THE ROLE OF MICROFINANCE IN THE CONTEXT OF ISLAMIC BANKING:

A STUDY OF THE PRODUCTS OFFERED BY BANKS IN PAKISTAN

By

Mahboob-ur-Rashid

(2012)

INSTITUTE OF MANAGEMENT STUDIES,
UNIVERSITY OF PESHAWAR, ISLAMIC REPUBLIC OF PAKISTAN
THE ROLE OF MICROFINANCE IN THE CONTEXT OF ISLAMIC BANKING:

A STUDY OF THE PRODUCTS OFFERED BY BANKS IN PAKISTAN

July 2012

A thesis submitted to the Institute of Management Studies, University of Peshawar, in partial fulfillment of the requirement for the award of the degree of

DOCTOR OF PHILOSOPHY
INSTITUTE OF MANAGEMENT STUDIES,
UNIVERSITY OF PESHAWAR, ISLAMIC
REPUBLIC OF PAKISTAN

APPROVAL SHEET

This is to certify that the content and format of this thesis titled, “The Role of Microfinance in the Context of Islamic Banking: A study of the Products offered by banks in Pakistan” submitted by Mr. Mahboob-ur-Rashid in partial requirements for the award of the degree of Doctor of Philosophy has been approved by the supervisory committee.

SUPERVISOR: ___________________  EXTERNAL EXAMINER: ___________________

Prof. Dr. Abdul Qayium Khan
Institute of Management Studies,
University of Peshawar.

DR. Sajjad Ahmad Khan
Director
Institute of Management Studies,
University of Peshawar.

Date: _____________________
DEDICATION

This humble effort is dedicated to my very respectable and Loving Father

Mr. Abdul Quddus (Late)

Who himself was as uneducated person but still, he was always very much enthusiastic about my achievements, struggles and explorations in the field of education.
# Table of Contents:

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table of Content</td>
<td>i</td>
</tr>
<tr>
<td>List of Tables</td>
<td>ix</td>
</tr>
<tr>
<td>List of Figures</td>
<td>xii</td>
</tr>
<tr>
<td>List of Acronyms</td>
<td>xv</td>
</tr>
<tr>
<td>Acknowledgement</td>
<td>xvi</td>
</tr>
<tr>
<td>Abstract</td>
<td>xvii</td>
</tr>
<tr>
<td><strong>CHAPTER 1</strong></td>
<td></td>
</tr>
<tr>
<td><strong>INTRODUCTION</strong></td>
<td>1</td>
</tr>
<tr>
<td>1.1 Introduction</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Research Aim &amp; Objectives</td>
<td>3</td>
</tr>
<tr>
<td>1.3 Significance of the Study</td>
<td>4</td>
</tr>
<tr>
<td>1.4 Plan of Work</td>
<td>4</td>
</tr>
<tr>
<td><strong>CHAPTER 2</strong></td>
<td></td>
</tr>
<tr>
<td><strong>LITERATURE REVIEW</strong></td>
<td>5</td>
</tr>
<tr>
<td>2.1 Conventional System</td>
<td>5</td>
</tr>
<tr>
<td>2.1.1 Concept of Microfinance</td>
<td>5</td>
</tr>
<tr>
<td>2.1.2 Evolution of Micro-Finance</td>
<td>7</td>
</tr>
<tr>
<td>2.1.3 Integrating Social Intermediation</td>
<td>10</td>
</tr>
<tr>
<td>2.1.4 Group based Financial Services</td>
<td>11</td>
</tr>
<tr>
<td>2.1.5 Savings Mobilization</td>
<td>13</td>
</tr>
<tr>
<td>2.1.6 Over dependence on Subsidies</td>
<td>13</td>
</tr>
</tbody>
</table>
2.1.7 Microfinance and Islamic World ........................................ 14
2.1.8 Lack of access to funds for the developing countries .......... 15
2.1.9 MFI’s: Problems and constraints ...................................... 16
  2.1.9.1 Asymmetric Information Problems ............................... 16
  2.1.9.2 Economic Viability of Microfinance Institutions .......... 16
  2.1.9.3 High Drop-out Rate and Non Graduation from Poverty... 16
2.1.10 Microfinance services ..................................................... 16
2.1.11 The Case of Pakistan ...................................................... 17
  2.1.11.1 Loans ................................................................. 18
  2.1.11.2 Savings ............................................................. 18
  2.1.11.3 Insurance ........................................................... 18
2.2 Islamic System ................................................................. 19
  2.2.1 Islamic Banking .......................................................... 23
  2.2.2 Islamic modes of Financing ............................................ 24
    2.2.2.1 Murabahah ......................................................... 24
    2.2.2.2 Mudarabah ......................................................... 25
    2.2.2.3 Musharakah ....................................................... 25
    2.2.2.4 Ijarah (leasing) ................................................... 25
    2.2.2.5 Musawamah ....................................................... 25
2.3 Microfinance and Islamic banking ........................................ 26
  2.3.1 A Mudarabah Model .................................................... 27
  2.3.2 A Murabahah Model ................................................... 28
  2.3.3 A Murabahah Model in Yemen ....................................... 28
  2.3.4 Procedure of Hodeida Microfinance Program .................. 28
  2.3.5 A Murabahah Model in Bangladesh ............................... 30
2.5.7 Objective of Targeting women ................................. 42
2.5.8 Work incentive of staff members ................................. 42
2.5.9 Dealing with Default .............................................. 43
2.6 Potential of Islamic Microfinance in Pakistan ......................... 43

CHAPTER 3

PRODUCTS FOR ISLAMIC MICROFINANCE ............... 45

3.1 Live stocks on the basis of Mudarabah ................................. 45
  3.1.1 Functions of the bank ............................................. 45
  3.1.2 Functions of the client ............................................. 45
  3.1.3 Risks of the bank ................................................. 46
  3.1.4 Risks of the client ................................................. 46
  3.1.5 Risk management by the bank ................................. 46
  3.1.6 Risk management by the client ................................. 47

3.2 Agricultural input on the basis of Murabahah ......................... 47
  3.2.1 Risks of the bank ................................................. 47
  3.2.2 Risks of the client ................................................. 47
  3.2.3 Risk management by the bank ................................. 48
  3.2.4 Risk management by the client ................................. 48

3.3 Live Stocks using Murabahah (Poultry form) ......................... 48
  3.3.1 Risk to the bank ................................................. 48
  3.3.2 Risk management by the bank ................................. 49

3.4 Agriculture input using Salam ......................................... 50
  3.4.1 Functions of the bank ............................................. 50
  3.4.2 Functions of the client ............................................. 50
  3.4.3 Risks of the bank ................................................. 51
3.4.4 Risks of the client ................................................................. 51
3.4.5 Risk management by the bank .......................................... 51
3.4.6 Risk management by the client ......................................... 51

3.5 Tuck Shop using Murabahah ............................................. 52
3.6 Public Call office using Murabahah .................................... 52
3.7 Service Station .................................................................. 53

3.7.1 Financing the project using Ijarah ................................... 53
3.7.2 Financing the project using Murabahah .......................... 54

3.8 Financing tire-repairing shop setup using Ijarah .................... 55
3.8.1 Risks and their management .......................................... 56

3.9 Motorcycle Rickshaw (100 Horse power) financing using Diminishing
Musharakah ........................................................................ 56

3.9.1 Risks of the bank ......................................................... 60
3.9.2 Risk management by the bank ....................................... 61

CHAPTER 4

RESEARCH METHODOLOGY ................................................. 62
4.1 Population of the Study ...................................................... 62
4.2 Sampling frame and Sampling ........................................... 62
4.3 Methodology .................................................................. 62
4.4 Sources of data ............................................................... 63
4.5 Theoretical Framework .................................................... 63
4.6 Analytical Framework ...................................................... 65

CHAPTER 5

RESULTS AND DISCUSSION ................................................. 66
5.1 Distribution of sample on the basis of “Gender” ................. 66
5.2 Distribution of sample on the basis of “Position held in Organization”…… 66
5.3 Distribution of sample respondents on the basis of “Education”…………… 68
5.4 Distribution of sample on the basis of “Duration on the current post”…….. 69
5.5 Distribution of sample respondents based on “work experience in organization” 70
5.6 Distribution of sample respondents on the basis of “Training in Islamic banking” 70
5.7 Distribution of organization based on “Status in Islamic banking”……….. 71
5.8 Distribution of “Products offered by Islamic banking”……………………… 72
5.9 Distribution of organization on the basis of “Time-span spent in Islamic Banking” 72
5.10 Nature of Organization on the basis of ownership…………………………. 73
5.11 Grading of the Organizational Success………………………………………. 74
5.12 Offering of Microfinance services……………………………………………. 75
5.13 Why Islamic banks have not explored the potential of Islamic microfinance Services…………………………………………………………………………… 75
5.14 Integrating MF and IB operations need new accounting procedures 76
5.15 Integrating MF and IB operations need awareness program…………………. 77
5.16 Integrating MF and IB operations need Technological change……………. 79
5.17 Integrating MF and IB operations need Assistance from other MFI’s……. 79
5.18 Pursuing Islamic Microfinance will result in poverty alleviation .......... 80
5.19 Pursuing Islamic Microfinance will increase employment opportunities… 82
5.20 Pursuing Islamic microfinance will result in improving the standard of living of poor…………………………………………………………………………… 83
5.21 Pursuing Islamic Microfinance will result in Equitable distribution of wealth 84
5.22 Possibility of Integrating Microfinance and Islamic Banking………………. 85
5.23 Integration of Microfinance within Islamic banking is feasible because both have same guiding principles ………………………………………………… 86
5.24 Integration of Microfinance within Islamic banking is feasible because both serve the same Purpose

5.25 Integration of Microfinance within Islamic banking is feasible because both can have a Niche Market

5.26 Integration of Microfinance and Islamic Banking is feasible because there is a pressing need for Islamic Microfinance services

5.27 Implementing Microfinance within Islamic banking operations needs qualified workforce

5.28 Implementing Microfinance within Islamic banking operations needs Training and Capacity building Programs for employees

5.29 Implementing MF within IB operations needs Special Task Force

5.30 Implementing MF within IB operations needs Extensive Marketing and Awareness campaigns for introducing products of IMF in the market

5.31 Implementing MF within IB operations needs to reach Rural and sub-urban areas

5.32 Implementing MF within IB operations needs the use of modern Technology

5.33 Implementing MF within IB operations needs Support from Government and Civil society

5.34 Major Problems of Islamic Microfinance

5.35 Proposed Products for Islamic Microfinance

5.36 Is organizational Transformation of IB for Integrating IMF essential?

5.37 Benefits derived from Transformation of IB into IMF

5.38 Suggestions for the proposed Co-Integrated System

5.39 Chi-Square test for the Significance of the Statements Variables

5.40 Salient themes of the Interviews

5.41 Conclusion from the Interview Conducted

CHAPTER-6

RECOMMENDATIONS

116
CHAPTER-7

Conclusion ............................................................................................................. 119

Annexur 1............................................................................................................. 121

Annexur 2............................................................................................................. 140

Interview conducted............................................................................................ 140
  Interview No. 1................................................................................................... 140
  Interview No. 2................................................................................................... 145
  Interview No. 3................................................................................................... 148
  Interview No. 4................................................................................................... 151

REFERENCES ..................................................................................................... 155
LIST OF TABLES

Table- 2.1 Difference between Conventional and Islamic MFI.’s ....................... 43
Table-3.1 Motorcycle Rickshaw (100 Horsepower) financing using Diminishing
Musharakah.............................................................. 57
Table-3.2 Motorcycle Rickshaw (100 Horsepower) financing using
Diminishing Musharakah (alternate procedure)......................... 59
Table-5.1 Frequency Distribution of sample on the basis of “Gender” ............ 66
Table-5.2 Frequency Distribution of sample on the basis of “Position held in
Organization”............................................................. 67
Table-5.3 Frequency distribution of “Highest Level of Education”.............. 68
Table-5.4 Frequency distribution of “Duration on the current Post”............. 69
Table-5.5 Frequency distribution of “Work Experience in the Organization”... 70
Table-5.6 Frequency Distribution of respondents’ “Training in Islamic Banking” 71
Table-5.7 Frequency distribution of organizations’ status in Islamic Banking... 71
Table-5.8 Frequency Distribution of “Products offered by Islamic Banking” .. 72
Table-5.9 Frequency Distribution of “Time-span spent in Islamic Banking”.... 73
Table-5.10 Frequency distribution of “Nature of Organization on the basis of
Ownership”............................................................... 74
Table-5.11 Frequency Distribution of Organizations on the basis of its success. 74
Table-5.12 Frequency Distribution of Organizations on the basis of
Offerings of Microfinance service ....................................... 75
Table-5.13 Frequency Distribution of “why Islamic banks have not explored the
potential of Islamic microfinance services”............................... 76
Table-5.14 Frequency Distribution showing “integrating MF and IB operations
need New Accounting Procedures” ...................................... 77
Table-5.15 Frequency distribution showing “Integrating MF and IB operations
need Awareness Programs”............................................... 78
Table-5.16 Frequency distribution representing “Integrating MF and IB operations
need technological change”............................................... 79
Table-5.17 Frequency Distribution of “Integrating MF and IB operations need
Assistance from other MFI's” ............................................ 80
Table 5.18 Frequency distribution of Responses about “Pursuing IMF will Result In Poverty Alleviation”………………………………………………………… 81
Table 5.19 Frequency distribution of responses about “IMF persuasion will Increase Employment opportunities”…………………………………… 82
Table 5.20 Frequency distribution of responses about “pursuing IMF will Result in Improving Standard of Living of the Poor” …………………… 83
Table 5.21 Frequency distribution of responses about “Pursuing IMF will Result in Equitable Distribution of Wealth”………………………………… 84
Table 5.22 Frequency distribution of the “Possibility of Integration of IMF into IB” 85
Table 5.23 Frequency distribution of “Integration of MF into Islamic Banking is Feasible because both have the same guiding principles”………… 86
Table 5.24 Frequency distribution of “Integration of MF into Islamic Banking is Feasible because both serve the same purpose”……………… 87
Table 5.25 Frequency distribution of “Integration of MF and IB is feasible because both can have a special Niche Market”………………………… 88
Table 5.26 Frequency Distribution of “Integration of MF into Islamic Banking is Feasible because there is a pressing need of IMF services……….. 89
Table 5.27 Frequency distribution of “Implementing Microfinance within Islamic banking operations needs qualified workforce”………………. 90
Table 5.28 Frequency Distribution of “Implementing MF within IB operations needs Training and Capacity building Programs for employees”…….. 91
Table 5.29 Frequency distribution of “Implementing MF within IB operations Needs Special Task Force”……………………………………………… 92
Table 5.30 Frequency distribution of “Implementing MF within IB operations Needs Extensive Marketing and Awareness Campaign”……………… 93
Table 5.31 Frequency distribution of “Implementing MF within IB operations Needs to Reach the Rural and Sub-urban Areas”………………………… 94
Table 5.32 Frequency distribution of “Implementing MF within IB operations Needs the use of Modern Technology”…………………………… 95
Table 5.33 Frequency distribution of “Implementing MF within IB operations Needs Support from the Govt and Civil Society”…………………. 96
Table 5.34 Frequency distribution of “Major Problems of IMF”……………… 98
Table 5.35 Frequency distribution of “Proposed Products for IMF”…………….. 99
Table 5.36 Frequency Distribution of “Is transformation of IB essential for Integrating IMF?” …………………………………………………… 100
<table>
<thead>
<tr>
<th>Table-5.37</th>
<th>Frequency Distribution of “benefits derived from Transformation of IB into IM”</th>
<th>101</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table-5.38</td>
<td>Frequency Distribution of Suggestions for Proposed Co-integrated system</td>
<td>102</td>
</tr>
<tr>
<td>Table-5.39</td>
<td>Chi-Square test</td>
<td>103</td>
</tr>
<tr>
<td>Table-5.40</td>
<td>Chi-Square test</td>
<td>104</td>
</tr>
<tr>
<td>Table-5.41</td>
<td>Chi-Square test</td>
<td>105</td>
</tr>
<tr>
<td>Table-5.42</td>
<td>Chi-Square test</td>
<td>106</td>
</tr>
<tr>
<td>Table-5.43</td>
<td>Chi-Square test</td>
<td>107</td>
</tr>
<tr>
<td>Table-5.44</td>
<td>Chi-Square test</td>
<td>108</td>
</tr>
<tr>
<td>Table-5.45</td>
<td>Chi-Square test</td>
<td>109</td>
</tr>
<tr>
<td>Table-5.46</td>
<td>Summary of the interviews conducted</td>
<td>110</td>
</tr>
<tr>
<td>Figure-2.1</td>
<td>Factors that affect financial market failures for the poor</td>
<td>11</td>
</tr>
<tr>
<td>Figure-2.2</td>
<td>The process of social intermediation</td>
<td>12</td>
</tr>
<tr>
<td>Figure 4.1</td>
<td>Model identifying the key variables and a theoretical framework</td>
<td>65</td>
</tr>
<tr>
<td>Figure-5.1</td>
<td>Bar chart representation of “Gender”</td>
<td>121</td>
</tr>
<tr>
<td>Figure-5.2</td>
<td>Bar chart representation of “Position held in Organization”</td>
<td>121</td>
</tr>
<tr>
<td>Figure-5.3</td>
<td>Bar chart representation on the basis of “Education”</td>
<td>122</td>
</tr>
<tr>
<td>Figure-5.4</td>
<td>Bar Chart representation of “Duration on current post”</td>
<td>122</td>
</tr>
<tr>
<td>Figure-5.5</td>
<td>Bar chart representation of “Work Experience in organization”</td>
<td>123</td>
</tr>
<tr>
<td>Figure-5.6</td>
<td>Bar Chart Representation of “Training in Islamic Banking”</td>
<td>123</td>
</tr>
<tr>
<td>Figure-5.7</td>
<td>Bar chart Representation of Organizations’ “Status in Islamic Banking”</td>
<td>124</td>
</tr>
<tr>
<td>Figure-5.8</td>
<td>Bar chart Representation of “Products Offered by Islamic Banking”</td>
<td>124</td>
</tr>
<tr>
<td>Figure-5.9</td>
<td>Bar Chart Representation of “Time-span spent in Islamic Banking”</td>
<td>125</td>
</tr>
<tr>
<td>Figure-5.10</td>
<td>Bar Chart representation of “Nature of organization on the basis of ownership”</td>
<td>125</td>
</tr>
<tr>
<td>Figure-5.11</td>
<td>Bar Chart representation of Organizational success</td>
<td>126</td>
</tr>
<tr>
<td>Figure-5.12</td>
<td>Bar chart Representation of “Offerings of microfinance service by Organization”</td>
<td>126</td>
</tr>
<tr>
<td>Figure-5.13</td>
<td>Bar chart representation of “why Islamic banks have not explored the potential of Islamic microfinance services”</td>
<td>127</td>
</tr>
<tr>
<td>Figure-5.14</td>
<td>Bar chart representation of “Integrating MF and IB operations need new accounting procedures”</td>
<td>127</td>
</tr>
<tr>
<td>Figure-5.15</td>
<td>Bar chart representation of “Integrating MF and IB operations Need awareness Programmes”</td>
<td>128</td>
</tr>
</tbody>
</table>
Figure-5.16  Bar chart representation of “Integrating MF and IB operations need Technological Change”…………………………………………………………. 128

