DOI: 10.26652/cjif.8202324 COMSATS Journal of Islamic Finance

Impact of Islamic Microfinance on Poverty Alleviation: An Empirical Evidence

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Received: **May 15, 2023**
Last revised: **September 22, 2023**
Accepted: **December 07, 2023**

Abstract

This study aims to investigate the impact of Islamic microfinance on poverty alleviation. A case study has been conducted on the Akhuwat Islamic Microfinance institution to know its role in poverty alleviation. The sample comprises 250 Islamic microfinance clients, and respondents are selected through the convenience sample technique. The data are collected through a survey questionnaire from Islamic microfinance clients of Akhuwat Islamic microfinance institution. The regression analysis is carried out to analyze the impact of Islamic microfinance on poverty alleviation. The findings have shown the significant positive effect of Islamic microfinance on poverty alleviation. This research has implications for government, practitioners, and microfinance institutions.

Keywords: Islamic Microfinance, Poverty Alleviation.

1. Introduction

It is generally argued that both, the formal and informal, financial sectors remained unsuccessful in serving the poor segment of society in developing countries. The obstacles shown in the formal sector include collateral requirements, credit rationing, preferring clients with higher income levels, and the lengthy process of giving loans. Similarly, the informal financial sector has not served the poor segment of society due to problems like monopolistic power, charging high interest, and exploiting people experiencing poverty through the undervaluation of their collaterals. These issues in both sectors have restricted them from providing loans to the poor regarding income generation and poverty reduction (Venittelli, 2022).

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The weaknesses of formal and informal financial sectors in providing financial services, particularly credit, became the reason for the evolution of microfinance. Microfinance was started in 1976 with the purpose of loan provision without collateral. Effective measures like group member harmony, discipline in loan provision and repayment, and proper supervision of microfinance clients' activities have replaced collateral requirements essential for getting loans from formal financial institutions (Bashir et al., 2019). The Nobel Laureate Professor Yunus named this process of replacement of collateral requirement with group harmony and other aspects as "freeing of credit from the bondage of collateral" (Chowdhury, 2008).

Microfinance has been considered as an effort to provide access to small loans to the poorest that are not facilitated by banks (Kandpal et al., 2023). Globally, microfinance has gained significant attention as a powerful tool for poverty reduction in developing nations (Kumari, 2022). Numerous studies have concluded that microfinance substantially influences poverty alleviation and household well-being at distinct levels like asset acquisition, child education, food security, and women empowerment (Hasan et al., 2022; Roodman & Morduch, 2014).

The most significant issue of the current era is poverty,[3] as a considerable portion of the world's population including Pakistan lives below the poverty line (Saddique et al., 2023). Millions of people still live on less than $1.90 a day meaning that this portion of the population lives in extreme poverty due to the unavailability of financial access (Sullivan et al., 2023; Bruton et al., 2011). Globally, poverty alleviation has been discussed widely and is considered a key goal for development worldwide. For this purpose, microfinance emerged as an effective tool for poverty alleviation (Sofi & Sumaira, 2016).

Poverty alleviation is one of the critical objectives of the Sustainable Development Goals (Shahid et al., 2023). Over 3100 microfinance institutions (MFIs) struggle worldwide to alleviate poverty by providing loans to over 100 million individuals (Khanam et al., 2018). The authorities have focused on individuals' economic deprivation and poverty globally which have become critical issues for developing nations. Chakraborty et al. (2022) showed that providing micro and collateral-free loans to micro-entrepreneurs has emerged

[3] Shaffer (2008) defined poverty as the deprivation of material requirements for the minimum acceptable fulfillment of basic needs.

as an effective strategy to alleviate poverty because it offers loans to poor and income-generating businesses without collateral.

Recently, literature has questioned the influence of microfinance and argued that microfinance's impact varies between favourable, no effect, and negative influence (Samer et al., 2015). It has been shown that microfinance's role varies among contexts and depends on factors like financial literacy, population density, attitudes to debt etc. (Al-Shami et al., 2016). According to Gehlich-Shillabeer (2008), microfinance creates indebtedness and leads to poverty traps. In India, microfinance clients, who couldn't repay the loans, have committed suicides (Press, 2012), and organ trafficking has also been seen in Bangladesh (BBC, 2013).

