore, most of the Islamic bankers

gave a strong perception that Islamic microfinance has a positive effect in improving the economic status of the poor. Moreover, the top and middle management agree that Islamic microfinance has a great potential to provide a parallel support to the low-income people or those who rejected interest-based debt. However, they have a strong consensus that Islamic microfinance should be available, particularly to serve the weaker sections of the society.

The results also presented the perception of key players towards the main issues in offering Islamic microfinance. Compared to conventional microfinance, Islamic microfinance is constrained by lack of appropriate knowledge, experience and professionalism of other supporting staff involved in terms of trainings as well as lack of risk management tools to handle the cases of defaulters. The majority of the bankers are also not found to be satisfied with the present structure for the implementation of Islamic microfinance. Moral hazard also poses a serious problem. Lack of adequate loanable funds based on profit and loss sharing is also noted as a major concern.

Generally, both top and middle management agree that Murabahah, Diminishing musharakah and Ijarah are the most applicable contracts or instruments for Islamic microfinance schemes to unleash the potentials of micro-entrepreneurs. However, they view that the present operation of Islamic banks is not favourable for the implementation of Islamic microfinance because of some constraints as mentioned above. In addition, they strongly agree that Islamic banks should offer Islamic microfinance products and instruments to respond to the needs of the poor for poverty alleviation and treat it separately from other products.

6.3 Recommendations

To serve the poor Muslims, Islamic banks of Pakistan could learn from the successful operation of Shari'ah-compliant products as evident from Malaysia, Indonesia, Bangladesh and Sudan. IBBL which launched an Islamic microfinance under RDS in 1995 has been serving 5,622 villages with 0.3 million clients. Amanah Ikhtiar Malaysia (AIM) has made a great success in reaching the poorest of the poor. Indonesia has also largely pursued a network of Islamic microfinance with microfinance divisions of Islamic banks, Islamic rural banks and Islamic financial cooperatives (known as Baitul Maal wal Tamwil – BMT). Another notable example is Sudan; the largest number of Islamic banks is involved in microfinance. The Sudanese Islamic Bank (SIB) has successfully implemented Musharaka and Mudaraba to the poor families having potentials to improve their standard of living.

The Islamic banks need to offer short-term Shari'ah-compliant loans for lower-income groups without collaterals to fulfil the essence of microfinance. Additionally, the Islamic banks should make some significant efforts to solve the outreach problem and take an initiative to considerable levels to promote microfinance as a business enterprise with no more impediments. As the findings entail, the Islamic banks of Pakistan should endeavour to establish a society based on equity and justice such as IBBL.

Moreover, the specific guidelines on Islamic microfinance issued by the State Bank of Pakistan should strictly monitor Islamic microfinance system to ensure that Shari'ah rules are strictly followed by Islamic banks in future. With comprehensive internal and external controls, it is hoped that, subsequently, unequal distribution of wealth will be reduced and poverty be eliminated.

Note

1. BWTP, "Banking with Poor, Pakistan Country Profile", BWTP, Asia Resource Centre for Microfinance, pp. 1-4.

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