Figure-5.17  Bar chart representation of “Integrating MF and IB operations need assistance from other MFIs”…………………………………………………………. 129

Figure-5.18  Bar chart representation of “Pursuing Islamic Microfinance will result in poverty alleviation” ……………………………………………………………. 129

Figure-5.19  Bar chart representation of responses about “Pursuing IMF will Increase Employment opportunities” ……………………………………………………………. 130

Figure-5.20  Bar chart representation of “Pursuing IMF will Result in improving the Standard of Living of Poor” ……………………………………………………………. 130

Figure-5.21  Bar chart representation of responses about “Pursuing IMF will result in equitable distribution of wealth” ……………………………………………………………. 131

Figure-5.22  Bar chart representation of about the “Possibility of Integrating MF and Islamic Banking” ……………………………………………………………. 131

Figure-5.23  Bar chart representation of “Integration of Microfinance within Islamic banking is feasible because both have same guiding principles” ………………………………………. 132

Figure-5.24  Bar chart representation of “Integration of MF into Islamic Banking is Feasible because both serve the same purpose” ……………………………………………………………. 132

Figure-5.25  Bar chart representation of “Integration of MF into IB is feasible because both can have a special Niche Market” ……………………………………………………………. 133

Figure-5.26  Bar chart representation of “Integration of MF into Islamic Banking is feasible because there is a pressing need for IMF services” ……………………………………………………………. 133

Figure-5.27  Bar chart representation of “Integration of MF into IB needs Qualified workforce” ……………………………………………………………. 134

Figure-5.28  Bar chart representation of “Implementing MF into IB Needs Training and Capacity Building Programs for Employees” ……………………………………………………………. 134
Figure-5.29  Bar chart representation of “Implementing MF into IB needs special task force” ................................. 135

Figure-5.30  Bar chart representation of “Integrating MF into IB needs extensive marketing and awareness campaigns” ................................................. 135

Figure-5.31  Bar chart representation of “Integrating MF and IB needs to reach sub-urban and rural areas” ................................................................. 136

Figure-5.32  Bar chart representation of “Implementing MF within IB operations needs the use of modern Technology” ....................................................... 136

Figure-5.33  Bar chart representation of “Implementing MF within IB operations needs Support from the Government and Civil Society” ......................... 137

Figure-5.34  Bar chart representation of “Major Problems of IMF” ..................... 137

Figure-5.35  Bar chart representation of “Proposed Products for IMF” ............... 138

Figure-5.36  Bar chart representation of “Is Transformation of IB for integrating IMF essential?” .......................................................... 138

Figure-5.37  Bar chart representation of “Benefits derived from Transformation of IB for integrating IMF” ................................................................. 139

Figure-5.38  Bar chart representation of “Suggestions for Proposed Co-integrated system” ................................................................. 139
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADP</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>AVP</td>
<td>Assistant Vice President</td>
</tr>
<tr>
<td>BPR</td>
<td>Bank Parkreditan Rakyet</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultant Grouping to Assists the Poor</td>
</tr>
<tr>
<td>$f$</td>
<td>Frequency</td>
</tr>
<tr>
<td>IB</td>
<td>Islamic Banking</td>
</tr>
<tr>
<td>IM</td>
<td>Islamic Microfinance</td>
</tr>
<tr>
<td>KPK</td>
<td>Khyber Pakhtunkhwa</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance institutions</td>
</tr>
<tr>
<td>PCO</td>
<td>Public Call Office</td>
</tr>
<tr>
<td>RM</td>
<td>Regional Manager</td>
</tr>
<tr>
<td>Rs.</td>
<td>Rupees</td>
</tr>
<tr>
<td>SCI</td>
<td>Small and Cottage Industry</td>
</tr>
<tr>
<td>SIBL</td>
<td>Social Investment Bank Limited</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical package for Social Sciences</td>
</tr>
<tr>
<td>UCLA</td>
<td>University of California Los Angeles</td>
</tr>
</tbody>
</table>
ACKNOWLEDGEMENT

Thanks to Allah (JSH), Who gave me the strength to go through this hard task. All the Salutations be to our Holy Prophet Mohammad (S.A.W.W), the Teacher of Teachers and guiding light for all the humanity.

First of all I am very grateful to my respectable supervisor and teacher Prof. Dr. Abdul Qaiyum Khan, Institute of Management Studies, University of Peshawar, Pakistan, for his cooperation, guidance and constant supervision as well as for providing necessary information regarding the project support, without which it would not have been possible for me, to go through this hard task.

My sincere thanks are extended to all the faculty members of Institute of Management Studies, University of Peshawar, especially Dr. Shah Jehan Khan, the then Director, IMS, and Dr. Sajjad Ahmad Khan, Director IMS, University of Peshawar, for their support and cooperation.

I am highly indebted to all the organizations from where the data has been collected. I am very thankful for their cooperation and sincerity.

I would like to express my gratitude for my family members, especially my parents, my wife and my kids, their prayers, moral support and tolerating behavior enabled me to dare for such a great work.

Last but not the least, my thanks and appreciations to Dr. Muhammad Junaid, Coordinator Research & Development Department of IMS and his team for his cooperation and guidance in completing this thesis.

MAHBOOB UR RASHID
ABSTRACT

This research was conducted to find out the impact of microfinance programs, in the context of Islamic banking. To achieve this objective, a sample of one hundred (100) respondents was chosen randomly, which consists of highly qualified employees working in financial organizations, such as the top management of these organizations. Four types of variables were examined in the data collection process. The first type was dependent variables that included transformation of the Microfinance institutions and the Islamic financial institutions. Holistic time frame, coordination among groups and resources were acting as Moderating variables. The third set of variables examined was the intervening variables. Intervening variables included growth model of microfinance and Islamic banking practices. The last set of variables, which included the accounting practices used by these organizations, conventional banking, microfinance institutions and the awareness level in the community, are considered as independent variables. The results show that, time span of organization in Islamic banking, organizational success, offerings of microfinance services and the reasons for not exploring their potential in microfinance are all significant in their effects. Similarly the necessity of awareness programs, technological change, assistance from other MFIs, designing new accounting procedures are all statistically significant in its effect. Moreover, the impact of microfinance under the Islamic banking on improving the poor’s standard of living, equitable distribution of wealth and increasing employment opportunities are statistically significant. Similarly, integrating IMF within Islamic banking operations is also found to be statistically significant in its effect, because both have the same guiding rules. Similarly training and capacity building program were found significant, for the success of Islamic banking. Further results of the study show that less number of the people is trained in this respect. It is recommended to train the existing and future employees for success of IMF and integrate IB & MF, which will also help in equitable distribution of wealth in the society.
Key words: Islamic Banking (IB), Microfinance (MF), Islamic Microfinance (IMF), Conventional Banking, Organizational transformation, Training and Capacity building.
Chapter-1

INTRODUCTION

1.1 Introduction

The last quarter of the 20th century witnessed various financial innovations, which address different requirements of the society (Ahmed, 2007). Among these innovations, most of the financial products were launched for the interests of the economically developed countries. On the other hand, some initiatives were also taken, to address the needs and requirements of the Islamic world. The concept of microfinancing and Islamic banking emerged almost at the same time in 1970’s from its modest beginning. Since then, Islamic banking industry has developed in volume and capacity quickly. Keeping in view the prospects and high demand for Islamic financial products, the conventional banks and financial institutions have also included such services in their product line, which are in conformity with Islamic principles. Presently, it is one the most emergent segment in the financial market all over the world. In the same way, microfinance institutions (MFIs), initiated by Professor Muhammed Yunus of Grameen Bank in Bangladesh, have flourished in both developing and developed countries. Following the disappointing results of top down (trickle down) development policies during the last few decades, to alleviate poverty in developing countries, the microfinance initiative is considered to be an ideal innovation and a “new paradigm” for eradicating absolute poverty and bringing about development. “Microcredit Summit 1997” envisaged that, by the end of 2005, 100 million poor people would be able to have access to microfinance. International donors and multilateral financial institutions have adopted microfinance as a useful device for alleviating poverty and economic development in the developing world.

Islamic Banking and Microfinance both are emerging ideas in Pakistan. While a number of independent studies have been carried out separately in both areas, however, the correlation between Islamic banking and Microfinance is still an unfamiliar area. Islamic banking is a very feasible system in itself and this is one of the reasons for its acceptance, however, it is still facing resistance from various quarters even in the Islamic world.
The purpose of this study is to explore the importance of Islamic financial institutions, in view of their prospects and feasibility, to merge with the Microfinance activities, in their operations. The proposed co-integrated structure would be practicable, since the objectives of Islamic banking and Microfinance are consistent with each other, i.e. equitable distribution of wealth in the society and social justice. Due to the unwillingness of the members of society, to invest in the traditional interest-based financial institutions, Islamic banks can take care of Microfinance products as a niche market. Islamic banks may have specialty and a viable edge in Islamic microfinance. Moreover, Islamic financial institutions may create awareness among the masses to attract more customers in the market through such a co-integrated system of microfinance and Islamic banking, which is a critical requirement for both of them. The financial institutions established under such a system may take some steps to reach the neglected sectors of the society and offer such products in the market, which are more suitable and lucrative to them. This will be advantageous for the Islamic financial institutions to integrate Microfinance products, since it may be used for creating awareness among members of society, who are still unaware of Islamic financial institutions and may help in achieving the objectives of Islamic banking.

Microfinance has emerged as an economic development approach. The purpose of this device is to assist the low income people of the society. This concept is about the provision of financial services to the poor people with small savings and low incomes, including those people who have their own small businesses. These financial services generally include savings; payment services, microcredit and insurance, along with financials intermediations. Some Microfinance Institutions (MFIs) provide services of social intermediation, which include group training, developing their financial skills and managing capabilities and developing the inner self among group members. Therefore, the definition for Microfinance will cover both the financial as well as social intermediation. Microfinance is not only about providing banking services, but it is also a progressive device, which can be used for skill training, marketing and many others.

In Pakistan and across the world, Islamic Banking System is growing rapidly and getting popularity among the masses. Such a system is based on the conception of trade or asset-backed financing as compared to the conventional financial system, which is based on usury or *Riba*. Under Islamic economic system, business is conducted in the form of
partnerships. It is rigorously assured that, financial services put forward by the Islamic financial institutions, are designed according to the principles of Shari’ah. Therefore, each Islamic bank may have a Shari’ah Supervisory Board, to examine and then approve the financial services to be presented for sale. After getting approval, these financial products and services may be launched in the market.

This assessment of the Islamic financial institutions is purely from economic point of view, hence, the system may be well examined in the context of Islamic behavior, morals and wealth circulation, social and economic integrity in the society. The Principles such as risk sharing, property rights and the rights and duties of individuals are all Islamic codes which are the basis of Islamic banking system. There is a wide range of financial services, which may be used by the Islamic financial institutions to be offered within Microfinance.

This study will examine the products and services, offered by Islamic financial institutions, for example Murabaha, which may be applied in the small business of call centers, farm animals and car wash stations. Similarly, Salam may be used in the business of in farming and Ijarah may be applied in the Car wash and tire service centers. Moreover, Diminishing Musharakah for small vehicles.

1.2 Research Aims & Objectives

The fundamental aim of the research is to engage those citizens, who are reluctant to invest their savings in conventional banks, in small businesses, thereby investing their idle money in the productive economic activities. Moreover, the objective of the research is, to suggest strategies and guide lines to involve these poor people in small business, which are owned and managed by them.

Despite the fact that Pakistan is an Islamic State, however, its financial institutions are hold back by the traditional interest-based banking system. Islamic banking industry is going through its experimental stage and representing a small fraction of the overall banking sector of Pakistan i.e. five percent (SBP: Islamic Banking Bulletin, 2009). Presently, it is operating together with the traditional interest-based financial system of the country. Because of the involvement of interest, which is clearly forbidden in the content of Holy Qur’an and Hadith, a segment of the funds remain unused as these people
do not invest in conventional banks. While Islamic banking is still in its infancy stage, people have no or little knowledge about its existence and practices. The research objectives, which are going to be achieved in the current research, are given below:

1. To examine, those aspects of the Islamic banking and Microfinance practices, which complement each other in ideology and practice.
2. To review the effect of Microfinance on micro-businesses.
3. To assess the impact of Islamic Microfinance on the living standard of poor.

1.3 Significance of the Study

This research is an attempt to examine the financial services, offered by the Islamic financial institutions in Pakistan and more specifically in KPK. This study may explore, that Microfinance is one of the alternatives to be used in Islamic banking practices. Microfinance and Islamic economic system promotes the concept of entrepreneurship and risk sharing. Therefore, Microfinance can be used as a device for awareness by the Islamic banks and hence can attract the idle savings of masses, who are unwilling to invest in the financial products of conventional and interest-based banks.

There is no restriction on financial innovation in *shariah*, therefore, new and innovative products, for example, Islamic financial system encourage entrepreneurship and several Islamic agreements may be merged, to form new and innovative products. This research may investigate that, Islamic banks has the prospects to present more creative options in Microfinance. Moreover, this study may spot out that Islamic banking has the potential to reach millions of those people who has the ability to contribute in the economic activities, but have no access to the traditional financial system.

1.4 Plan of Work

This study has been carried out in three stages. The initial stage of the research work is about reviewing the available literature about the topic, which took six months. The next stage is regarding the analysis of data, which was collected from the field, applying quantitative and qualitative techniques. This phase was completed in five months. The last stage of the work is about the findings, recommendations and conclusions that are completed in three months.
Chapter- 2

LITERATURE REVIEW

The literature review about the Practice of Microfinance is divided into two parts; Conventional approach and Islamic approach. The first part of this chapter describes different aspects of microfinance according to the conventional approach. The concept of microfinance, its evolution and different problems faced by microfinance, in developing countries and Pakistan have been discussed. There is a wide range of products, which can be offered in microfinance, such as small loans, savings and insurance. These concepts have been explained with special reference to Pakistan. The last part of this chapter explains the concept of microfinance according the Islamic approach. Different models and products, which are being used in different parts of the world, have been discussed. A comparative analysis of Islamic Microfinance institutions (MFIs) and conventional Microfinance Institutions (MFIs) is also part of this chapter. In the end, the potential of Islamic microfinance in Pakistan has been explained.

2.1 Conventional Approach

This section explains the concept of microfinance as it is defined according to the conventional approach. The practice of microfinance has evolved in different parts of the world, according to their own social and economic requirements. Different aspects related to the process of microfinancing have been explained. In Pakistan, the banking sector and other financial institutions, promote the culture of microfinance facilities by offering a wide variety of products to their customers. The main purpose of providing micro credit is to alleviate poverty in Pakistan.

2.1.1 Concept of Microfinance

There is wide range of products and services which can be used in microfinancing by banks. These products and services are aimed to meet the needs of the members of the society. Therefore, Microfinance has been defined in different ways by scholars and researchers, based on the clients being targeted and according to the products being offered by these Banks. According to ADB (2000), “Microfinance is the provision of a broad range of financial services such as advances, deposits, payment services, money
transfers and insurance to the poor and low-income households and their micro-enterprises.” The Consultant Grouping to Assist the Poor (CGAP) defined Microfinance in a different way. According to this definition, “Microfinance is the provision of small loans (micro credit) to the poor families, to engage them in productive economic activities and assist them in establishing their small business ventures” (CGAP Official Webpage, 2009). However, microfinance has the potential include a much wider range of products such as savings, insurance and small credits. It has been learnt recently, that a large segment of the society, which consists of the poorest of the poor, has no access to the conventional financial institutions. Therefore, it was felt to replace the old system with a new and modern system, which may offer more financial services and products to address the needs of this ignored segment of the society.

According to Lidgerwood, "Microfinance is an approach used for the development of financial and social intermediation, aimed at providing benefits to the households with low-income.” Financial services include provision of small credit and saving facilities. Moreover, some other Microfinance institutions may offer services such as payment facilities and insurance to their clients. Apart from credit intermediation, a number of MFIs are providing the services of social intermediation. These services generally include educating the members of a group about developing financial and managerial skills, group training and developing self-awareness among members of the group. Therefore, the definition of Microfinance now may include both financial and social intermediation. There is no doubt that Microfinance is a device used by banks for financing purposes, it has the potential to be used as a mechanism for economic development. (Lidgerwood, 1999).

The traditional process of advancing loans, specifically to the poor, is normally without any guarantee or security (collateral). The only guarantee is the reputation and trust of the individuals to whom these loans are being granted. Therefore, the traditional system recognizes these poor people as non-creditworthy and non-bankable, hence advancing loans to these people can negatively affect the interests of these traditional institutions. Microfinance can be considered as the best substitute of the traditional approach of advancing loans. Under this system, a new procedure is being devised for advancing loans to the poor clients of the society. The most distinguishing aspect of the procedure is, to advance credit to the people in such a way that, people should not go to
the bank, but the bank should go to the people. For availing the facility of loan, the
borrower must remain as a member of the respective target group of Microfinance. Each
member of the group is granted small loans and renewed after reimbursement of earlier
loans. The repayment of these loans is generally made on a short-term basis such as
weekly or fortnightly. Moreover, such loans can also be in the shape of compulsory
savings package (such as mandatory savings to the group fund) or it can be in the form of
voluntary savings. The basis of granting loans is the amount of capital established by the
joint group, for the borrower’s social capital. (Abdul Rahman, 2007).

Therefore, it can be said that, Microfinance is the provision of different type of
financial services, such as small credits and savings. Apart from these, microfinance also
includes the services of insurance and payments to those clients, who have low incomes
and have no access to the formal financing facilities. Thus, providing them an
opportunity, to get an easy access to these facilities, such as small credits, savings,
insurance and venture capital, on a micro-scale (Obaidullah, 2008). The provision of
financial services and microfinance facilities to these poor people may help to increase
both income and economic security of the household. This will result in increasing the
assets and trim down vulnerability.

Moreover, social intermediation is also included in Microfinance. Social
intermediation include, developing the self-confidence among the group members,
training in financial management and administrative capabilities. Informational
intermediation is also incorporated in the scope of Microfinance. The targeted Customers
of the Microfinance may include those poor people who have low incomes and small
enterprises, which have business opportunities (economically active) but have little or no
access to the formal financial facilities.