On the other hand, it has been believed that Islamic microfinance can improve the economic conditions of poor individuals by implying Islamic principles, as it provides Riba (Interest) free loans (Hassan, 2015; Wulandari & Kassim, 2016). Although the demand and popularity of Islamic microfinance has increased since the last decade, little research has been carried out on Islamic microfinance, and there exists a gap in the literature on the role of Islamic microfinance towards poverty alleviation which needs to be fulfilled (Hassan et al., 2021). Therefore, this study investigates the impact of Islamic microfinance on poverty alleviation by taking the case study of the most prominent Islamic microfinance institution "Akhuwat" in Pakistan. Such rich empirical investigations are rarely found in the literature particularly from developing countries like Pakistan. Akhuwat was established in 2001 to provide Qard-e-Hasn or interest-free microfinance to improve poor communities' living standards. It is trying to improve the poor's lives particularly those who are financially abused and disregarded by society. Akhuwat believes in social justice and brotherhood principles for poverty alleviation to develop a mutual support system. It started with the first loan of Rs.10,000, and its disbursements have exceeded than 2 billion rupees. The Akhuwat Islamic Microfinance institution has shown active borrowers to over 762 thousand by the end of 2020 (Zeenoor Sohail Sheikh, 2020). It is considered the largest Islamic microfinance institution in Pakistan, that was the reason for selecting this Islamic microfinance institution in this study.

2. Literature Review

Islamic microfinance has significant importance in the finance and microfinance sectors. It is a socially responsible investment, as investors participating in Islamic microfinance projects mainly concentrate on Halal projects, i.e., Zakat, contributing to community welfare (Harahap et al., 2023). Islamic microfinance principles are based on a significant element of interest that Shari'ah prohibits. Islamic microfinance has focused on the desire for prosperity, and its prime objective is to boost economic growth and social prosperity through Islamic principles. Islamic microfinance has been considered as a panacea to alleviate poverty and promote social development through increased economic growth (Khan & Akhter, 2017).

Islamic microfinance is based on *Shari'ah* (i.e., Islamic Law) ----a collection of Islamic laws and principles. It has benefited poor people by providing interest-free loans and resolved the issue of high interest rates (Salem & Abdelkader, 2023). It has been believed to be the shining example of Islamic finance's social and participatory nature (Khartoum, 2016). Additionally, it is considered as the heart of Islamic finance because of its primary focus on financial intermediation as demanded by Shari'ah, like income growth and equal distribution of income for improving the socio-economic standards of people experiencing poverty. Islamic finance principles like Mudarabah, Musharakah, Murabahah, Ijarah, and Qardhul Hasan have the potential to be adapted as Islamic microfinance schemes (Aderemi & Ishak, 2023)

Tamanni and Besar (2019) investigated whether Islamic MFIs have diverted from the objective of poverty reduction (mission drift) because of increased financial measures. The research adopted mixed methods, and regression analysis was used. The results have shown that Islamic MFIs have not diverted from their poverty reduction mission despite increased financial measures. Literature has shown that Islamic MFIs like Akhuwat and Wasil Foundation have worked successfully in Pakistan for over a decade, indicating that Islamic MFIs are sustainable despite not charging interest from Islamic microfinance clients. Therefore, wealthy people should provide their charity, Zakat, and Sadaqat to Islamic MFIs so that these Islamic MFIs can help the poor in society (Khalequzzaman et al., 2023). Further, it has been recommended to increase the size of Islamic MFIs to achieve the objectives of poverty reduction and profitability.

Similarly, an attempt was made to accept or reject the positive connection between Islamic microfinance and socio-economic welfare (Hassan & Saleem, 2017). The study found that Islamic microfinance contributes positively to socio-economic welfare. It was recommended to review Islamic microfinance programs like those initiated by Bank Islami Bangladesh. Further, Adnan and Ajija (2015) analyzed the impact of Islamic Micro Financial Cooperatives (Baitul

Maal wat Tamwil (BMT)) on poverty alleviation based on the lack of empirical studies on BMTs despite having greater attention towards poverty reduction. This study concluded that BMTs have a significant contribution towards poverty alleviation. Keeping in view the potential of BMTs regarding poverty reduction, this research has recommended to start Islamic microfinance institutions like BMT on a large scale for reducing the level of poverty.

Further, literature has shown that Islamic microfinance has the potential to be considered as a sustainable solution for poverty alleviation, and it has economic benefits for livelihood (Begum et al., 2019). It can target a large segment of individuals who cannot benefit from conventional microfinance due to their religious beliefs regarding interest. Further, Islamic microfinance facilitates the repayment procedure and recommends creditors to provide charity in case of excessive funds. The study found that Islamic microfinance is more ethical than conventional microfinance. Therefore, Islamic microfinance stands in a better position regarding poverty alleviation and has the potential to lead to sustainable long-run development. Moreover, Islamic microfinance can provide credit and Zakat to the poorest to meet their basic needs.

Zitouni and Jedidia (2022) have shown the problems with conventional microfinance and represented Islamic microfinance as a sustainable alternative to poverty alleviation. It was found that microfinance benefited poor individuals. Further, Zahid et al. (2017) explored the role of Islamic microfinance on socio-economic status and the poverty level of households. They found a positive contribution of Islamic microfinance in poverty alleviation. This research recommends that the Government of Pakistan should develop a policy for Islamic microfinance with the help of SBP.

Similarly, Ahmad et al. (2020) showed the picture of the global spread of Islamic MFIs and compared their performance with conventional MFIs. This study explored the trade-offs that Islamic MFIs faced in pursuing a double bottom line and developed a data set to show the international expansion of Islamic MFIs. By identifying about 101 Sharia-compliant MFIs in 33 countries, the study found that Islamic MFIs perform better than conventional MFIs regarding outreach but not in financial output. Future studies have been suggested to compare the performance of Islamic and conventional MFIs. Based on the above literature review, the following hypothesis has been developed;

H_1: There is a significant impact of Islamic microfinance on poverty alleviation

Further, a conceptual framework for this study has been developed based on the above literature, which is given below;

Figure 2.1. Conceptual Framework

3. Research Methodology

This research is cross-sectional and adopted a quantitative research design for achieving this study's objectives. Quantitative analysis involves collecting numerical data on the variables and analyzing cause-and-effect relationships through appropriate statistical tests (Apuke, 2017). Further, this research is explanatory, and a survey research strategy has been used to collect data from the respondents based on its benefits like quick data collection and data collection from many respondents (Fischer et al., 2023). Moreover, this study has followed the positivism research philosophy involving utilizing social realities to make law-like generalizations. In positivist research philosophy, the researchers objectively study the world and gather data to test the research hypothesis and establish generalizations. Therefore, this research uses a positivist philosophy and a deductive research approach (Alharahsheh & Pius, 2020).

This study's target population consists of rural areas of Punjab province, Pakistan, and respondents are selected through convenience sampling based on its advantages like quick application and inexpensive etc. (Etikan et al., 2016). Additionally, convenience sampling does require a sampling frame, and the sample should be adequate, enabling the researcher to address research questions and make the findings generalizable (Willoughby, 2015). A minimum sample size of 200 is considered good for any statistical analysis (Hoe, 2008). The sample size in this study consists of 250 Islamic microfinance clients from Akhuwat Islamic microfinance institution (Lakens, 2022). In this study, there is one independent variable, "Islamic microfinance (IM)," and one dependent variable, "poverty alleviation (PA)," which is measured through items, and scales of these variables have been adopted from previous studies. The instrument of Islamic Microfinance consists of 4 items, and it is measured on a five-point Likert scale marked from "Strongly Disagree" to "Strongly Agree". Similarly, the instrument of Poverty Alleviation consists of 6 items, and it is measured on 5 points Likert scale marked from "Strongly Disagree" to "Strongly Agree". For data analysis, this study has used SPSS software, and regression analysis has been carried out to investigate the impact of Islamic microfinance on poverty alleviation. Therefore, equation (1) shows the effect of Islamic microfinance on poverty alleviation.

$$PA = \beta_0 + \beta_1 (IM) + \varepsilon \qquad (1)$$

PA = Poverty Alleviation IM = Islamic Microfinance ε = Error Term β_0 = Intercept term of Poverty Alleviation

Table 3.1.shows constructs with measuring items and references.

Table 3.1: Constructs with Measuring Items

Sr.	Constructs	Items	Measurement Items	References
1.	Islamic Microfinance	ME1	Provides sufficient loan amount to run the business	(Kumari, 2021; Win, 2019)
		ME2	Provide operational assistance, which helps run the business.	
		ME3	The loan is sufficient for the improvement of household appliances.	
		ME4	The loan repayment schedule is convenient.	
2.	Poverty Alleviation	PA1	Income has increased.	(Kumari, 2021; Nkwocha, 2019)
		PA2	Better access to education	
		PA3	Better access to healthcare	
		PA4	The better financial situation of the family	
		PA5	Employment opportunities have increased.	
		PA6	Improvement in the living standard of the family	

The data has been collected from a rural district, "Bhakkar," of Punjab province, one of Punjab's rural districts. Being a native researcher, the author was well aware of the local languages and feelings of the microfinance clients. The researcher visited microfinance clients at homes, working places, and in the Akhuwat microfinance institution office to collect data. The clients were informed about the research objectives and assured that their information would be kept confidential. In this way, the researcher completed 250 questionnaires with the clients.