2.1.2 Evolution of Microfinance

The basic idea of Microfinance has been prevailing in different parts of the world in
diverse shapes. It is called "Susus" in Ghana, Indian call it “Chit Funds", "Tandas" is the
term used in Mexico. Whereas, "Arisan" is the name of microfinance in Indonesia.
Similarly, in Sri Lanka, West Africa and Bolivia the product are known as Cheetu,
Tontine and Pasanaku respectively (Lidgerwood, 1999).
Moreover, for the last many years, different financial institutions used public savings and funds for advancing loans to the neglected segments of the society. These customers have been traditionally ignored by commercial banks or have no access to the formal financial services, thus enabling them to avail these financial services. For the first time, advancing small loans without any security was started by the Irish Loans Fund system and targeted customers were the underprivileged farmers. The Irish Loans Fund system was initiated by the nationalist Jonathan Swift in the early 1700s. The idea of swift was grown up to a network of three hundred (300) funds being established all over Ireland by the mid of eighteenth century. Advancing interest-bearing loans for short periods was the main purpose of these funds. Every year, twenty percent (20%) of all the Irish households were able to obtain micro credit from these funds (Helms, 2006). Later on, early in the nineteenth century, a variety of bigger and official financial institutions were established for providing small loans to the poor people in Europe (Ibid).

Similarly, Indonesia also started establishing microfinance industry in the country during 1895. In the first instance, The Bank Parkreditan Rakyet (BPR) was established for the purpose of running the major Microfinance system inside the country, which have a set-up of 9,000 branches (Claus, 1999).

Earlier in twentieth century, different applications of these models started to emerge in parts of rural Latin America. On one hand, modernizing the agricultural sector was the purpose of such rural finance interventions and on the other hand, they generally had two-tier objectives; to commercialize the rural sector by activating the idle funds and to increase investment by means of advancing loans. This may result in reducing the pressure of oppressive feudal system, which was enforced through indebtedness. These new banks belong to these poor people and they were the owners themselves in rural Latin America, as they had been in Europe. With the passage of time, some of these banks became incompetent and some times, offensive (Belli, 1996).

Between the 1950s and 1970s, governments and other agencies started focusing on advancing loans to the agricultural sector, assist small and financially weak farmers. The purpose of this initiative was to raise their efficiency and productivity and thus increase their incomes. These loans were granted through government organizations, or farmer’s cooperatives, at lower charges. Robinson (2001) stated that, the main reason for the failure of these schemes was the inability of to recover their principal amounts. The
main reason for this erosion was the subsidized lending rates and poor repayment habits of the borrowers. As a result, these funds very rarely reached the deserving poor, and often circulated among fewer well-off farmers.

Bangladesh, Brazil, and some other countries started to advance loans of smaller amounts, in early 1970s. These loans were granted on experimental basis to groups of poor women, for the purpose of investing in small businesses. This type of small loans was characterized solely on group-lending. Each member of the group has an unlimited liability and guaranteed the repayment of the loans by all the members. These “micro-enterprise lending” programmes were exclusively used to provide small loans to very poor (mostly women) borrowers, for income generating activities. ACCION International, Grameen Bank and the SEWA Bank are the early pioneers of such programs (Yunus, 1998).

The major reasons for intervention of financial services at micro level were the failure of commercial banking to provide financial facilities to the poor and the disadvantages of using informal markets. As a result, microfinance comes out as an economic development device with the intention to meet the financial requirements of the neglected segments of the society. Therefore, the term “microfinance” means “the provision of financial facilities to those customers, who have low-incomes and low-income entrepreneurs in both urban and rural areas” (Ledgerwood, 1999). Throughout 1970s and 1980s, the new paradigm of microfinance was emerged as a successful story to serve the poor clients. The Grameen Bank Bangladesh, the unit desa system of Bank Rakyat Indonesia, ACCION International in United States and Latin America and PRODEM, BancoSol’s predecessor in Bolivia were some of the examples of these success stories of the microfinance innovations. The main reason for the success of the microfinance is adopting market-oriented and enterprise development approach. This stresses the need for innovative steps all over the world, to minimize the operating expenses and risks. It has better opportunities to extend operations to the deprived individuals of the society in effective way (Littlefield et al., 2003).

**2.1.3 Integrating social intermediation**

Conventional financial system may not reach the marginalized section of the society to provide them the services of financial intermediation. Providing financial facilities to this section involve taking genuine steps of investment, to raise their personal strengths, such
as education, proficiency, self-assurance and knowledge. Thus, developing local organizations, this may fill the space generated by poverty, illiteracy, gender and remoteness (Ledgerwood, 1999). The procedure of capacity building for the neglected sections of society is called social intermediation in micro-finance literature. Therefore, the term “social intermediation” is defined as “a process in which investments are made in the development of both human resources and institutional capital, with the aim of increasing self-reliance of marginalized groups, preparing them to engage in formal financial intermediation” (Bennett et al., 1996; Pitt and Khandker, 1996). This type of social intermediation differs from the rest of social welfare services, since it provides different opportunities to the participants to become members and sign an agreement that will involve mutual responsibilities. The aim of such type of social intermediation is to train the individuals for entering into strong business association with recognized financial system. This procedure generally includes educating individuals in basic accounting, financial management and business strategies to enable them about the feasibility and sustainability of financial products being offered to them.
Figure 2.1: Factors that affect financial market failures for the poor

Source: (Dusuki, 2008)

Figure 2.1 demonstrates the procedure of social intermediation which is applied in microfinance practices. The aim of this process is preparing groups for entering into strong business agreements with formal financial institutions, which involve reciprocal responsibilities. As a result, independent groups of the neglected individuals in rural areas are created, who have the required know-how and skill to handle business issues in long run. Moreover, benefits in controlling the expenses through self supervision and management may be exploited in the long term operations. In this way, financial institutions may play a significant part in more valuable process of financial intermediation.

2.1.4 Group-based financial services

The main reason for the success of microfinance operations worldwide is the implementation of group-based lending approach, which is capitalized on peer monitoring and guarantee mechanism. Group-based strategy is characterized by bringing those
people in one place, who have a common goal of getting access to financial markets. Similarly, another major feature is the use of peer pressure as a replacement to security. The research has suggested it as an effective device to design an incentive-monitoring system in the existence of expensive information.

Moreover, group-based lending techniques have the capacity to minimize the operating costs in selling goods on credit and collections such as searching, monitoring and enforcement of the customers by focusing on groups instead of individuals. In this system, the role of acquiring information, supervision and management of financial agreements and dealings are shifted from the financial institutions to groups. It may also create “social collateral” comprising a strong motivating technique for a higher collection rate as compared to individual loans (Besley and Coate, 1995). These self-administered group members have the same objective to get access to loans and savings facilities. These group members have the capacity to compete for obtaining the facility and to exclude those, who do not fulfill the requirements.

**Figure 2.2 The process of social intermediation**

Source: (Dusuki, 2008)
Therefore, it the operating costs reduces financial risk and provides a wide mixture of products, credit, land and labor that may yield higher profits. For instance, a solid linkage amongst the group members improves their capability to deal in credit transactions. Especially, social capital may result in an improved flow of information among the parties, thus minimize selection problems and ethical vulnerability in the credit market. This will also help in improving collection process in a situation, where applying legal steps are expensive. Moreover, trust (social capital) also contributes an important part in the success of group lending formation, specifically when collateral does not exist (Besley and Coate, 1995; Bhatt and Tang, 1998; Collier, 1998; Krishna et al., 1997; Narayan and Pritchett, 1999; Otero and Rhyne, 1994; Stiglitz, 1990; Zeller and Sharma, 1998).

2.1.5 Savings mobilization

Another important factor in establishing a self-sufficient microfinance culture is the mobilization of savings, which will minimize reliance on government subsidies NGOs for obtaining cheaper loans (Gurgad et al., 1994; Pischke et al., 1986; Rhyne and Otero, 1992, 1994). Providing these facilities may convert these non-financial savings into financial savings, which will help in providing liquidity and funds for investment to the society (Vogel, 1984). For instance, Grameen Bank, Amanah Ikhtiar Malaysia and various projects of ACCION International have impose a condition of obligatory savings, if the borrowers. For instance, Amanah Ikhtiar Malaysia, has imposed a condition that before borrowing, the members are required to save RM1 weekly and an amount of RM3 to RM15 for those customers according to the size of the credit. Another feature of these obligatory savings is that, the members may not avail the loaning facility if there is still an outstanding loan. Hence, savings provide a form of collateral for ensuring repayment of loans.

2.1.6 Over-dependence on subsidies

This was seriously felt to establish microfinance institutions, which are self- sustainable. The problems of dependence on government subsidies have been highlighted by many researchers with respect to microfinance organizations. They argue that over-dependence on subsidies may result in financial chaos for both the parties. Such as, the financial institution may not be concern about the collection of loans; the customers consider this credit as just a grant and may trim down their feelings about the repayment of this loan.
Charging below market interest rates have also been statistically verified to result in deterioration in profit allocation, allotment of loans and dependent organizations (Gurgad et al., 1994). Moreover, the arrangement of subsidized loans may persuade access and put bad effects to benefits of customers in the prevailing strong contest among the non-regulated institutions (Hoff and Stiglitz, 1998).

Thus, there is a strong feeling that financial facilities may be provided to the customers and at the same allowing these institutions to be financially self-sufficient. For this purpose, the economic rationality of credit project interest rates of the World Bank may be considered (Pischke, 1996). Charging normal rates of interest may permit these financial institutions to cover their operational expenses and profits, without depending on subsidies of government and NGOs. However, charging such interest on microfinance services offered by Islamic financial institutions is not allowed.

2.1.7 Microfinance and Islamic World

Very few conventional and Islamic banks have initiated to offer microfinance products and services to their clients. Islamic banks have a basic dissimilarity from conventional financial institutions, which has been discussed by Khan (1997). According to him, conventional banking can offer Islamic financial services in much better way as compared to Islamic banks, if the only difference in affairs of both institutions is the “interest”. He stresses on the point that a major objective of the Islamic financial system is to provide social justice and this may be achieved by providing loans to the poor people to improve their financial position. The modern approach of providing loans by the MFIs to the poor may be used by the Islamic financial institutions, because it is feasible to advance loans to the poor.

Islamic world is facing many challenges at present, such as raising the extreme level of poverty and overcome below par social and economic development. Although, some serious steps have been taken during the last thirty years all over the world, to provide financial assistance to the poor, to eradicate the extreme poverty, the challenge is still to be defeated. Therefore, it has been strongly felt as a policy matter, to provide financial services to those small and medium business, who have limited or no access to the traditional financial market. Thus the emergence of microfinance movement, with a variety of financial products, which suite their needs, has increase and expand their
business activities, improve their earnings and social welfare (Bennett and Cuevas, 1996; Ledgerwood, 1999).

Alleviating poverty through microfinance services attracted the attention of Islamic financial institutions as well. While business organizations are developed within the domain of Shariah (Islamic principles), Islamic financial institutions may be guided in such a manner to ensure that the objectives of Islamic economic system are obtained, such as equitable distribution of wealth in the society and social justice (Ibn Ashur, 2006).

Islamic banking industry is growing rapidly worldwide and always recorded a growth rate in two figures over the last three decades (Iqbal and Molyneux, 2005). Early in 1970s, with a humble start to offer Islamic banking services in a small town of Egypt, Islamic banking industry has attained a level that various multi-national financial institutions has started to offer Islamic banking products. Although, the approximation related to precise extent of the Islamic financial industry differ, it may be carefully assumed that at present, it exceeds US$150 billion and is expected to grow further (Iqbal and Molyneux, 2005).

2.1.8 Lack of access to funds for the developing countries
Smaller businesses are normally denied to enter the conventional financial system. The main reason of fact is the conventional problems of asymmetric information in financial intermediation. Bennett (1998) highlights few problems, which emphasize on the asymmetric information problems on small business in developing countries of the world. Lack of physical facilities, such as markets, transportation, energy, communications, may add to the poor selection and ethical problems. Such barriers restrict the bank’s efforts to monitor the use of loans advanced to these poor people. Similarly, socioeconomic issues of customers, such as illiteracy, caste/ethnicity/gender issues may also cause poor selection. Moreover, the inability of the customer to provide any security or guarantee also add to the ethical problem. The problems of appraisal and monitoring as well as management of these small loans, make them very expensive, thus making it impossible for the conventional financial institutions to offer them. Bennett (1998, pp. 106-7) has presented two methods to provide micro credits to small business, i.e.to create a link between the traditional bank and the target group (poor people) with the help of an intermediary; and providing these small loans through NGOs, government agencies, cooperatives, and development finance institutions.
2.1.9 MFIs: Problems and Constraints

There is mixed reaction on the success of MFIs. According to some scholars, it has been a successful initiative for curbing the extreme poverty, however, few researchers has proved it as a failure of these institutions to meet their goals. In this section, some reasons that resulted in the failure of these organizations are given.

2.1.9.1 Asymmetric Information Problems

Most of the micro credits are given to female customers; however, in real world these loans are managed and controlled by men, which some time results in misuse of the funds (Rahman 1999, p. 75). Whenever, loans are utilized in non-productive activities, the risk of default is increased. Buckley (1996, p. 390) points out, that in 1993, 46 % of the Malawi Mudzi Fund’s (a MFI in Malawi) customers did not pay their loans in time because they use the funds in other activities 33% were defaulted.

2.1.9.2 Economic Viability of Microfinance Institutions

The most successful MFIs would be those operating at a profit and providing credit facilities to the poor, however, it is not the case in reality (Morduch 1999). The high cost of doing business and poor movement of funds, make it very difficult for the financial institutions to survive.

2.1.9.3 High Drop-out Rate and Non Graduation from Poverty

Ditcher (1996), Hulme and Mosley (1996a), and Montgomery (1996) pointed out that microfinance institutions may not provide credit facilities to those poorest, who have no access to the micro credit and may be dropped out of the credit schemes. Karim and Osada (1998) stated that dropout rate decreasing from Grameen Bank (15 % in 1994) and 88 % of these cases were not able to qualify the status of non-poor. Assaduzzaman (1997) argues that microfinance operations may not improve the economic conditions of the poor and positively change the lives of the extreme poor.

2.1.10 Microfinance Services

Microfinance services generally include a wide range of financial products and services, intended to help those people, who have no access to the conventional financial
Institutions. Traditionally some very poor people are considered as non-bankable, because they would not be able to furnish the required guarantees or collateral, which is used by the financial institution as a protection against the risk of default. Therefore, Microfinance services have evolved as an alternative economic development device. The main purpose of Microfinance services is to benefit those segments of the society, who have low incomes, by extending the financial services to them including the self-employed people. The mix of products and services offered by these financial institutions comprise of advancing loans, accepting savings, insurance facilities and funds transfer (Segrado, 2005).

Apart from the above products, a number of Microfinance Institutions (MFIs) also provide social networking services to their clients. These services generally include group training, developing self-confidence of the members of the groups, and training in financial and management skills. Moreover, improving literacy rate, health facilities, education facilities, and marketing facilities are included in the social networking services. Therefore, the scope of microfinance covers both the financial and social aspects of economic development. Therefore, Micro Financing is used to provide banking facilities to the poor on one hand and it is used as an economic development device on the other. The main beneficiaries are those people, who have no access to the traditional financial markets. There are some people, who have got the ability and skill to carry on with their own small ventures. They have the capacity to generate new and productive ideas using the existing resources. Therefore, any financial support, subsidies and dependence may give a chance to extend and develop their businesses with microfinance. This is evident from the history of Microfinance services all over the world that the clientele of MFIs, which normally include low-income groups, now demand a wide variety of other financial products and services. They are willing to reimburse the related costs and are reasonably bankable. Moreover, the targeted clients of microfinance services includes the poorest of the poor and those groups of the society, who are just below the edge of the poverty line and those who have creative ideas but have no access the traditional financing facilities. (Younus, 1998; Segrado, 2005).

2.1.11 The Case of Pakistan

In Pakistan, the micro credit facilities are being granted to the poor people by offering a wide range of products the clients. The major promoters of micro credit facilities in
Pakistan are the banking industry, Non-Government Organizations (NGOs) and other Microfinance institutions. In Pakistan, the major objective of providing these small loans is to eradicate poverty. The government of Pakistan took a major step in 2001, for the promotion of microfinance in the country, when the Microfinance Institutions Ordinance was promulgated. The purpose of the ordinance was to promote the microfinance culture in the country and to establish MFIs. The ordinance states that:

“Promoting the establishment of microfinance institutions to support the organization, structure, financial and infrastructure for poor people, in particular the women, to reduce poverty and promote social welfare and economic justice through community building and social mobilization and problems expected and there with their assistance.”

The MFIs can play an important role in alleviating poverty and can assist in the economic development of the country. A wide range of products and services are being offered by Microfinance Institutions in Pakistan. Some of the products are explained below:

2.1.11.1 Loans
- It is typically considered as a short-term loan which is provided for working capital purposes.
- Sometimes loans are advanced for acquiring long term asset.

2.1.11.2 Savings
- MFIs usually demand some sort of protection to cover the risk of default. Therefore, people may be asked to make compulsory savings and deposit them in these MFIs. These savings are used as a security for the reimbursement of loan and also as a protection for the MFIs against the risk of default. However, MFI’s cannot activate the micro credit operations and the collection of deposits without a license from the State Bank.
- Advancing credit is important but savings are more suitable for the poor, which can be used as a financial device. These savings will engage them to interact with traditional financial sector and members of the society.

2.1.11.3 Insurance
- Insurance with respect to loan is common.
- The following procedure is followed while giving loan’s insurance:
- The client purchase the insurance as a percentage of loan at the time he/she borrows a loan;
- At the same time an emergency fund is created in the bank of the village, and community loan associations.

Unlike Bangladesh, Indonesia and Latin American States, the operations of Microfinance services were launched very late in Pakistan. However, various financial institutions have taken some serious steps in the recent past, which are proving successful in alleviating poverty and promoting the Microfinance culture in the country. For the success of MFIs, some serious issues need to be addressed, so that they may be able to keep pace with the ever growing economic scenario. Some suggestions are given here, to easily achieve these objectives:

- Subsidization of the services can affect the performance of the Microfinance institutions. Therefore, they should move to the commercialization of the services. This will result in improving the efficiency of the MFIs and they will be self-sufficient.
- They should enrich their product mix by introducing more products to meet the needs of the society.
- MFIs should price their products efficiently to remain sustainable.

2.2 Islamic System

In pre-Islamic era, the major economic activity of Quraish (ethnic group of Arab) was trade and some of the caravans were financed by those wealthy people, who may not go along with them. Homoud (1982, p.135) quotes Al-Razi (circa 606H) saying that, battle of ‘Uhad’ was financed by Quraish, using those funds, which were collected through interest. While explaining the Verses 275-280 of Chapter II of the Holy Qur’an, mostly the scholars are unanimous that, there were inherent applications of interest in the economic activities of pre-Islamic Arab. This practice was more common among the people of Quraish, Thaif and the Jewish society.

Abbas, uncle of the Prophet (S.A.W.W), was one the major financiers in Makkah along with some other prominent families of Thaif. Commenting on the Qur’anic verse about the Jewish involvement in interest-based activities; early writer, Homoud (1982, p. 131) strengthen the opinion that, most of the Jews would work as money lenders in
Madina and charge interest at twelve percent (12%) per annum. Hence, it is evident from the history that, the leading method of advancing loans in the pre-Islamic era was interest-based borrowing. Mudarabah may be given the next position because it was practically feasible in those days.