4. Statistical Analysis

4.1 Descriptive Statistics

The descriptive statistics have shown that about 146 male and 104 female Islamic microfinance clients have participated in this study which is 58.4% and 41.6% respectively indicating that most of the respondents in this research are male. Further, the microfinance clients with an age range of 18-23 are 10, with age 24-29 are 34, having an age range of 30-35 are 60, with age 36-41 are 118, and finally having an age range of 42 & above are 28. These statistics show that the majority of the clients of this research are young adults (Mishra et al., 2019). Similarly, the clients with an income range of 10000-15000 are 10; an income range of 15000-20000 is 80; an income range of 20000-25000 are 90; and clients with an income range of 25000 & above are 70. These statistics show that most of this study's clients are poor individuals with income below 25000. Likewise, the clients with rural background are about 133, and clients with urban background are about 117 indicating that most of the clients, who participated in this research, are from rural areas.

Moreover, the illiterate clients are 57, those below matric are 128, those with matriculation are 45, and those with intermediate educational levels are 10. The clients with a master degree or above are 10. It shows that the majority of Islamic microfinance clients are educated. Additionally, the married microfinance clients are about 211, and those unmarried are 39 indicating that most are married. Table 2 shows the descriptive statistics.

Table 4.1: Descriptive Statistics

Sr.	Variable	Categories	Frequency	Percentage
1.	Gender	Male	146	58.4%
		Female	104	41.6%
		Total	250	100%
2.	Age	18-23	10	4.0%
		24-29	34	13.6%
		30-35	60	24.0%
		36-41	118	47.2%
		42 & Above	28	11.2%
		Total	250	100%

3.	Monthly Income	10000-15000 15000-20000 20000-25000 Above25000 Total	10 80 90 70 250	4.0% 32.05 36.0% 28.0% 100.0%
4.	Residential Area	Rural Urban Total	133 117 250	53.2 46.8 100.0
5.	Educational Level	Illiterate Below Matric Matric Intermediate Master & Above Total	57 128 45 10 10 250	22.8 51.2 18.0 4.0 4.0 100.0
6.	Marital Status	Married Unmarried Total	211 39 250	84.4 15.6 100.0

* Note: Income is in Pakistan rupees.

4.1.1 Descriptive Statistics of Islamic Microfinance

Descriptive statistics of Islamic Microfinance have indicated that most clients have shown agreement regarding sufficient loan amount provision by Islamic microfinance for business purposes. Regarding operational assistance, most clients agreed towards effective operational assistance provided by Islamic microfinance. Further, clients agreed that the loan amount is sufficient to improve the household appliances. Moreover, Islamic microfinance has also indicated that the loan repayment schedule of Islamic microfinance is convenient (Keller, 2022). Figure 1 shows the description of Islamic microfinance.

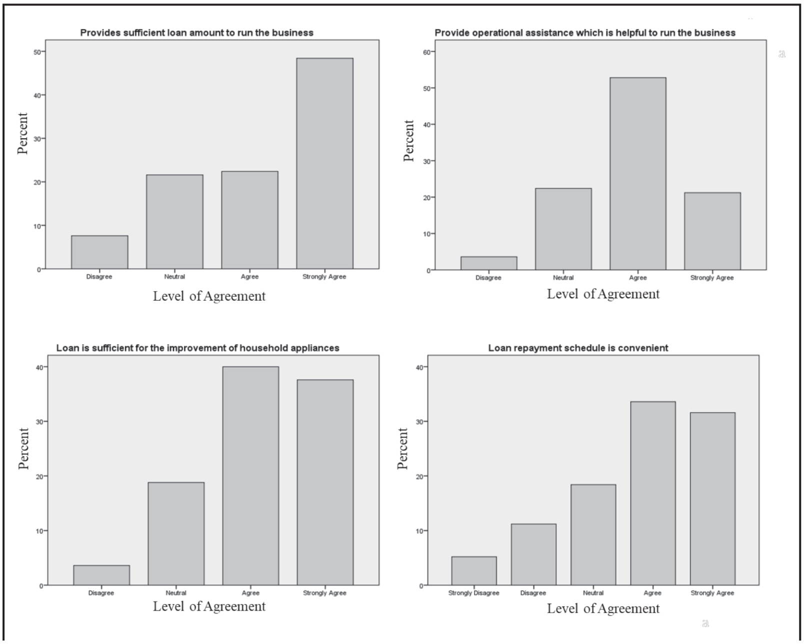

Figure 4.1: Descriptive of Islamic Microfinance

4.1.2 Descriptive of Poverty Alleviation

Similarly, the descriptive of poverty alleviation has shown that Islamic microfinance has significantly contributed towards the income level of the microfinance clients, access to education and healthcare, and the family's financial situation. Further, Islamic microfinance has also shown a significant contribution towards increasing the employment opportunities of microfinance clients and improving the living standards of the family. Figure 2 shows the description of poverty alleviation (McCarthy et al., 2022). Figure 2 shows the description of poverty alleviation.

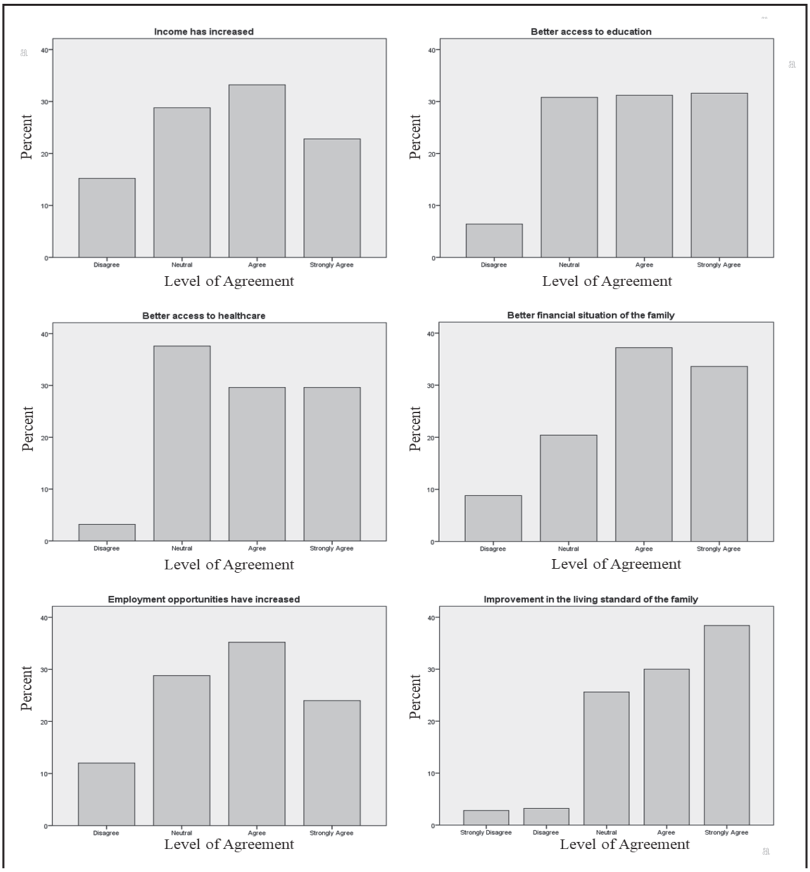

Figure 4.2: Descriptive of Poverty Alleviation

4.2 Reliability and Validity Analysis

The reliability of the constructs is ensured through Cronbach's Alpha, for which the recommended value is greater than 0.7. The values of Cronbach's Alpha for Islamic Microfinance and poverty alleviation are 0.77 and 0.91 respectively, greater than the required level of 0.7 ensuring the constructs' reliability. Further, the validity of the constructs is assured through convergent and discriminant validity measured through average variance extracted and correlations (Taherdoost, 2016). Table 3 shows the reliability and validity analysis of the constructs.

Table 4.2: Reliability and Validity of the Constructs

Sr.	Variables	Items	Description	FL	CA	AVE	CR
1.	Microfinance Effectiveness	IM1	Provides sufficient loan amount to run the business	.70	0.77	0.59	0.85
		IM2	Provide operational assistance, which helps run the business	.84			
		IM3	The loan is sufficient for the improvement of household appliances	.77			
		IM4	The loan repayment schedule is convenient	.76			
2.	Poverty Alleviation	PA1	Income has increased	.69	0.92	0.69	0.92
		PA2	Better access to education	.89			
		PA3	Better access to healthcare	.87			
		PA4	The better financial situation of the family	.74			
		PA5	Employment opportunities have increased	.89			
		PA6	Improvement in the living standard of the family	.78			

* Note: FL = Factor Loadings, CA = Cronbach's Alpha, AVE = Average Variance Extracted, CR = Construct Reliability.