While arguing on the legality of Mudarabah, the religious scholars (fuqaha) frequently refer to the Mudarabah enterprise, between the Prophet Hazrat Mohammad (S.A.W.W) and Hazrat Khadijah (May Allah be Pleased with Her), that began about fifteen years before the Revelation. These Jurists further revealed that Mudarabah was the most widely used business practice in Makkah at that time. Profit distribution between the partners may take place in Mudarabah, after the actual realization of profit, at the completion of the project (Usmani, 1998). Cihak and Hesse (2010) conducted an empirical study to test the stability of Islamic banking over the conventional banking system and the results were in favour of the argument. Whereas, Errico and Farahbaksh (1998) and Solé (2007), explored the issues related to the rules and regulations associated with the applied side of Islamic banking system.

Muzara’ah and Musaqah was another type of business partnership among the citizens of Madina for agricultural production. The term Muzara’ah refers to fields for crops while the term Musaqah refers to fields with palm trees in particular. The working partner was given Muzara’ah fields and Musaqah i.e fields with palm trees and these fields were treated as fixed assets. This practice can be viewed as identical to financing because the working partner obtained the rights to use these assets without having to actually pay for it. Musaqah and Muzara’ah both require the contribution of gross output and permit for some degree of relaxation in allocating the operating expenses.

Furthermore, credit sale was prevalent in the days of the Holy Prophet (S.A.W.W). Reference has been give to the people, who said that, the Prophet’s (S.A.W.W) used to buy on credit basis, taking loans and few times furnishing personal possessions as collateral. For example, Abdullah ibn abi Rabi’ah said:

“Hazrat A’ishah (RA) narrated that, ‘The Prophet (S.A.W.W) bought some food on credit from a Jew and he (the Prophet PBUH) gave him (the Jew) his male (armor iron cloth) as a security (in other version she said; thirty sa’ of barley instead of saying some food)’.”

Abu Hurairah also reported:
“The Prophet (S.A.W.W) borrowed (once) a male camel”.

Therefore, as quoted above, purchasing on credit basis can be used to finance consumption. Another common practice was found, whereby the producer was paid the cash in advance to finance the production and delivery was deferred to a future date. This advance payment can be considered as credit, which creates a kind of debt and is referred to as *Salam*.

Seasonal trade and agriculture was the most common modes, used by Arabs for earning their livelihood, therefore, the *Salam* a familiar practice of business during that era. *Al bukhari* reports from *Albara’bin’ Azib*:

“(When) the Prophet (S.A.W.W) came (to Madina) we used to undertake Salam against cash payment until the season”.

The religious scholars highlighted the phenomenon in more detail in the context of interest. According to them, it was a common practice in those days to sell goods through *salam* and exchange silver and gold inter se.

During the eighteenth, nineteenth and early twentieth century, most of the Muslim countries of the world were colonized by Europe. They took over and managed the economies and financial affairs of these countries according to their own interests. The new financial systems, launched by the European countries, were accepted by the native allies but the Muslims were still unaware about the fact that, these financial transactions involved interest. With the passage of time, awareness and national freedom movements in the last part of previous century, the Muslims strongly realized that, they should manage their affairs according to their own way of life. 1945 to 1963 was the era, when most of the countries with Muslim majority got independence. A debate was initiated on, how to manage the economies and resources, and to promote the interests of Muslims according to their own values. These ideas led to open ways for initiating the movement for Islamic Financial System. Apart from this, patriotism strongly felt the need for a swift economic development. Another very strong motivating factor in the movement of liberation was the religion, which fascinated many non-Muslims to embrace Islam, and they accept the teachings of Islam as a bench mark for living their lives. (*Chapra, M. Umar* 1970, *Khan, Muhammad Akram* (1994), *Siddiqi*, 2001, *Ferro, Nicoletta* 2005)
The concept of Islamic banking and finance got serious attention during the 1980s, and the Muslim world took initiatives to implement the theme of Islamic banking in their banking industry. For smooth and swift implementation of the idea, experts in the field of Islamic economics were hired, technical committees were formed to work out the details. A number of universities produced hundreds of PhDs in the field of Islamic economics, which boosted the research based activities in the said field. Similarly some universities started offering the subjects related to Islamic banking and finance. A series of lectures, seminars and conferences were arranged on Islamic banking and finance in various cities of the world, such as Islamabad, Bahrain, Jeddah, Kuala Lumpur, Dhaka, Cairo, Khartoum, Sokoto (Nigeria), London, Tunis, Geneva and New York. Moreover, many research centers were established to provide books, academic writings, forums for conversation and distribution of information all over the world. (Ibid)

Siddiqi (2001), delivered a number of lectures in a seminar at University of California, Los Angeles (UCLA) during 2001. He acknowledged the initial theoretical work, which took place during 1940s and 1960s, on the subject of Islamic economics. The said work is published in different languages, such as Urdu, Arabic and English and the main focus was on the entire economic system instead of only banking and finance. The earlier theoretical model about Mudarabah was based on two-tier aspect. In the two-tier Mudarabah model, interest was replaced by sharing the profit and loss and the relationship of bank-depositor was substituted by bank-borrower. Islamic banking can play the role of financial intermediary in place of conventional commercial banks. This may eradicate interest from the operations of these banks and the concept of partnership may be promoted for conducting the business and sharing of the profit and loss. Meanwhile, some other Islamic modes of financing were emerged, such as Salam in agriculture, Istisna in manufacturing business and some other contracts, such as Wakala were discovered. Many religious experts and academicians have put their efforts forward in this regard and contributed significantly in guiding and designing the desired model for Islamic Financial Institutions. (Grace, L and Al ZamZami, A, 2002, Akacem, M and L Gilliam 2002)

Developing a system for housing-finance, which is in accordance with the Islamic principles, was one of the main problems of the government. Therefore, a set of three models were developed, which were free from all sorts of interest. The first model
became the foundation for establishing the House Finance Corporation of Pakistan (HBFC) in 1980. This arrangement was based on the joint-ownership and payment of rent (diminishing Musharakah). Ownership of the house is gradually transferred to the client in a manner as if he or she has bought it from the organization bit by bit. Similarly, the second model was a Cooperative, where participants of the cooperative accumulate the financial resources and in hence get funded. The pooled financial resources are invested to earn a reasonable profit on it. The last model is related to Murabaha. This arrangement calls for paying a higher amount by the client, on deferred payment basis and in a series of installments. Transactions on Murabaha basis are closely observed to make sure that it is according to the principles of Sharia and financially viable. Sometimes changes are made on the applied side, if the transaction is not in accordance with Islamic principles. (Ibid).

2.2.1 Islamic Banking

Islamic banking is an emerging concept and consists of all those financial activities that are in conformity with the principles of Sharia and its operations are governed by the principles of Sharia. Islamic principles strongly forbid usury i.e. collection and payment of interest. Another term is frequently used for “interest” in Islamic discourse that is known as “Riba”. The Holy Quran has clear instructions in this regard, consider the following example:

Suppose a person has some funds which he wants to invest to earn some return. There are two available options for investing these funds: the funds can be invested in some business venture and can earn a reasonable income or he can lend this money on interest. The Quran has very clear perspective, which states that: “do the former and avoid the latter, for they are not the same though some do argue so.” Islamic principles do not allow trading in financial risks, which is another shape of gambling. Similarly, Islam also forbids dealing in those activities in which extreme uncertainty is involved. Moreover, Islamic principles prohibits investing in such businesses, which are not allowed in the Sharia, such as dealing in alcohol or pork, gambling and many others.(Usmani, 1998, Akacem and Gilliam 2002: 125).

Islamic banking and conventional banking has the same purpose, however, the operations of Islamic banking are carried out in accordance with the Islamic principles i.e.
Sharia or Fiqh-al-Mauamalat. Islam permits dealing in trade but prohibits Interest (Riba). Therefore, Islamic banks always deal in goods and never provide money to the borrowers. The profit of Islamic banks is in the from rent in case of Leasing (Ijarah) and cost plus profit in case of Murabaha, while, profit of the conventional banks is based on income from interest charged on the loans advanced. Profit margin in Islamic banking is decided through a mutual agreement between the financial institution and the borrowers.

The procedures of Islamic banking are simple and religious experts or ‘Ulema’ organize the operations of these banks in accordance with the provisions set by Sharia. This is the responsibility of Bank's Sharia advisory experts to make sure that, the financing agreements are valid and in conformity with the principles of Sharia. These transactions are characterized with high risks and create a moral hazard problem. These contracts generally require a good understanding between the banks and their clients, in terms of honesty, management, integrity, and business skills. However, the process of monitoring and supervision also create serious problems for Islamic banks. No security or collateral is required in both Musharakah and Mudarabah because both are types of equity financing. For smooth functioning of Islamic banks, each bank is required to have a Sharia Advisory Board. The Central Bank does not issue the license to begin operations unless the bank has its Sharia Advisory Board.

2.2.2 Islamic Modes of Financing

The following methods are commonly applicable in Islamic banking:

2.2.2.1 Murabahah

In Murabahah, the financial institution sells goods to the customer on cash or credit basis. Normally sale is made on credit basis. The bank sells the particular goods at an agreed profit, by revealing its actual cost to the client. This is a condition in Murabahah that, the seller must take the possession of the goods and assume the risk of ownership, before selling it to the customer. The price remains fixed once it is decided. In traditional banking, the possession is instantly transferred to the customer even if sale is made on credit basis and after acquiring the goods, the client is liable to pay the installments. Moreover, conventional banks may charge extra amount on account of interest for late payment, while Islamic banks do not charge any interest for late payment. However, Islamic banks charge a fine for late payment, which goes to charity and not included in the profit of the banks.
2.2.2.2 Mudarabah

In Mudarabah, one party invests funds whereas, the other partner provide labor or skills. The investor is known as Rab-ul-Mal and the manager as Mudarib. The same model is used in Pakistan, in which bank acts as the Mudarib whereas, the investor as Rab-ul-Mal. The Mudarib may invest these funds according to his/her own plans or according to the instructions provided by the depositor (specialized investment). Profit of the business is distributed between the parties at an agreed rate, while losses are borne by Rab-ul-Mal only. On the other hand, if this model is applied in Microfinance practices, then possibly the financial institution will act as the Rab-ul-Mal and the client as the Mudarib.

2.2.2.3 Musharakah

Musharakah is a type of partnership, in which all the partners invest capital and get a share in the profit and loss of the business. Profit sharing ratio is decided in the agreement, which is not necessarily in proportion of their investments, while losses are suffered by the partners in proportion of their investments. The partners have the right of ownership against the assets of the partnership in proportion to their investments.

2.2.2.4 Ijarah (Leasing)

In Ijarah, the financial institution purchases the asset and provides it to the leasee on a rental basis as agreed upon in the contract. In this type of arrangement, leasee is required to pay rental charges only when the asset is transferred to him/her. During the lease period, the title of the ownership remains with the leasor. However, if the loss resulted by the misuse of the leasee, then he/she will be held accountable for it. Either party may make a promise to sell/buy the leased asset after the expiry of the leased period. Similarly, the lease agreement may be cancelled any time, when the leased asset stops providing services or at a mutual agreement of the leasor and leasee.

2.2.2.5 Musawamah

Musawamah is another kind of sale where price of the goods to be sold is decided between the seller and the buyer, irrespective the costs incurred by the seller in acquiring these goods. So the main difference between Murabaha and Musawamah is the pricing procedure. In Murabaha, the cost of the goods is disclosed before they are sold whereas, in case of Musawamah, it is kept in secret. Rest of the procedures remains the same for both products. Musawamah can be the best mode of financing if the seller can not accurately determine the cost of the products to be sold.
2.3 Microfinance and Islamic Banking

The objectives of Islamic economic system and Microfinance are identical. Islamic banking was started with a vision to improve the social and economic situation of the Muslims all over the world. Moreover, it is an attempt to employ them in the financial service industry to conduct banking operations according to principles of Sharia. Similarly, to curb the extreme poverty and provide social justice in developing countries, the modern microfinance movement was launched. Thus the aims of both Islamic banking and microfinance institutions are the same, i.e. to prevent the poor people from the economic exploitation and providing social justice to them. In 2006, Muhammad Yunus was awarded by the Nobel Committee and the Grameen Bank, the Nobel Peace Prize, for recognizing the significant humanitarian efforts of microfinance.

"An important function of Islamic finance that is seldom noted ... is the ability of Islamic finance to provide the vehicle for financial and economic empowerment ... to convert dead capital into income generating assets to financially and economically empower the poor ..."

(Mirakhoro 2002)

The Islamic banking system has grown rapidly over time and caught the attention of masses, especially those, who are reluctant to invest their savings in the traditional banks. In Malaysia, it is Nineteen Percent (19%) of the overall banking industry, whereas, about four percent (4%) in Pakistan (SBP: Islamic Banking Bulletin, 2009).

It is very difficult to merge Islamic Banking practices with microfinance operations. Microfinance and Islamic banking are still in its infancy stage. Similarly the administrative costs of microfinance are very high. Therefore, introducing microfinance in Islamic banking is a daunting task but still possible. Lots of hard work has already been done in many countries of the world to incorporate Microfinance products and services within the operations of Islamic banking. Many countries, who have already implemented Microfinance within Islamic banking can serve as role-models and provide guidance to other countries for pursuing it according to their own economic and financial requirements. Combining these two approaches is quite possible and Islamic religious
leaders can be persuaded about the possibility of applying of microfinance within Islamic banking (Shahinpoor, 2009 and Karim, N., M. Tarazi and X. Reille 2008).

Several elements of Microfinance are considered in accordance with the needs of Islamic world and can help in achieving the goals of Islamic banking system. Both systems promote sharing of risk and entrepreneurship and strongly believe that the poor can participate in these economic and financial activities (Dhumale and Sapcanin 1999).

Both Islamic banking and microfinance provide loans without any security or collateral, and this is a common element in both institutions. Therefore, both Islamic banking and microfinance programmes complement each other ideologically and on the applied side. This strong association is quite beneficial to the poor entrepreneurs, especially those, who would be left out of financial markets otherwise. Investing in small businesses is also a diversification of investors in the field of Islamic banking and is expected to get fruitful results.

Takaful “Islamic insurance” and kifala “mutual-guarantee product” both are in accordance with the spirit of mutual responsibility and can be implemented to meet the needs of group lending. Similarly, microfinance organizations can merge the products and services offered in Islamic banking, such as taking deposits, product financing and other financial facilities and hence, encourage financial inclusion (El-Hawary and Grais, 2005, Fadel 2004).

Different models are applied by Islamic banks to promote Microfinance in different parts of the world. Mudarabah and Murabahah, the products of Islamic banks, are proposed by many scholars, which can be used as a device for successful Microfinance operations.

2.3.1 A Mudarabah Model
The financial institutions offering Microfinance and the owners of small businesses are partners in this model, whereby the Microfinance institution acts as investor and the owner of the business contributes labor or skill. The entrepreneur of the small business shares the profit for the work that benefits the entire organization. Certainly, the model is complex, mainly when the owner of the small business has no responsibility, which makes it complicated to determine, what can be the exact share of the profits to the owner of the business. The management and control of this model is difficult, hence, the parties
may be trained to get the basic knowledge in the related field. For easy understanding and managing the affairs of Mudarabah, the model may be simple for businesses and have a longer operating period.

2.3.2 A Murabahah Model

Under this agreement, the Microfinance institution purchases goods and sells them to the small businesses for a price, which covers cost of the goods and administrative cost plus a profit. This arrangement calls for the payment of equal installments by the client, and the Microfinance institution remains the owner the goods, until the last installment is paid by the client. Although, the main objective of Microfinance is to alleviate poverty and advance financial support to those ignored poor, who got the skill but have no funds, Islamic banks have to face a number of problems in achieving these objectives. This is evident from the fact that, small businesses have a high administrative cost, lack of proper documentation and improper accounting procedures by these micro-enterprises. This model is easy to understand as the cost and profit is known, while the only problem is to assure that the installments are paid in time.

The prohibition of Riba is not problem in implementing a strong Islamic Microfinance system; rather it could probably enhance it. This can result in higher profits as the small savings of poor people are utilized in the productive activities, which also create more jobs and boosting the overall economic conditions of the society. The ultimate outcome is a better-off, peaceful and prosperous society, which is the main goal of Islamic economic system.

2.3.3 A Murabahah Model in Yemen

During 1997, the first ever microfinance scheme was launched in Yemen, which was known as the Hodeida Microfinance Program. This programme was is a Murabahah model in nature. The people of Yemen were strongly devoted to Islam, so, they were reluctant to approach the conventional financial system for financing requirements. Therefore, this program was initiated for those people how have low incomes.

2.3.4 Procedure of Hodeida Microfinance Program

This program was characterized by the mechanism of a joint liability of the group. The process to make this scheme operational is given below.
• The poor people of the urban districts were the targeted clients of this programme and the loan turnaround was one week.

• The interested people are also advised to make groups among themselves, comprising five members and submit an application to the programme giving details about:
  ▪ Basic business data
  ▪ Personal information
  ▪ Proposed amount of the loan (Initial loan was amounted to be 300 USD, upper size of the loan was 1500 USD, while the average loan was amounted to be 240 USD). The applicants were required to sign a contract for the payment of loan on behalf of other partners, if they failed to pay in time.

• The loan officer prepares the feasibility report of proposed business by the group for advancing the loan. As soon as this appraisal is made, the application is forwarded to the district manager and district loan committee for evaluation and approval.

• In case, application is approved, the proposed items for the business are purchased. The loan officer resells these goods to the group after adding a profit margin.

• After this, a contract is signed between the parties, giving details about the sale, such as the sale price, the amount of installment and repayment period.

• For the convenience of the group, the finance department of the programme opens an account for each group member, giving details about the number and size of installments and the repayment dates. A receipt is issued to the borrowers after collecting the installment.

• The loan officer also collects additional 30 Riyals from group members on account of insurance and deposits the same with the finance department. A separate account is maintained for the insurance fund, giving details of its incomes and expenditures. The borrower can also use the insurance fund, after getting approval from the group members and the loan officer.

• Regular visits to the site of the business are made by the district supervisor, project manager and assistant project manager, to ensure that the funds are properly utilized. Moreover, the project management team assist finance department, in preparing monthly progress reports, giving details about the
number of loans distributed, business types, distribution of borrowers on the basis of gender, repayment rate, overdue rate and other issues. If the borrowers conduct their businesses successfully and efficiently, they are eligible to apply for larger amounts of loans.

The procedures of Murabaha model is simple to understand and convenient for the borrowers. Unlike Mudarabah, the amount of profit and installment is revealed at the time of signing the agreement, and there is no need to show profit in every period. Moreover, the mechanism of grouping is a useful device in reducing the risk of default to the Microfinance institution or bank to some extent. If any group member failed to return the loan in time, then the other members of the group are held responsible to repay this loan.

The weekly collection of insurance fund is another advantage of this model, which is beneficial to both borrowers and the bank. These advantages are:

- Emergency funds are available to the borrowers, which reduces their excessive level of risk.
- It also reduces the banks’ risk because bank is maintaining insurance account with itself.

Similarly proper utilization of funds is ensured by closely monitoring and supervising the fieldwork. As a result, the overall economic condition is improved in the long run.