4.3 Regression Analysis

For analyzing the role of Islamic microfinance on poverty alleviation, regression analysis has been carried out which resulted in a significant impact of Islamic microfinance on poverty alleviation. The value of R is 44.2% which shows a moderate correlation between Islamic microfinance and poverty alleviation. The value of R2 is 19.4% indicating that Islamic microfinance has brought a 19.4% variance in poverty alleviation. It shows that Islamic microfinance leads towards poverty alleviation indicating that Islamic microfinance loan provision is effective and helps the poor alleviate their poverty level. Table 4 shows the results of the regression analysis (Pal et al., 2019).

Table 4.3: Impact of microfinance effectiveness on poverty alleviation

Sr.	Independent Variables	Unstandardized Coefficients	t
		Beta	
1.	(Constant)	1.929	7.685***
2.	Islamic Microfinance	0.480	7.732***
	R = 44.1 % R^2 = 19.4 %	F Change = 59.788	

Note: Level of significance: ***p<0.001
Predictors: (Constant), Islamic Microfinance (IM)
Dependent Variable: Poverty Alleviation (PA)

4.4 Decision of the Hypothesis

Based on the results of the regression analysis, the hypothesis of this study has been supported which showed that Islamic microfinance significantly impacts poverty alleviation.

5. Conclusion and Discussions

This research aimed to investigate the impact of Islamic microfinance on poverty alleviation. For this purpose, it has conducted a case study on Akhuwat Islamic microfinance institution (the largest Islamic microfinance institution in Pakistan) to analyze the influence of Islamic microfinance on poverty alleviation. The results have shown that Islamic microfinance significantly impacts the poverty alleviation of microfinance clients. This result has confirmed that Islamic microfinance is more suitable for poverty alleviation than conventional microfinance mainly due to interest factors, as Islamic microfinance does not charge interest on loans (Begum et al., 2019).

The result of this study, i.e. the positive role of Islamic microfinance on poverty alleviation, supports the results of previous studies (Adnan & Ajija, 2015; Ahmad et al., 2020; Begum et al., 2019; Hassan & Saleem, 2017; Zahid et al., 2017). It has been found that Islamic microfinance is more suitable for poverty alleviation because of the interest-free factor, as it does not charge interest from microfinance clients. This result supports previous studies findings on the efficient role of Islamic microfinance towards poverty alleviation as compared to conventional microfinance (Begum et al., 2019; Sofi & Sumaira, 2016; Tamanni & Besar, 2019).

The findings of this study can provide useful indications to policymakers and practitioners for improving their microfinance strategies aiming to fulfil the objective of poverty alleviation. To improve the impact of microfinance on poverty alleviation, the government and policymakers should revise their policies by shifting their focus from conventional microfinance to Islamic microfinance which is more suitable for poverty alleviation, as conventional microfinance charges high interest rates from poor microfinance clients. Further, there is a need to reduce red tape involved in loan application processing which can be possible only by adopting information communication technology (ICT) system and educating the microfinance clients to use this system. Adopting an ICT system can improve the microfinance loan applications and repayment process.

Therefore, the government should take solid steps through proper legislation to implement Shari'ah (Islamic law) principles in microfinance sector so that Islamic microfinance schemes could be developed which could provide interest-free loans to poor individuals aiming to reduce their poverty level. Adopting Islamic microfinance will reduce unethical practices undertaken by conventional microfinance like harsh behaviour of loan officers with the clients and confiscation of any microfinance client's assets due to other clients' inability to repay the loans. In this way, this study provides important indications to the policymakers so that effective policies can be planned to uplift the poor from the poverty cycle. Further, it provides policy recommendations for microfinance institutions, donors in the microfinance sector, and the government.

The study has certain limitations; the data for this study have been collected from a rural district of Bhakkar, Punjab province, Pakistan, as a case study has been conducted on an Islamic microfinance institution, i.e. Akhuwat; therefore, the results may not be generalized in urban areas of Pakistan as well as in other countries because microfinance clients are practising different cultures in different regions and countries. Further, countries use distinct regulatory frameworks and policies to protect financial service users. Moreover, there are chances of having different perceptions about interest rates on loans by clients living in a secular state than those living in a religious state.

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