2.3.5 A Murabahah Model in Bangladesh

Islamic banking sector in Bangladesh has used a Microfinance model, for the small and medium business and cottage industry. In this model, personal savings of the individuals are used as a basis for granting loans. To avail the micro credit facility, every client was asked to open a bank account and deposit some amount for a particular time period. It was observed in the conventional Microfinance system that, the loans granted for the purpose of production were not properly utilized by the clients. Therefore, it was made obligatory on part of the clients to make compulsory savings and deposit some amount of money before getting a loan.
One of the Islamic banks in Bangladesh “Social Investment Bank Limited (SIBL)” started to grant small loans to micro-businesses and cottage industry in the rural areas of the country. Poultry/dairy farms, handloom industries and other micro businesses were established for these clients. The Islamic mode of financing “Bai-Muajjal” was used for advancing loan and its procedure is different from the conventional approach of loaning. For obtaining loan from Social Investment Bank Limited, the following procedure is followed:

2.3.5.1 The Bank Initiates Groups and Teams among Customers

The bank advances interest-free loans to those customers, who form a group for the purpose of availing this loaning facility for the first time. Each group should compose of five (5) members and a leader among themselves to manage and guide the affairs and other activities of the group members.

On the bank level, a team is formed, consisting of five different groups. Now each group in a team is responsible for the activities of the other groups. An executive committee is constituted, which is comprised of the group leaders. The main functions of the committee are to elect a team leader among themselves, a secretary, and a treasurer.

Bank staff provides training for the group leaders such as information sessions, where they learn wide-ranging ideas and techniques to manage their businesses efficiently. For example, a team leader representing farmers will be taught about how to prepare the land before seed is cultivated, which type of fertilizer to be used at different stages, issues related to water and supporting them in all other problems that they face.

2.3.5.2 Group format

The Small and Cottage Industry (SCI) owners (respondents) are advised by the Social Investment Bank, to constitute different groups, consisting of five members in a group, who are willing to take loan from the bank. A representative is appointed by the bank for holding meetings with each group on specified days. Thus, every group has a direct link with and communicates to the bank through the official person appointed by the bank. Whenever, clients want to discuss any issue related to business or personal affairs, they can contact the official representative.
2.3.5.3 Opening a Bank account

Group members are asked to open a bank account, before applying for the loan. After opening the account, they are asked to deposit an agreed sum of money in the account on weekly basis. In this way, savings are accumulated slowly and steadily for ten weeks.

These types of accounts are known as “Mudarabah Savings Accounts” (Profit and Loss Sharing Accounts). After opening the account, every member of the group is anticipated to start depositing the required sum of money in a maximum weekly working time, assigned by the bank.

2.3.5.4 Collection Procedure of the Weekly Deposits

The team leader is responsible to collect money from his/her group members during the week. A record book is maintained to record all the amounts deposited by each person. The team leader submits the amount of cash collected, along with the list of names of the depositors to the cashier of the team on weekly basis. The bank representative is responsible for monitoring and supervising the affairs of the projects and the groups. Moreover, he/she handles the amount, which is collected from the group members, by visiting the cashier of that team on weekly basis. The same amount collected is then transferred to the members’ savings accounts.

2.3.5.5 Requirement of Minimum Deposits

This is the responsibility of the bank staff to prepare a list of those customers, who are interested to borrow money from bank. Then the proposals submitted by these customers are evaluated to determine whether they are viable or not. Care must be taken while receiving and depositing weekly savings, because the amount of customer deposits should not exceed 5% of the loan. Otherwise, the customer becomes ineligible to get any loan from the bank and hence he/she is not entitled to borrow capital from the bank. Therefore, the bank representative provides proper guidance and gives advice and ideas to the clients regularly as the bank’s consultant. This is his job to motivate them to submit and deposit their weekly savings in time and regularly. Apart from these advices and support, the bank representative is also responsible for arranging trainings to the clients for smooth and efficient conduct of their small businesses.
2.3.5.6 Bank Officers Direct Contacts

Besides collecting and depositing the savings of ten weeks, the bank representative is responsible to examine the personal skills of individual clients and the type of business they want to run in future. Bank officials hold meetings with each group and educate them about the operations of Islamic banking, i.e. its methods, aims, techniques and objectives.

2.3.5.7 After The Saving Period Ends

After the completion of ten weeks’ time, assigned to deposit the savings with the bank, the group leader organizes a meeting with members of the group. The purpose of the meeting is to pass a resolution, for the approval of the amount of loan; each member intends to borrow from the bank. A copy of the same resolution is presented to the bank representative for their own record. In the next step, the field officer of the Bank arranges meeting with various group members and invites them to the bank along with their group leader for signing the loan agreement.

2.3.5.8 Payment of Loans

After meeting all the requirements, the bank advances the amount of loans to the clients in the form of *Bai-Muajjal* (credit plus profit), a product of Islamic banking. At the time of signing loan agreement with the bank, the applicants are advised to submit a detailed pro-forma invoice, giving details about particulars of the supplier and prices of the goods to purchased. The applicants in turn, ask their suppliers to provide the details of the prices of raw materials. Another bank official looks after this whole process and keeps in touch with the clients for any help and support to the customers. Once the bank authorities are satisfied with the process, such as the invoice prices, the quality of raw materials, arrangements for the business and other issues, the amount of loan is paid to the customers.

Payments are made directly to the chosen suppliers after raw materials are delivered to the clients. So, the bank will make sure that, funds from the small and Cottage industry owners are properly consumed and customers are granted loans in such a way to help them achieving their desired objectives.
2.3.5.9  Direct Supervision of Borrowed Funds

Once the amount of loan is advanced, customers are allowed to spend it for business operations. However, they are required to provide evidence to the bank authorities, that the funds are utilized on purchasing the necessary items for conducting the business. For this reason, customers are required to prepare and collect all the invoices from suppliers of raw materials regularly and submit them to the bank. Then the client is allowed to utilize the amount of loan for any appropriate purpose. This is allowed when the credit is advanced and charged to the customers’ Profit and Loss Sharing Account.

2.3.5.10  Profits Charged by the Bank

After receiving the invoices from customers, the bank figure out the profit margin with the prices of raw materials they want to purchase. The bank receives the principal amount of loan and the mark-up separately and in equal installments. After purchasing the raw materials, it is given in ownership of the customer for its proper utilization.

2.3.5.11  Security

For securing the repayment of loan, the bank may ask the applicants to submit the papers of their agricultural land, or provide a reference letter from an individual, specified by the financial institution or some prominent customer in the area.

2.3.5.12  Repayment of Loans

The arrangements of the repayment of loans along with profits include a series of partial installments payments by the client. Social Investment Bank Limited has set the amount of the installment, in accordance with the volume of the loan to be repaid. The reimbursement of the loan commences fifteen days after the borrower receives the amount of credit or when the products are completed set for delivery.

2.3.6 Microfinance Program in the North Mali

After the end of the civil war in 1997, Microfinance practices was initiated by the Islamic bank “Azaouad Finances” in the city of Leer, North Mali, in collaboration with the
German Development Cooperation. The German development cooperation was assigned three responsibilities in the post civil war scenario:

- relocation
- restoration
- Microfinance

To alleviate poverty in the country, the need of micro credit programs was felt strongly. In the beginning, it was recommended that traditional financial setup may be developed to advance small credit to the poor and neglected citizens of the country. However, after rejecting the conventional system of banking by most of the tribes of the country, Islamic banking was initiated. The unique characteristics of this program are as follows:

- Initially, only those people were allowed to avail the facilities of loan, who were the account holder of the bank. However, with the passage of time, small merchants were also given the facility and hence, the loan was provided to all the people, irrespective of their ethnic group. The banks provide interest free loans and encourage the collection of savings and participating in the profit and loss of the business.

- If a borrower did not repay the loan in time, he/she would not be held responsible for this failure, if it is not caused by his/her carelessness. However, in case of success, the bank may also get higher payments for profits. Therefore, in Islamic banking system, the clients have no burden and worries for excessive payments of interest and hence, their economic and financial conditions deteriorated.

- In case Musharakah is applied as a mode of financing, the profits are shared in any ratio as agreed upon by the partners. While, losses are shared in the ratio of their capitals.

- In case of disputes and conflicts, the Clergyman (Imam) of the area resolve the issue as an arbitrator, appointed by the bank. They are responsible for interpreting the problem in light of the teachings of the Holy Qur’an.

- Initially only men were allowed to take loans however, with the passage of time, the facility was provided to women as well and now they can take loans for different purposes.

The local merchants ranked this program as a successful step for boosting their businesses, who availed this opportunity of loan. As a result, the programme is expanded
to the neighboring countries as well, such as Abidjan and Arabian Peninsula. SWIFT system was started by the bank “Azaouad Finances”, for the convenience of the businessmen in which they could deposit savings in their accounts.

This successful implementation of the Microfinance certainly shows that Islamic Microfinance may be better option as compared to conventional banking system. In fact, it is the real means of financing, which may be used for eradicating poverty. The North Mali Microfinance program may be used as a model for other countries, especially those countries where Islamic banking already exists.

2.4 Islamic banking approach to microfinance

It was strongly felt that Islamic microfinance may be a better alternative to provide credit and financing facilities to the neglected segments of the society. This may result in placing greater emphasis on the well-being and religious responsibilities of the poor, while achieving the goals of the Islamic economic system, such as social justice and equitable distribution of wealth. El-Gamal (2006), Al-Harran (1990, 1996, 1999), Akhtar (1996, 1998), Dhumale and Sapcanin (1998), Ahmed (2001), and many other writers have spoken in the favour of the probable prospects of Islamic microfinance, which may be used to address the financial needs of those poor people, who have no access to the traditional financial market.

The initial testing of Islamic banking in India and Egypt were small rural co-operatives which are stimulated by European mutuals. Similarly, other financial institutions likes Mit Ghamr in Egypt stressed on the development of economic side, eradicating extreme poverty and promoting the culture of savings amongst the poor Muslims. On the other hand, some of them were promoting profit maximization policy for the future growth of Islamic banking and finance. Consequently, the proposed products are designed in such a way that is most attractive for the well-off customers and the poor are left out of the main stream. The basic distinction between Islamic banking and conventional banking is the Islamic principles and teachings, which guide the conduct and design of operations of the Islamic financial institutions (Ahmad, 2000; Ahmad, 1984; Chapra, 1987, 2000; Khan and Mirakhor, 1987; Rosly and Bakar, 2003; Siddiqi, 1983, 1985; Siddiqui, 2001). The objectives of Islamic banking include not only providing interest-free loans but also help in obtaining the socioeconomic goals of Islamic
economic system as described in *Maqasid al-Sharia* (the objectives of *Sharia*). Whereas, Islamic financial institutions are expected to follow the present modes of microfinancing, the activities may be in accordance with the principles of *Sharia*. Therefore, the operations of Islamic microfinance may not involve any sort of usury (*riba*), gambling (*maisir*), injurious stuff (*darar*) and excessive ambiguity (*gharar*). Keeping in view all these points, Islamic financial institutions may adapt a variety of methods applied by microfinance institutions for efficient and effective provision of microfinance services to the neglected segments of the society. Moreover, applying the modern techniques used by MFIs, Islamic financial institutions may adjust these financial products along with other existing products like *zakah*, charity and *waqf*, to encourage entrepreneurship among the poor people and hence eradicate poverty (*Akhtar*, 1996, 1998; *Al-Harran*, 1995, 1996, 1999; *Al-Harran*, 1990; *Al-ZamZami* and *Grace*, 2000; *Dhumale* and *Sapcanin*, 1998; *Hassan* and *Alamgir*, 2002).

Different techniques are used in Islamic banking operations for mobilizing the financial resources and providing financial services to the poor. These instruments are explained in the following section.

### 2.4.1 Mobilization of funds

Traditional MFIs are greatly dependent on interest-based deposits, government subsidies, funding from other NGOs and agencies. While, Islamic financial institutions may apply various modes for mobilizing funds. These modes may be divided into two broad categories, such as internal resources and external resources. The first method includes those financial resources, which can be generated and accumulated internally to make sure self-sustainability and self-support, whereas, the other is mainly related to traditional application of microfinance services all over the world, which depends heavily on the external providers of funds, such as governmental loans, subsidies and donation. These modes of funds mobilization are discussed in the following section.

#### 2.4.1.1 Internal resources

These resources may be categorized as “deposits” and “equity” and both have the following main features:
(1) Deposits: Different instruments may be used by Islamic financial institutions for their microfinance activities to mobilize funds, like *wadiah* (safekeeping), *qard al-hassan* (benevolence loans) and *mudarabah* (profit sharing). According to the *wadiah* method, the funds may be retained as *amanah* (trust) and the bank invests it at its own risk. The profits generated by these investments belong to the bank and the depositors have no right to share the profit with the bank. However, banks may offer some compensation to the client in the shape of gifts, which are equivalent to the rate of interest, prevailing in the financial market. Similarly, under *qard al-hassan* method, the depositors advance interest-free loans to the bank. The bank ensures the repayment of the principal but do not offer any profit to the depositors. Under *Mudarabah* mode, the profit of the business is distributed between the parties, where bank acts as the entrepreneur (*mudarib*) and the client as investor (*rabb-ul maal*).

(2) Equity: The second mode used by Islamic financial institutions for mobilizing funds includes *musharakah* and *mudarabah*. These models are very attractive to rich people, who are willing to provide charity through Islamic modes of financing on the basis of sharing risk and return. In *musharakah* model of Islamic banks, the shares of the microfinance project may be purchased by these rich people to become owners of the whole program. Incomes generated by the project are distributed among the shareholders while losses are borne by the capital providers only.

2.4.1.2 External resources

Traditional MFIs provide loans to its customers charging very high interest rates for covering their operational expenses and profits and reduce dependence on government subsidies and donations from other agencies. On the other hand, Islamic financial institutions do not charge interest, thus they need to use some other instruments for mobilizing funds. Islamic economic system provides a fair chance of equitable distribution of wealth and social justice, to ensure that every Muslim maintains a reasonable fair standard of living (*Metwally*, 1997). *Zakah* is an obligatory tax, which is collected from qualified Muslims and distributed among the deserving Muslims, according to the principles of Sharia (*Al-Omar* and *Abdel-Haq*, 1996). Similarly *Waqf* is an everlasting charity, which involves the use of assets like cash, land, and other property. One of the exceptional features of this method is its continuity, which means that such assets cannot be sold or purchased.
2.4.2 Demand-oriented financing

Various researches have been conducted on microfinance as an effective technique for eradicating the extreme poverty and the results have shown that the way these MFIs perceive the demands of the customers have a great impact on such programs. Designing financial products in accordance with the needs of the customers will motivate them to more innovative products, operational efficiency and reaching the remote areas. For example, these products may not only serve the lending purpose but also focus on how to use these loans on other needs, such as health care, education and social responsibilities. As a result more useful financial services will reach the poor and hence their standard of living will improve. This will have a positive impact on the society as whole (Seibel and Parhusip, 1998; Zeller and Meyer, 2002).

Similarly, Islamic financial institutions may present a wide range of financial products and services, which are in accordance with the principles of Sharia and are designed in such a way to meet a variety of the wants and strain of the customers. Such products or services may be categorized as: (1) sharing in profit and loss such as mudarabah and musharakah; (2) barter (muawadat) methods such as murabahah (cost plus profit), bay’ bithaman ‘ajil (selling on deferred payment basis), Salam (forward sale) and Istisna’ (manufacturing activities), and Ijarah (leasing); (3) intentional charitable agreements (tabarru`), for example, pawning agreement (ar- Rahn) and interest-free loans (qard al-hassan) and (4) mixed products such as diminishing musharakah, and (ijarah thumma al-bay’).

2.5 Islamic MFIS and Conventional MFIS: A Comparative Analysis

Both Islamic banking and traditional microfinance practices were initiated in the mid-1970s. Because Islamic banking is still in the age of infancy, it could not attract the attention of the experts and scholars with respect to microfinance products in Islamic banking. Although, it was strongly felt, to finance micro-businesses through MFIs and Islamic banks (see Mohsin 1995 and Yousri 1995), the emerging design which is focused on eradicating extreme poverty, used by the traditional microfinance institutions have not been tested. It has been stated before; that the innovative operating design used by these institutions is feasible to meet the needs of those poor people, who have no access to the conventional financial market because they don’t have any security. Therefore, Islamic
banks may follow the new paradigm presented by the traditional microfinance institutions after adjusting it according to the teachings of sharia. There might be some operational similarities in both traditional and Islamic financial institutions; however, the basic ideology and certain qualitative differences definitely exist, which are explained below:

2.5.1 Sources of Funds

There are many differences between the Islamic financial institutions and traditional microfinance institutions. On the liability side of traditional microfinance institutions, mostly the finances come from national and international NGOs and other agencies, government and the state bank IMFs, however, Islamic banks may also get financial resources from religious institutions of waqf and other forms of charities.

2.5.2 Modes of Financing

Similarly on the asset side, most of the financial resources of the conventional MFIs are interest-based loans, advanced for different business activities, such as trading, manufacturing transportation services. However, interest is strongly forbidden in Islam, therefore, the financial resources of Islamic banks will compose of some other types of interest-free financial products and services. The main feature of Islamic economic system is that, capital may not claim any remuneration in itself; rather all dealings may be backed by some tangible assets. Apart from interest-free loans (qard-hasan), some other techniques may be used by the Islamic banks, such as joint ventures (shirakat) and exchange agreements (mu’awadat). In deferred-sale agreement, payment of the price may be deferred on sale or the delivery of the products may be deferred on sale. The first method is relevant to be applied in microfinance activities, in which the delivery of goods is made in advance while the payment is made at a future date. This method is known as “bay‘-mu’ajjal” in which the products of sale is delivered at the time of the agreement but the payment is deferred.

Similarly, in (murabahah,) products are sold to the customers on cost plus profit basis. Moreover, Ijarah or leasing agreement is another option, in which the customer uses an asset by paying rent. Another method may be the hire-purchase arrangement (ijarah wa iqtina’), where each installment payment covers both rent and part of the cost of the asset. Musharakah may be another option which is suitable in manufacturing and
agriculture businesses. In this arrangement, the Islamic bank contributes in the investment and in return share the profit and loss of the business. In mudarabah type of business, the Islamic bank will contribute the financial resources while the clients take care of the business activities. In the business of agriculture, it is known as muzara‘ah, where the bank buys various assets, such as irrigation system, fertilizers and other equipments, and the farmer use these resources in cultivating different crops, which is divided between the parties at an agreed ratio.

2.5.3 Financing

The Islamic Microfinance Institutions may merge zakah and some other intentional charity (sadaqah) for a better mix of microfinance services to the poor people. Zakah and sadaqah are the main religious instruments for curbing poverty and economic development of the poor Muslims. Zakah is one of the five pillars of Islam and mandatory on well-off Muslims. Thus Zakah and sadaqah may be used to bring the poor people in the main stream (El-Ghazali, 1994, p. 48). Zakah may be incorporated into the microfinance products and services in different ways to help the poor. It may be advanced as interest-free loan or qard e hasan that may be used for consumption or investment activities. Zakah may also be given to the poorest for production purposes. Thus, the merger of zakah and microfinance may result in economic development and improving the standard of living of the poor people.

2.5.4 Amount of Funds Transferred to Beneficiaries

Under the traditional financial system, once the credit is advanced, the MFI allocate part of the loan to different accounts, such as group and emergency funds. However, interest is paid on the total amount of loan advanced to the client. Thus, the interest rate is increasing with the passage of time. Similarly, the client may use the loans for other purposes as well. Under Islamic economic practices, the transactions are baked by real assets and no changes can be made in the price of the goods once it is decided upon between the parties. Hence, cash payments are not involve, miss-use of the assets are difficult rather impossible.

2.5.5 Group Dynamics

kafalah may be used as group guarantee for the repayment of loan, in which each member
is the guarantors of their co-members, who undertakes to assist one another at the time of needs. Thus interest-free loans or *qard-hasan* may be provided to the group members, who face financial difficulties in repaying their loans.

### 2.5.6 Social Development Program

While the substance of the social development plans of traditional microfinance institutions may be against the spirit of Islamic principles, Islamic banks have made it in accordance with *sharia*. In such programs various religious aspects are highlighted. People may easily adapt them because they will feel a sense of worship and it creates social capital such as relations of brotherhood and comradeship, which may assist in returning the loans regularly.

### 2.5.7 Objective of Targeting Women

The purpose of choosing women as clients under the traditional financial system is to make them powerful. The main reason behind this move is to employ women in more productive economic activities and hence improve their standard of living. However, in reality, this is not the case (*Khandker* 1998 and *Rahman* 1999). The male members of the family dominate the affairs of the house and hence they control the financial activities and the loans borrowed by the female members of the family, but the repayment obligation still rest with the women. This creates complications in their families. On the other hand, the target group of Islamic banks is also female members of the society. However, under Islamic banking system, the focus is not only female, rather the family as a whole and it is evident from the fact the agreement is signed by both female and the spouse and both are responsible the repayment of loan. It is understood that bringing women in the main stream may result in better economic output and a prosperous society as a whole. Thus the religious behavior of the Social Development plan will not generate complications among the members of the family.

### 2.5.8 Work Incentive of Staff Members

Under the Islamic banking system, the behavior of the employees may be different as compared to the traditional financial organizations. In the recruitment process, apart from work related skills, the candidates are expected to have the desire and commitment to work for the well-being of the deprived segments of the society. The workers treat their
duty as a religious obligation, which also provide them a source of earning their living. This feeling motivate them to work effectively and efficiently and decreases the avoidance attitude of the employees in IMFIs.

2.5.9 Dealing with Default

To cope with outstanding amounts and defaults, the traditional MFIs may use the group pressure or coercions may be made and lastly the assets of the collateral may be sold to realize the outstanding amount. Islamic banking has a different style to deal in such situations. Such as, the attitude of brotherhood and helping others, motivate them to assist other group members in paying the outstanding loans. The following table highlights the major differences between Islamic MFIs and conventional MFIs.

Table-2.1: Differences between Conventional and Islamic MFIs

| Liabilities (Sources of Funds) | External Funds, Savings of clients | External funds, Savings of clients, Islamic Charitable Sources |
| Assets (Mode of Financing)     | Interest-based                     | Islamic Financial Instruments                               |
| Financing the Poorest          | Poorest are left out                | Poorest can included by integrating zakah with microfinancing |
| Funds transfer                 | Cash given                         | Good transferred                                           |
| Deductions at inception of contract | Part of the funds deducted at inception | No deductions at inception                                    |
| Target group                   | Women                              | Family                                                     |
| Objective of targeting Woman   | Empowerment of women               | Ease of availability                                        |
| Liability of the loan (when given to women) | Recipient | Recipient and spouse                                      |
| Work incentive of employees    | Monetary                           | Monetary and religious                                     |
| Dealing with Default           | Group/center pressure and threats  | Group/center/spouse guarantee, and Islamic ethics          |
| Social Development Program     | Secular (or un-Islamic) behavioral, ethical, and social development | Religious (includes behavior, ethics, and social)          |

Source: (Ahmed, 2002)

2.6 Potential of Islamic Microfinance in Pakistan

Majority of Pakistani population lives in rural parts of the country and agriculture is the major source of earning their livelihood. These poor people are forced to live in immense
poverty. They are strangled in the feudal system and lack proper educational services, health, and other facilities. Demographically, Pakistan is considered as a youthful state, because approximately sixty percent (60%) of the residents are below the age of forty (40) years. Therefore, it represents a vast potential market for the Microfinance services.

Islamic Microfinance services can be provided to the rural population of Pakistan and thus, the Islamic banking industry can exploit this huge potential market. The State Bank of Pakistan may devise such policies to alleviate poverty and Islamic Microfinance services can play a vital role in this regard. Expanding the network of Islamic banks and providing microfinance services in those rural areas, which lag behind in the development process, may bring positive change in eradicating poverty. This may be used as an effective device in eradicating poverty.
Chapter-3

PRODUCTS FOR ISLAMIC MICROFINANCE

There is a large variety of financial services, which may be offered in Microfinance by Islamic Banking. Given below are the proposed products or services, which may be used by Islamic Banks in Microfinancing and advancing micro-credit to its customers.

3.1 Livestock on the basis of Mudarabah

According to this model, the financial institution or bank (Rab-ul-Mal) purchases livestock such as cattle, cow, goat etc for the client (Mudarib). The client takes care of the cattle and profits are shared with the bank in a pre-determined rate, agreed upon by the parties at the time of signing the agreement. Similarly, losses are borne by the Rab-ul-Mal only, unless it is incurred due to the negligence of the client. Therefore, if cattle die, the Rab-ul-Mal may suffer the losses. Moreover, the operating expenses, related to the business are shared by both the parties equally. The sources of revenues include selling milk, offsprings and farmyard manure.

This model of financing is presently being used in rural parts of Swabi and Charsaddah districts. This traditional mode of financing is based on Islamic principles, which is practiced in the livestock business. A guarantor may be engaged by Rab-ul-Mal to manage the risk of default. For this purpose the services of someone, who got good reputation in the village may be hired, for the recovery and supervision of the loans.

3.1.1 Functions of the Bank:

- financial contribution: the bank purchase livestock for the customer on the basis of Mudarabah, to be used in the business.
- 50% of the feed cost is contributed by the bank, in case it is purchased
- The bank also contributes 50% of the cost in the construction of shelter for livestock.
- The bank’s contribution in any the cost of treatment is also 50%.

3.1.2 Functions of the Client:

- The client contributes his/her services, skills and care in Mudarabah.
- The share of clients in the cost of food is 50%, in case it is purchased.
- The client’s construction in the cost of constructing shelter is 50%.
- Similarly, 50% of the treatment cost is contributed by client.

3.1.3 Risks of the Bank:
- Mortality of the cattle: This is a serious risk for the bank. Death of the cattle at an early age and suffering from other diseases, are some of the problems, which the bank has to face.
- Delayed Payments: The poor clients may not be able to repay their loans until the business start yielding some fruits to them. Therefore, bank may wait for a longer period to get back its capital from the clients.
- Capital is stuck: This is another risk which is faced by the bank because investing in the business of livestock may not yield profits urgently.
- Default of client: Default of the client is another serious problem that the bank has to face. The poor client may default in case the business does not produce the desired results.

3.1.4 Risks of client:
- Mortality of the cattle: The client may also face the problem of mortality. Deaths and diseases of livestock are serious problems being faced by the client.
- Loss or no profit: The business may not produce the desired results and can result in little or no profit.
- Credibility is lost: The client may lose credibility if the business does not produce the desired results.

3.1.5 Risk Management by Bank:
- Purchasing good quality cattle may reduce the risk of mortality.
- Shares 10% of the profit with guarantor for his services in the process.
- Purchases cattle through experts in consultation with the client.
- Getting information regarding creditworthiness of the applicant from members of the society.
- To furnish a written agreement, because it may always be helpful to enforce the terms and conditions of the agreement.
3.1.6 Risk Management by client:

- Purchases good quality cattle, which will reduce the risk of mortality.
- Receives training for how to take care of the cattle.
- Links up to veterinary hospital for timely health care facilities.
- Obtains market information from different sources, such as government agencies and NGOs.

If the contents of the agreement are not properly observed, it will be considered as invalid.

3.2 Murabahah financing for agri-business

*Murabahah* may be used as mode of financing for agri-business. Under this model, the bank buys different assets/items and sells them to the farmer on credit, such as seed, fertilizers, water pumps, and generators. Both the parties may agree, to pay a lump-sum amount or payment in installments. However, the farm output in agriculture completed within six months, thus full payment may be more appropriate to the farmers in the shape of two semiannual installment payments. Sales price is determined by the two parties with mutual agreement, at the time of signing the contract, which covers profits and operating costs.

The risk of non-payment and defaults by the customers is the most alarming problem in banking sector. The bank may reduce this risk by taking some steps, such as keeping a proper record, ask for the documents of the property as collateral or ask for a reference, engaging a guarantor (someone who has ability and power to collect the borrowed funds). The agreement may always be in written form. The risks associated to this model and how these risks may be managed, are given below:

### 3.2.1 Risks of Bank:

- Late Payment on part of the client i.e. the farmer.
- Capital gets stuck in a business where the output comes after about six months.
- The risk of default on part of the client is high.

### 3.2.2 Risks of client:

- No Profit or Loss until the crops is ready for harvesting.
3.2.3 Risk Management by Bank:

- Feasibility of Crops, Water, Land, weather, mixture of seeds consumed, may be prepared before entering into the agreement.
- Pre-condition for loaning may be observed strictly.
- Provision for refinancing in case of mishaps, for the coming crop may be introduced.
- Updated about the price variations in the market may be obtained from different sources, such as government agencies and NGOs etc.
- Profit rates may not be stiff, if demand conditions are miserable.
- Engaging the members of society to minimize the risk of default.

3.2.4 Risk Management by client:

- Information related to market may be obtained from different sources, such as government agencies and NGOs etc.
- Profit rate may be realistic, giving fair return to the farmers.
- In case of natural disasters, provision for renewal of the agreement may be provided.

3.3 Live Stock under Murabahah financing (Poultry farm):

According to this arrangement, the financial institution will supply the chicks and their feeds to the client on credit basis. The client will look after and nourish them and sell them to customers so that payment may be made to the bank. The mode of repayment is normally in the form a series of equal amounts periodically. Under the agreement, each party will bear their own expenses, such as; bank will pay for the purchase of chicks and their food, while the customer will pay the operating expenses, such as utility bills, salaries and health care expenses of chickens.

3.3.1 Risks to Bank:

- **High death rate of the chicks due to immaturity of the customers:**
  
  Lake of experience of the client may result in high rate of mortality, because of the inability of the client to take care of the chicks properly.

- **Consumer Default:**
Another major risk to the bank is the risk of default of the client. The bank may consider this risk before advancing loans to anyone. Non payments of loans on part of the clients may be a big risk to the development of the bank. The client may not repay in time because of the failure of the business, any disease may destroy the chicks or there may be some other reasons, which makes it difficult for the client to repay the amount of loan in time.

- **Diseases to the chicks:**
  There are some diseases, which may destroy the chicks. In case, chicks die due to these diseases, it will make it difficult for the client to conduct the business smoothly and eventually the bank will suffer.

### 3.3.2 Risk Management by the bank:

- **Security from the client:**
  In order to deal with the default risk, the bank may demand the client to furnish a collateral or security. For this purpose, the bank may ask for submitting the documents of the property by the client. In case of the failure of the customer to repay the loan, the bank will sell the property to recover the loan.

- **Environmental feasibility and expediency of other resources:**
  The client may choose a place, where the environment is feasible for this type of business and all other facilities, needed to conduct the business smoothly, are easily available. Such as feasibility of climate for the survival of the chickens, transportation medical facilities may be easily approachable.

- **Experienced clients:**
  To eliminate the risk of default, loans may be granted to those customers, who are aware of the poultry business to some extent. Screening out the inexperienced candidates from the proposed borrowers list, may eliminate the risk of default to a great extent. Bank may advance loans to those candidates, who are equipped with the required know-how of the poultry business.

- **Current updates about Market:**
  Regular updates about the fluctuations in the markets may be obtained by
both the parties. Such as information about the prices of chickens, different types of the available checks prices of food stuff and medical facilities.

3.4 Agriculture financing through *Salam*

*Salam* is a special type of financing, which is normally applicable in agricultural business. In this type of financing the price of goods is paid in advance while the delivery is delayed to some future date. *Salam* may be used for those products only, where the specifications of the products are known in advance. The amount received in advance is used acquire different necessary items for the conduct of business operations, such seeds, fertilizers and equipments. After harvesting the crops, the client makes delivery of goods to the bank.

To ensure the timely supply of approved products, the bank may ask the client to furnish collateral like submitting the documents of the ownership of the land. Similarly, to make sure timely delivery of goods, the bank may engage a guarantor, who will responsible for the supply of approved products on the specified dates. Moreover, the risk may be minimized by the bank, to have regular updates about the market prices, signed a written contract and monitor the feasibility of the business such as land, crops and seeds.

3.4.1 Functions of the bank:

- Cash worth say, 10 bags of wheat at current price is provided.
- Involvement of community group for minimizing the risk of default.
- Written contract for smooth functioning of the business.
- Feasibility of Land, Crop, Water, weather, Diseases and type of seed used, before signing the contract.
- Pre-condition for calamities i.e. provision for new contract for refinancing next crop may be provided.
- Market information about the prices, quality and quantity of goods.
- Rate of profit (not principal) may be flexible in case of depressed markets.

3.4.2 Functions of the Customer:

- Purchase seeds, and fertilizers according to the instructions of the bank.
- Return 10 bags of wheat to the bank, according to the agreed specification of quality and time period.
- Written contract may be furnished.
- Feasibility may be made for smooth conduct of the business.
- Market information about the prices of different items may be obtained from government agencies and NGOs.
- Rate of profit should be realistic to provide adequate margin to both bank and the customer.
- Clause for new contract in case of natural calamities may be provided.

### 3.4.3 Risks of the Bank:
- Delayed delivery in case of natural calamities.
- Capital gets stuck because the agriculture output comes after six months.
- Default of customer if natural disasters destroy the fields.

### 3.4.4 Risks of the customer:
- Loss or no profit if the crops do not yield the desired results.
- Credibility is lost if the delivery is not made in time.

### 3.4.5 Risk management by Bank:
- Written contract may be provided.
- Feasibility of Land, Crop, Water, weather, Disease and type of seed used may be made before approval of the deal.
- Pre-condition for calamities i.e. provision for new contract for refinancing next crop may be provided.
- Market information about prices and other matters may be obtained from the government and NGOs.
- Rate of profit (not principal) may be flexible in case of depressed markets.
- Introducing Parallel Salam.
- Involvement of community group for smooth functioning of the business.

### 3.4.6 Risk management by customer
- Written contract may be provided
- Feasibility of the business may be made before entering into the contract.
- Market information about prices and other matters may be obtained from the government and NGOs.
- Rate of profit may be realistic to provide adequate margin to both bank and customer.
Clause for new contract in case of natural calamities may be provided.

3.5 Tuck Shop using Murabahah

Murabahah may be used as a mode of financing to setup a shop as well. This model is feasible because it requires little amount of investment and its operations are less costly. The bank buys the necessary goods for setting up the tuck shop and sells them to the client on credit basis; while, the client is responsible to make repayment of the credit in installments.

To reduce the cost of goods purchased, the bank may prefer such products for financing that are accessible at one point. The bank may also hire the services of an agent, who will act on behalf of the bank for buying the products. The amount of the installment may be decided mutually between the parties, in accordance with the size of the shop. In the above example, the loan was advanced for a period of eighteen months.

On the other hand, the amount of each installment may be arranged in such a way that neither of the parties suffers. Initially, the earnings of the shop may be low and increases with the passage of time, therefore, the amount of installment may be adjusted accordingly.

3.6 Public Call Office (PCO) Using Murabahah

Along with some other modes of financing, Murabahah may be used as a mode of Islamic financing to set up a Public Call Office. The other models, such as Musharakah and Diminishing Musharakah are also feasible to establish this business. Public call offices are characterized by low costs to the bank in terms of management. It is evident from the fact that, many privately owned and public corporations in the telecom industry are heavily investing in such projects. As a result, the clients are provided with fully equipped shop for a P.C.O, furnished by the latest assets, such as the telephone sets, controlling and monitoring systems.

The cost to the client includes the expenses incurred by the bank for acquiring the assets and the profit earned through the resale of the assets to the client. The amount of each installment and the duration of loan are decided with mutual agreement between the two parties. In this model, the loan may be advanced for a period of one and a half years (18 months). According to the mutual agreement between the client and the bank, the
amount of loan may be returned in the form of eighteen equal installments. The risk identified in other Murabahah models also applies here.

3.7 Setting up Service Station (Car wash Center for small Vehicles)

This business is growing rapidly due to the ever-increasing number of personal vehicles and public transport in Pakistan. Since there is a great demand for these services, therefore, establishing a service station may be feasible because the machinery and equipment needed for setting up this business are cheaper. Different modes of financing may be applied to finance this venture such as Murabaha, diminishing Musharakah and Ijarah. In this example, the model is being demonstrated by using Ijarah and Murabaha as modes of financing.

The risk of default may be reduced; if a partnership is established with a group of customers instead of individual customer for advancing the loan. In this model, it is assumed, that a group of two persons was planning to establish a service station as a joint venture and they have applied for the loan to finance this project. As part of the loan agreement, each partner undertakes that, if one partner fails to repay the loan due to any reason, the other partner will be liable to repay the amount of loan on behalf of the bankrupt partner, to the bank.

3.7.1 Establishing service station on the basis of Ijarah:

The procedure of Ijara for setting up a service station is simple and easy to implement. Under this arrangement, the bank acts as lessor and responsible for providing the necessary machinery and equipments to the partnership (lessee) on Ijara basis and charges rent from the lessee for getting benefits from the assets. The bank may remain as the owner of the asset until the lease period is expired and after expiry of the lease agreement the partners may make a one-sided offer to buy the leased asset. The amount of rental charges is decided between the parties and payments of such charges commence from the time when the assets is physically received by the client. In case, the leased assets stop working and need some repairs, then the rent would not be paid until the repairs are made to the equipments. Losses related to the leased asset, caused by wear and tear and other normal losses, will be borne by the bank; while, losses incurred due to the negligence of the client will be borne by him. An imaginary calculation for the cost of setting up a service station for small vehicles is presented below:
<table>
<thead>
<tr>
<th>Name of equipments</th>
<th>Estimated cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pressure Lift equipment</td>
<td>Rs.60,000</td>
</tr>
<tr>
<td>Air Filling equipment</td>
<td>Rs. 20,000</td>
</tr>
<tr>
<td>Water Pump</td>
<td>Rs.26,000</td>
</tr>
<tr>
<td>Other equipments</td>
<td>Rs.6,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Rs.112,000</strong></td>
</tr>
</tbody>
</table>

It is assumed that, the term of *Ijara* is twelve months and the parties has mutually agreed on the amount of monthly rent at Rs. 7000/-; while, the parties has agreed, that the leased asset will be bought by the group after the expiry of the lease agreement.

### 3.7.2 Establishing a service station using *Murabahah* as a mode of financing:

Using *Murabahah* as a mode of financing, to establish a service station for small vehicles, is more suitable to the bank because the risks related to the ownership, are transferred to the group or clients. Similarly, the equipments are worth less in cost; therefore, leasing is not feasible for these assets. A bank may choose any of these modes, keeping in view such factors as the management of the equipments, profitability of the deal and the associated risks. In this case, it is assumed that, the loan is advanced for a period of one and a half year (18 months). An imaginary calculation for the costs to the bank and the client and bank’s profits are presented below:

<table>
<thead>
<tr>
<th>Name of the item</th>
<th>Cost to bank</th>
<th>Cost to client</th>
<th>Banks’ profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pressure lift</td>
<td>Rs.30,000</td>
<td>Rs.36,000</td>
<td>Rs.6000</td>
</tr>
<tr>
<td>Air filling Machine</td>
<td>10,000</td>
<td>14,000</td>
<td>4000</td>
</tr>
<tr>
<td>Water Pump (1.5hp)</td>
<td>13,000</td>
<td>16,000</td>
<td>1000</td>
</tr>
<tr>
<td>Other items</td>
<td>3,000</td>
<td>4,000</td>
<td>1000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>56,000</strong></td>
<td><strong>70,000</strong></td>
<td><strong>14,000</strong></td>
</tr>
</tbody>
</table>
The cost to customer is Rs.70,000/- and covers the expenses for purchasing the equipments and the profit margin charged by the financial institution, which is realized by selling the equipment to the customer. The amount of each installment and the credit term is decided between the two parties as per mutual agreement. In this model, it is assumed that, the loan is advanced for one and a half year (18 months); hence, repayment will be made in 18 equal installments i.e. Rs. 3,889 per month.

3.8 Setting up Tire-Repairing Shop using Ijarah as a mode of financing

Tire-repairing shop may be established using Ijarah as a mode of financing. According to this model, the bank buys the required equipments, for establishing a shop for the client. The shop and equipments are handed over to the client on rental. Meanwhile, the client makes a unilateral contract that he/she will buy the equipment at the expiry of the leasing agreement. Salient features of this arrangement using Ijarah are as follows.

- The bank is responsible for the losses/damages caused to the equipment because the ownership remains with the bank. However, if the damages or losses are caused by the carelessness of the customer, then he/she will be held liable for such losses.
- If the asset is not functioning properly due to any damage, the client is not required to pay the rent to the bank.

For setting up a Tire repair shop, the estimated costs to the bank and time frame for rental charges are given below:

<table>
<thead>
<tr>
<th>Equipment</th>
<th>Rs.60,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Filling machine</td>
<td>Rs.25,000</td>
</tr>
<tr>
<td>Time duration</td>
<td>12 months</td>
</tr>
<tr>
<td>Monthly rentals</td>
<td>Rs.4000</td>
</tr>
<tr>
<td>Total rentals</td>
<td>Rs.48,000</td>
</tr>
</tbody>
</table>

The arrangements call for charging monthly rent of Rs.4000; hence the total accumulated rentals for the full year will be Rs.48,000, which is the total profit of the financial
institution. Similarly, as it was decided in the agreement, the client will make an offer to purchase the asset from the bank after expiry of the term.

### 3.8.1 Risks and risk Management:

- Sometimes an accident or natural disaster may cause serious damages or losses to the business that is borne by the bank. Therefore, to counter such risks, the bank may ask the client for submitting the certificate of performance or a progress report of the business.
- Similarly, normal or daily repairs and maintenance are also paid by the financial institution. These expenses may be controlled if there is a proper system for managing and monitoring the affairs of the business on part of the bank.

### 3.9 Financing Motorcycle Rickshaw through Diminishing Musharakah

Diminishing Musharakah may be used by the bank and the client, to form a joint venture for the purchase of an asset or to start a business. In Diminishing Musharakah, the bank makes major part of the financing, whereas, the client contributes a small proportion. Furthermore, it is pre-decided in the agreement that the client will purchase the ownership of the bank in installments. This will gradually increase his/her share in the ownership of the asset and reduce that of the bank and the process will continue till the entire ownership is transferred to the client.

In this model, the Motor Cycle Rickshaw is purchased for the client. The bank makes major part of the investment, while the rest is contributed by the client. The bank lends the Motor Cycle Rickshaw to the client and charges rent for its usage. Therefore, diminishing Musharakah has the features of both Musharakah and Ijarah, such as the joint ownership in the assets is a type of Musharakah, while the payment of rent to the bank for using the asset may be considered as Ijarah.

The total estimated cost of the Rickshaw is Rs.85,000, of which Rs.70,000 is paid by the bank, while Rs.15,000 is contributed by the client. It may be decided at the time of agreement that the bank will lend the rickshaw to the client on rental basis. The bank will charge rent for his proportion in the ownership of the asset, such as 10% per month of 82.35% of the assets’ value which constitute the ownership of the bank. Ownership status of the parties will vary at different stages as the client gradually buys the ownership of
the bank, thus, the amount of rent also varies for different periods. Moreover, the client has promised to purchase one unit of the bank’s ownership in the asset, after every three months. Both these agreements will be independent of each other, because combining them in one agreement will make them against the provisions of *Shari’ah*.

After taking the possession of Rickshaw, Rs.7000/- will be paid as monthly rent to the financial institution. At the end of the first month, the share of the banks’ ownership in the Rickshaw will be reduced to 82.35%, while that of client to 17.65%. The client will purchase one unit of the banks’ ownership at the end of the first quarter, increasing his/her share in the investment to Rs 25,000/- and reducing the banks’ share to Rs.60,000/- and the monthly rent is decreased to Rs.6000/-. As a result the ownership of the bank is reduced to 70.58%, while that of the client is increased to 29.41%. Thus the ownership of the asset is gradually transferred to the client and this process continues till the client become the sole owner of the Rickshaw. The estimated costs and other ingredients of the process are given below:

<table>
<thead>
<tr>
<th>Total cost of the Rickshaw</th>
<th>Rs.85000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment of the Bank</td>
<td>Rs 70000</td>
</tr>
<tr>
<td>Investment of the Clients</td>
<td>Rs.15000</td>
</tr>
<tr>
<td>Rental charges</td>
<td>10% of the Bank’s contribution</td>
</tr>
<tr>
<td>Total number of shares</td>
<td>7</td>
</tr>
<tr>
<td>Total duration of the agreement</td>
<td>1 year and 9 months</td>
</tr>
</tbody>
</table>

A presentation of the whole process is given in the following table:

<p>| Table 3.1: Diminishing Musharakah as a mode of financing for Motorcycle Rickshaw |
|-------------------------------|------------------|---------------------|-----------------|-----------------|-----------------|</p>
<table>
<thead>
<tr>
<th>Periods</th>
<th>Banks’ investment</th>
<th>Clients’ investment</th>
<th>banks’ share in %</th>
<th>Clients’ share in %</th>
<th>Monthly Rent</th>
<th>Total accumulated rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>70000</td>
<td>15000</td>
<td>82.3529412</td>
<td>17.6470588</td>
<td>7000</td>
<td>7000</td>
</tr>
</tbody>
</table>
The rate of the rent may be determined by the bank in accordance with the prevailing rates in the market. So it can be concluded that, Diminishing Musharakah may be employed by the bank as a mode of financing, because it suites to both the parties i.e. the
client and the financial institution. It is beneficial to the bank because it generates profits, for example the Rs.84,000/- in the above example is the banks’ profit, which is the total amount of rent charged to the client. Diminishing Musharakah is also beneficial to the customer, because it provides a source of earning to him and after getting the full ownership of the asset, this source of earnings rest with him permanently.

This model may be applied in another way, i.e. how to purchase the units and monthly rent etc. This procedure is demonstrated below:

Total cost of the Rickshaw  Rs.85000
Investment of the Bank              Rs.70000
Investment of the Clients           Rs.15000
Rental charges                             10% of the Bank’s contribution
Total number of shares                       20
Per Month (unit cost)                    Rs.3500

<table>
<thead>
<tr>
<th>Periods</th>
<th>Banks’ investment</th>
<th>Clients’ investment</th>
<th>banks’ share in %age</th>
<th>clients’ share in %age</th>
<th>Monthly Rent</th>
<th>Total Rent of the period</th>
<th>Total payment 3500+rent)</th>
<th>Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>70000</td>
<td>15000</td>
<td>82.3529412</td>
<td>17.6470588</td>
<td>7000</td>
<td>7000</td>
<td>10500</td>
<td>19</td>
</tr>
<tr>
<td>2</td>
<td>66500</td>
<td>18500</td>
<td>78.2352941</td>
<td>21.7647059</td>
<td>6650</td>
<td>13650</td>
<td>10150</td>
<td>18</td>
</tr>
<tr>
<td>3</td>
<td>63000</td>
<td>22000</td>
<td>74.1176471</td>
<td>25.8823529</td>
<td>6300</td>
<td>19950</td>
<td>9800</td>
<td>17</td>
</tr>
<tr>
<td>4</td>
<td>59500</td>
<td>25500</td>
<td>70</td>
<td>30</td>
<td>5950</td>
<td>25900</td>
<td>9450</td>
<td>16</td>
</tr>
<tr>
<td>5</td>
<td>56000</td>
<td>29000</td>
<td>65.8823529</td>
<td>34.1176471</td>
<td>5600</td>
<td>31500</td>
<td>9100</td>
<td>15</td>
</tr>
<tr>
<td>6</td>
<td>52500</td>
<td>32500</td>
<td>61.7647059</td>
<td>38.2352941</td>
<td>5250</td>
<td>36750</td>
<td>8750</td>
<td>14</td>
</tr>
<tr>
<td>7</td>
<td>49000</td>
<td>36000</td>
<td>57.6470588</td>
<td>42.3529412</td>
<td>4900</td>
<td>41650</td>
<td>8400</td>
<td>13</td>
</tr>
</tbody>
</table>
3.9.1 Risks of the Bank

- **Client Default**

  There is a high risk of client default. He/she may fail to repay the loan, due to some unforeseen reasons. Similarly, an accident to the asset may result in a default of the client. To reduce such risks, a promise may be taken from the client to purchase the equipment after the expiry of the agreement.

- **Damages**

  There may be some damages to the vehicle, and all the losses are borne by the bank, so the net profit of the bank will decrease or in some cases, may result in a loss, although it happens very rarely.

- **Market Risk**

  The risks associated to market are very high, because the prices of the Rickshaw may fall in the market due to a number of reasons; hence the demand for small

---

<table>
<thead>
<tr>
<th>8</th>
<th>45500</th>
<th>39500</th>
<th>53.5294118</th>
<th>46.4705882</th>
<th>4550</th>
<th>46200</th>
<th>8050</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>42000</td>
<td>43000</td>
<td>49.4117647</td>
<td>50.5882353</td>
<td>4200</td>
<td>50400</td>
<td>7700</td>
<td>11</td>
</tr>
<tr>
<td>10</td>
<td>38500</td>
<td>46500</td>
<td>45.2941176</td>
<td>54.7058824</td>
<td>3850</td>
<td>54250</td>
<td>7350</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>35000</td>
<td>50000</td>
<td>41.1764706</td>
<td>58.8235294</td>
<td>3500</td>
<td>57750</td>
<td>7000</td>
<td>9</td>
</tr>
<tr>
<td>12</td>
<td>31500</td>
<td>53500</td>
<td>37.0588235</td>
<td>62.9411765</td>
<td>3150</td>
<td>60900</td>
<td>6650</td>
<td>8</td>
</tr>
<tr>
<td>13</td>
<td>28000</td>
<td>57000</td>
<td>32.9411765</td>
<td>67.0588235</td>
<td>2800</td>
<td>63700</td>
<td>6300</td>
<td>7</td>
</tr>
<tr>
<td>14</td>
<td>24500</td>
<td>60500</td>
<td>28.8235294</td>
<td>71.1764706</td>
<td>2450</td>
<td>66150</td>
<td>5950</td>
<td>6</td>
</tr>
<tr>
<td>15</td>
<td>21000</td>
<td>64000</td>
<td>24.7058824</td>
<td>75.2941176</td>
<td>2100</td>
<td>68250</td>
<td>5600</td>
<td>5</td>
</tr>
<tr>
<td>16</td>
<td>17500</td>
<td>67500</td>
<td>20.5882353</td>
<td>79.4117647</td>
<td>1750</td>
<td>70000</td>
<td>5250</td>
<td>4</td>
</tr>
<tr>
<td>17</td>
<td>14000</td>
<td>71000</td>
<td>16.4705882</td>
<td>83.5294118</td>
<td>1400</td>
<td>71400</td>
<td>4900</td>
<td>3</td>
</tr>
<tr>
<td>18</td>
<td>10500</td>
<td>74500</td>
<td>12.3529412</td>
<td>87.6470588</td>
<td>1050</td>
<td>72450</td>
<td>4550</td>
<td>2</td>
</tr>
<tr>
<td>19</td>
<td>7000</td>
<td>78000</td>
<td>8.23529412</td>
<td>91.7647059</td>
<td>700</td>
<td>73150</td>
<td>4200</td>
<td>1</td>
</tr>
<tr>
<td>20</td>
<td>3500</td>
<td>81500</td>
<td>4.11764706</td>
<td>95.8823529</td>
<td>350</td>
<td>73500</td>
<td>3850</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Presented by Association for Creation of employment (Executive Director ACE, Muhammad Zahid Elahi) in context of NGOs
loans is badly affected. Similarly, the client may not be able to buy the Rickshaw as it was promised and ultimately the bank will suffer.

3.9.2 Risk Management

- **Security or Collateral**

The bank ask the customer to furnish a security, such as submitting the documents of land or other property through hypothecation or general lien or deposit a certain amount of cash in the bank as security. This may help the bank to manage and reduce the risk of default.

- **Takaful**

For reducing the risks, the bank may offer insurance on those assets, which are being sold to the clients. This may provide protection to the client, in case of any damage or disaster to the asset. Insurance is also useful for the bank, because even if there are no whimsical happenings to the clients, they may repay the loan to the bank in time.
Chapter-4

RESEARCH METHODOLOGY

This section of the thesis includes the details of the plan and the process of making this research operational. It consists of the population of the study, the sampling frame, sample and the methods of sampling selection. The theoretical and analytical framework of the study is also given in this section.

4.1 Population of the Study

The study requires a population of the people having expertise in Islamic Economics, banking and micro finance. Therefore, population for this study includes high profile employees and executives of the financial institutions of Pakistan, with focus on Islamabad and Khyber Pakhtunkhwa (KPK).

4.2 Sampling Frame and Sampling

The nature of the study requires contacting specialists and experienced respondents for the purpose of data collection. For this purpose, a list of all the financial institutions working in the area of Islamic Economics was prepared. The top management personnel’s names were subjected to lottery method of simple random sampling method to attain a representative and reliable sample. The sample size was one hundred (100) top managers and executives. The sample frame was the list of Islamic financial institutions and the second frame was the list of the names of the top managers and executives serving in these institutions.

4.3 Methodology

This research is focused on employing the microfinance products and services within Islamic banking operations, to create an economic environment, which may attract the idle savings of those Muslims, who are reluctant to invest these funds in the conventional banks because of the involvement of interest in their operations. This may facilitate in creating entrepreneurs and generating more job opportunities. The related literature was reviewed, to identify the changes, which have occurred in the loaning process of
Microfinancing and Islamic banking and are presented in the quantitative section of the thesis. Data have been collected through questionnaires and interviews.

4.4 Sources of Data

This was an extensive study on the products of Islamic Microfinance. The data was collected through mixed methods approach (both quantitative and qualitative methods). Secondary data was collected through different sources, such as books, journals, newspapers, magazines, catalogues and websites. While, primary data was collected through interviews, field studies, and online opinion polls.

4.5 Theoretical Framework

The available literature on Microfinance and Islamic modes of financing has recommended that, Islamic Microfinance products and services may be used as powerful tool in curbing the extreme poverty. However, this objective may not be achieved, until the financial sustainability issues of Islamic microfinance institutions are addressed. For example, they should generate enough revenues to cover their operating expenses, costs related to non-performing loans and raising capital and handsome margin of profit. The government and other agencies may provide subsidies and technical support as mechanism to grow a Microfinance industry; however, they may not reach such a large number of clients in the market, although it may be possible for them to do it efficiently or effectively. Similarly, Islamic Microfinance may be an effective device for elevating poverty; however, financially sustainable Microfinance Institutions (MFIs), may not reach the neglected segment of the society effectively. Although, currently it has been observed that, Islamic microfinance intuitions may be financially sustainable and effectively reach the poor people. However, those MFIs which have made poverty elevation as their prime goal and are developing this goal as part of their organizational culture, are more effective at reaching poor segments of the society, as compared to those institutions, who have consider financial objectives as their core goals. It may, therefore, be hypothesize that information and communication technologies have a strong contingent effect on the survival of MFIs in the management of their resources.

The current research is meant to examine the complementary aspects of microfinance schemes and Islamic banking operations in ideological as well as practical
terms, therefore, different important variables that are considered in this study are given below: (See Figure 1)

1. The first type was dependent variables that included transformation of the Microfinance institutions and the Islamic financial institutions.

2. The next set of variables, which included the accounting practices used by these organizations, conventional banking, microfinance institutions and the awareness level in the community, are considered as independent variables.

3. Holistic time frame, coordination among groups and resources were acting as Moderating variables. It is evident from the fact that, time factor may have a strong contingent effect on developing an effective model of Islamic Microfinance within the Islamic banking operations. Similarly, the said model may be the product of development in information and communication technologies and its existence may be dependent on a strong resource-based approach and effective coordination among groups. Thus, coordination among groups and resources along with the holistic time frame may be termed as moderating variables.

4. The last set of variables examined was the intervening variables. Intervening variables included growth model of microfinance and Islamic banking practices, which is the function of independent and variables.

The concept of the proposed model may be further strengthened, according to the earlier theoretical model, which is based on the two-tier Mudarabah i.e. interest is replaced by profit sharing and interest is eliminated from its practices and it is based on partnership.
4.5 Analytical Framework

The chi-square test suits the requirements of goodness-of-fit test for the data of the study. We tested the hypothesis at 5% significance level. Our data is interval and nominal in nature and the proposed test is best suited for hypothesis testing (Champion, 1981). Similarly, descriptive statistics was used for frequencies and percentages as well.

\[ \chi^2 = \sum \left( \frac{(O_k - E_k)^2}{E_k} \right) \]

This follows a chi square distribution with n-1 degrees of freedom.

Where

- \( O_k \) = Observed frequencies in the \( k_{th} \) cell.
- \( E_k \) = Expected frequencies in the \( k_{th} \) cell.
Chapter-5

FINDINGS AND DISCUSSIONS

This chapter contains the outcomes of the analysis, made of the collected data for testing the hypothesis for the execution of stated objectives. The data was analyzed using SPSS (Statistical Package for Social Sciences) and the results are presented in the form of frequency distributions and Bar charts. Chi-square test was applied for testing purposes. The detail of the whole process is presented in the following section:

5.1 Frequency Distribution of Sample, Based on “Gender”

The Islamic Banks operating in banking industry are employing both men and women in their organizations. The sample shows (table 5.1) that, out of 100 respondents, 96.0 % were male and 4.0 % female.

<table>
<thead>
<tr>
<th>Valid</th>
<th>Male</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>96</td>
<td>96.0</td>
<td>96.0</td>
<td>96.0</td>
</tr>
<tr>
<td>Female</td>
<td>4</td>
<td>4.0</td>
<td>4.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*

5.2 Frequency Distribution of Sample on the Basis of “Position held in Organization”

Table 5.2 shows the frequency distribution of sample on the basis of different positions held by the respondents. It is evident from the results that, the highest percent is that of officers, i-e 48.0 %. Managers were 26.0 % of the sample and financial consultants 8.0 %. All the other positions i.e. audit controllers, AVPs, Branch supervisors, managers,
officers, operation officers, RM Corporation and service quality controllers constituted 2%
of the sample.

**Table-5.2: Frequency Distribution of “Position held in Organization”**

<table>
<thead>
<tr>
<th>Position</th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid audit coordinator</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>AVP</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>4.0</td>
</tr>
<tr>
<td>branch supervisor</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>6.0</td>
</tr>
<tr>
<td>financial consultant</td>
<td>8</td>
<td>8.0</td>
<td>8.0</td>
<td>14.0</td>
</tr>
<tr>
<td>In charge</td>
<td>4</td>
<td>4.0</td>
<td>4.0</td>
<td>18.0</td>
</tr>
<tr>
<td>Manager</td>
<td>26</td>
<td>26.0</td>
<td>26.0</td>
<td>44.0</td>
</tr>
<tr>
<td>Officer</td>
<td>48</td>
<td>48.0</td>
<td>48.0</td>
<td>92.0</td>
</tr>
<tr>
<td>Operation</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>94.0</td>
</tr>
<tr>
<td>Personal bank</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>96.0</td>
</tr>
<tr>
<td>RM Corp.</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>98.0</td>
</tr>
<tr>
<td>Service quality</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.3 Distribution of Sample Respondents on the basis of “Education”

The highest level of education possessed by the respondents was post graduation. They constituted 78.0 % of the sample. 2 % were possessing technical diplomas. Graduates were 12.0 %, while 6.0 % were undergraduate degree holders.

Table-5.3: Frequency distribution of “Highest Level of Education”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undergraduate degree</td>
<td>6</td>
<td>6.0</td>
<td>6.1</td>
<td>6.1</td>
</tr>
<tr>
<td>Postgraduate degree</td>
<td>78</td>
<td>78.0</td>
<td>79.6</td>
<td>85.7</td>
</tr>
<tr>
<td>Technical Education</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>87.8</td>
</tr>
<tr>
<td>Graduation</td>
<td>12</td>
<td>12.0</td>
<td>12.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.4 Distribution of Sample on the basis of “Duration on the current Post”

The length of time for which the position is held by employees in the institution is presented in table 5.4. It shows that 14.0 % of the employees had spent less than one year on the present post, 34.0 % spent more than three years; whereas. The highest number of employees, i.e. 52 %, has spent between one and three years in their current position.

Table-5.4: Frequency distribution of “Duration on current Post”

<table>
<thead>
<tr>
<th></th>
<th>( f )</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid less than one year</td>
<td>14</td>
<td>14.0</td>
<td>14.0</td>
<td>14.0</td>
</tr>
<tr>
<td>1 to 3 yrs</td>
<td>52</td>
<td>52.0</td>
<td>52.0</td>
<td>66.0</td>
</tr>
<tr>
<td>more than 3 yrs</td>
<td>34</td>
<td>34.0</td>
<td>34.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.5 Distribution of Sample Respondents based on “Work experience in Organization”

Table 5.5 relates to the frequency distribution of respondents, based on their experience in the organization, while serving in various positions. It shows that most of them, i.e. 48 % have an experience of one to three years in the organization. 30 % for four to six years, 12 % for less than one year and 10% have spent more than six years in the organization.

<table>
<thead>
<tr>
<th>Valid</th>
<th>Less than one yr</th>
<th>12</th>
<th>12.0</th>
<th>12.0</th>
<th>12.0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 to 3 yrs</td>
<td>48</td>
<td>48.0</td>
<td>48.0</td>
<td>60.0</td>
</tr>
<tr>
<td></td>
<td>4 to 6 yrs</td>
<td>30</td>
<td>30.0</td>
<td>30.0</td>
<td>90.0</td>
</tr>
<tr>
<td></td>
<td>more than 6 yrs</td>
<td>10</td>
<td>10.0</td>
<td>10.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: survey*

5.6 Distribution of Sample Respondents on the basis of “training in Islamic Banking”

Training helps workers in an organized manner, to equip them for the job requirements. Employees working in Islamic banking (table 5.6) were not trained well in the field of Islamic banking. Most of them (i.e. 74 %) have gone through different training programs while 26 % were not trained at all in this respect.
Table-5.6: Frequency Distribution of respondents’ “Training in Islamic Banking”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Yes</td>
<td>74</td>
<td>74.0</td>
<td>74.0</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>26</td>
<td>26.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: survey

5.7 Distribution of Organization based on “Status in Islamic Banking”

The Islamic banking is involved in providing a variety of financial products and services to its customers. Few of them are full fledge Islamic banks (table 5.7) which accounts for 68 % of the total. Stand alone Islamic branches are 22 % and subsidiaries 10 %.

Table-5.7: Frequency Distribution of Organization’s “status in IB”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Full fledge Islamic bank</td>
<td>68</td>
<td>68.0</td>
<td>68.0</td>
</tr>
<tr>
<td></td>
<td>Stand alone Islamic banking branch</td>
<td>22</td>
<td>22.0</td>
<td>90.0</td>
</tr>
<tr>
<td></td>
<td>Subsidiary</td>
<td>10</td>
<td>10.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: survey
5.8 Distribution of “Products Offered by Islamic Banking”

Islamic banks are dealing a range of financial services, which conform to the principles of *shariah*. Table 5.8 explains that 36% of the products offered by these banks constituted the types of *Ijarah*, *Musharakah*, *Mudarabah* and *Murabahah*. Moreover, 30% of the products are in the form of *Ijarah*, *Murabahah* and *Musharakah*. The remaining 34% are *Musharakah*, *Mudarabah* and *Murabahah* and *Ijarah* loans.

**Table-5.8: Frequency Distribution of “Products Offered by Islamic Banking”**

<table>
<thead>
<tr>
<th>Valid Products</th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Musharakah, Mudarabah, Murabahah, Ijarah</td>
<td>36</td>
<td>36.0</td>
<td>36.0</td>
<td>36.0</td>
</tr>
<tr>
<td>Musharakah, Murabahah, Ijarah</td>
<td>30</td>
<td>30.0</td>
<td>30.0</td>
<td>66.0</td>
</tr>
<tr>
<td>Musharakah, Mudarabah, Murabahah, Ijarah, loan</td>
<td>34</td>
<td>34.0</td>
<td>34.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: survey*

5.9 Distribution of Organization on the Basis of “Time-span spent in Islamic Banking”

Table 5.9 shows that most of the banks (80%) have started Islamic banking operations in the near past. It means that Islamic banking is new phenomena. Only 2% have begun it
11 to 20 years ago and 14% have six to ten years experience. The data shows that Islamic banking industry has evolved over time in Pakistan.

**Table-5.9: Frequency Distribution of “Time-span in Islamic Banking”**

<table>
<thead>
<tr>
<th>Time-span</th>
<th>Valid</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 5 yrs</td>
<td>80</td>
<td>80.0</td>
<td>83.3</td>
<td>83.3</td>
</tr>
<tr>
<td>6-10 yrs</td>
<td>14</td>
<td>14.0</td>
<td>14.6</td>
<td>97.9</td>
</tr>
<tr>
<td>11-20 yrs</td>
<td>2</td>
<td>2.0</td>
<td>2.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>96.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>4</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*

**5.10 Nature Of organization on the basis of ownership**

Table 5.10 shows the distribution of organizations operating in Islamic banking on the basis of their ownership status. It is evident that the highest percentage (36%) is that of totally foreign owned organizations, 34% owned jointly by both foreign and domestic owners while 30% of the organizations are totally domestic owned.
Table 5.10: Frequency distribution of “Nature of Organization on the basis of Ownership”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totally domestic owned</td>
<td>30</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Domestic/foreign jointly owned</td>
<td>34</td>
<td>34.0</td>
<td>34.0</td>
<td>64.0</td>
</tr>
<tr>
<td>Totally foreign owned</td>
<td>36</td>
<td>36.0</td>
<td>36.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: survey

5.11 Grading of the Organizational Success

Table 5.11 shows different grades assigned to organizations, based on level of their success. According to the results, 68% of the Islamic banks are considered as successful to provide Islamic banking services while continue to be profitable. Similarly, 30% organizations are partially successful and only 2% at break even.

Table 5.11: Frequency Distribution of Organizations on the basis of its success

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Successful</td>
<td>68</td>
<td>68.0</td>
<td>68.0</td>
<td>68.0</td>
</tr>
<tr>
<td>partially successful</td>
<td>30</td>
<td>30.0</td>
<td>30.0</td>
<td>98.0</td>
</tr>
<tr>
<td>break even</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.12 Offerings of Microfinance Services

The banks operating in Islamic banking offer microfinance services only to a small extent as exhibited in Table 5.12. Only 24% of the banks offer microfinance services and the rest (74%) have no such facility.

Table 5.12: Frequency Distribution of Organizations on basis of “Offerings of MF services”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Yes</td>
<td>24</td>
<td>24.0</td>
<td>24.5</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>74</td>
<td>74.0</td>
<td>75.5</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: survey

5.13 Why Islamic banks have not explored the potential of Islamic microfinance services

There are various reasons why Islamic banks have still not explored the potential of Islamic microfinance services. According to the collected data, 42% are of the views that Islamic banking could not achieve its potential target because of the low level of awareness in the society, 6% are of the opinion that loss in business by the clients led to this situation, 24% attributed it to ineffective management of the organizations and 4% attributed it the lack of interest by Government. Thus Islamic banking has under achieved its potential in Pakistan.
Table 5.13: Frequency Distribution of “why Islamic banks have not explored the potential of Islamic microfinance services”

<table>
<thead>
<tr>
<th></th>
<th>Valid Percent</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Awareness</td>
<td>42</td>
<td>55.3</td>
</tr>
<tr>
<td>Loss</td>
<td>6</td>
<td>63.2</td>
</tr>
<tr>
<td>Management</td>
<td>24</td>
<td>94.7</td>
</tr>
<tr>
<td>Government</td>
<td>4</td>
<td>100.0</td>
</tr>
<tr>
<td>system</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: survey

5.14 Integrating MF and IB operations Need New Accounting Procedures

Table 5.14 shows the responses regarding the probable need of new accounting practices. A high percentage the respondents agreed to the statement. 26% strongly agreed, 54% agreed, 8% disagreed and 8% uncertain whereas, 2% strongly disagreed. Hence, it may be concluded that new accounting practices may be introduced in Islamic banking.
Table-5.14: Frequency Distribution showing “integrating MF and IB operations need New Accounting Procedures”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Strongly agreed</td>
<td>26</td>
<td>26.0</td>
<td>26.5</td>
<td>26.5</td>
</tr>
<tr>
<td>Valid Agreed</td>
<td>54</td>
<td>54.0</td>
<td>55.1</td>
<td>81.6</td>
</tr>
<tr>
<td>Valid Uncertain</td>
<td>8</td>
<td>8.0</td>
<td>8.2</td>
<td>89.8</td>
</tr>
<tr>
<td>Valid Disagreed</td>
<td>8</td>
<td>8.0</td>
<td>8.2</td>
<td>98.0</td>
</tr>
<tr>
<td>Valid Strongly disagreed</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Valid Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*

5.15 Integrating MF and IB operations Need Awareness Programs

The responses about need for awareness programs are presented in table 5.15, which shows that majority of the respondents either agreed (i.e. 42%) or strongly agreed (i.e. 54%) that there can be a strong campaign for need awareness programs regarding Islamic banking.
Table-5.15: Frequency distribution showing “Integrating MF and IB operations need Awareness Programs”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>54</td>
<td>54.0</td>
<td>55.1</td>
<td>55.1</td>
</tr>
<tr>
<td>Agreed</td>
<td>42</td>
<td>42.0</td>
<td>42.9</td>
<td>98.0</td>
</tr>
<tr>
<td>Disagreed</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.16 Integrating MF and IB operations need technological change

Technology plays a vital role in the economic development and growth. To introduce advanced technologies in Islamic banking, 26 % respondents were in strong agreement, 46 % agreed, 12 % uncertain and a same percentage disagreed to the argument that advanced technologies may be introduced in Islamic banking.

Table-5.16: Frequency distribution representing “Integrating MF and IB operations need technological change”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>26</td>
<td>26.0</td>
<td>27.1</td>
<td>27.1</td>
</tr>
<tr>
<td>Agreed</td>
<td>46</td>
<td>46.0</td>
<td>47.9</td>
<td>75.0</td>
</tr>
<tr>
<td>Uncertain</td>
<td>12</td>
<td>12.0</td>
<td>12.5</td>
<td>87.5</td>
</tr>
<tr>
<td>Disagreed</td>
<td>12</td>
<td>12.0</td>
<td>12.5</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>96.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>4</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey

5.17 Integrating MF and IB operations need Assistance from other MFI’s

An organization may seek guidance from the pioneer organizations in the industry to improve its performance. The results of responses about the argument that, whether Islamic banks should take help from other Microfinance institutions or not, are presented in table 5.17. 26 % of the respondents strongly agreed, 42 % agreed, 20 % uncertain and 10 % disagreed with the proposition.
Table-5.17: Frequency Distribution of “Integrating MF and IB operations need Assistance from other MFI's”

<table>
<thead>
<tr>
<th></th>
<th>$f$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>26</td>
<td>26.0</td>
<td>26.5</td>
<td>26.5</td>
</tr>
<tr>
<td>Agreed</td>
<td>42</td>
<td>42.0</td>
<td>42.9</td>
<td>69.4</td>
</tr>
<tr>
<td>Uncertain</td>
<td>20</td>
<td>20.0</td>
<td>20.4</td>
<td>89.8</td>
</tr>
<tr>
<td>Disagreed</td>
<td>10</td>
<td>10.0</td>
<td>10.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*

### 5.18 Pursuing Islamic Microfinance will result in Poverty Alleviation

Table 5.18 shows the responses that, perusing Islamic microfinance will result in poverty alleviation. 36% of the respondents strongly agreed to the notion whereas 48% agreed and 14% uncertain.
Table-5.18: Frequency distribution of Responses about “Pursuing Islamic Microfinance will Result in Poverty Alleviation”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>36</td>
<td>36.0</td>
<td>36.7</td>
<td>36.7</td>
</tr>
<tr>
<td>Agreed</td>
<td>48</td>
<td>48.0</td>
<td>49.0</td>
<td>85.7</td>
</tr>
<tr>
<td>Uncertain</td>
<td>14</td>
<td>14.0</td>
<td>14.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.19 Pursuing Islamic Microfinance will Increase Employment Opportunities

About 36% respondents were in strong agreement that perusing Islamic Microfinance will increases employment opportunities (table 5.19). 46% of the respondents agreed, 14% uncertain and 2% disagreed. Results were recorded in context of increase in employment by pursuing Islamic banking.

Table-5.19: Frequency distribution of responses about “Islamic Microfinance persuasion will Increase Employment Opportunities”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Strongly agreed</td>
<td>36</td>
<td>36.0</td>
<td>36.7</td>
<td>36.7</td>
</tr>
<tr>
<td></td>
<td>Agreed</td>
<td>46</td>
<td>46.0</td>
<td>46.9</td>
</tr>
<tr>
<td></td>
<td>Uncertain</td>
<td>14</td>
<td>14.0</td>
<td>14.3</td>
</tr>
<tr>
<td></td>
<td>Disagreed</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Missing System</td>
<td></td>
<td>2</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.20 Pursuing Islamic Microfinance will Result in improving the standard of living of poor

Table 5.20 contains the summary of responses that, perusing Islamic banking will result in improving the standard of living of the poor. According to the statistics, 30% of the respondents strongly agreed, whereas 46% agreed to the statement. The uncertainty was 12% and disagreement 8%.

Table 5.20: Frequency distribution of responses about “pursuing Islamic Microfinance will Result in Improving Standard of Living of the Poor”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>30</td>
<td>30.0</td>
<td>31.2</td>
<td>31.2</td>
</tr>
<tr>
<td>Agreed</td>
<td>46</td>
<td>46.0</td>
<td>47.9</td>
<td>79.2</td>
</tr>
<tr>
<td>Uncertain</td>
<td>12</td>
<td>12.0</td>
<td>12.5</td>
<td>91.7</td>
</tr>
<tr>
<td>Disagreed</td>
<td>8</td>
<td>8.0</td>
<td>8.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>96.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>4</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.21 Pursuing Islamic Microfinance will result in equitable distribution of wealth

Table 5.21 shows a mixed opinion about, pursuing Islamic microfinance will result in equitable distribution of wealth. There was a significant level of uncertainty, i.e. 22% and 18% of the respondents were in disagreement. However 22% strongly agreed and 32% agreed that, perusing Islamic banking can ensure equitable distribution of wealth in society.

Table-5.21: Frequency distribution of responses about “Pursuing Islamic Microfinance will Result in Equitable Distribution of Wealth”

<table>
<thead>
<tr>
<th></th>
<th>f</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>agreed</td>
<td>22</td>
<td>22.0</td>
<td>22.9</td>
<td>22.9</td>
</tr>
<tr>
<td>Agreed</td>
<td>32</td>
<td>32.0</td>
<td>33.3</td>
<td>56.2</td>
</tr>
<tr>
<td>Uncertain</td>
<td>22</td>
<td>22.0</td>
<td>22.9</td>
<td>79.2</td>
</tr>
<tr>
<td>Disagreed</td>
<td>18</td>
<td>18.0</td>
<td>18.8</td>
<td>97.9</td>
</tr>
<tr>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>disagreed</td>
<td>2</td>
<td>2.0</td>
<td>2.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>96.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>4</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.22 Possibility of Integrating Microfinance and Islamic banking

The responses about the possibility of integration of Microfinance and Islamic banking are shown in table 5.22. The results show that 32% responded that it is very likely possible that there would be integration, 48% responded likely and 14% were uncertain about this integration. 2% of the respondents were of the view that, it is unlikely to integrate microfinance and Islamic banking.

Table-5.22: Frequency distribution about the “possibility of Integrating Microfinance into Islamic Banking”

<table>
<thead>
<tr>
<th></th>
<th>f</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Very likely</td>
<td>32</td>
<td>32.0</td>
<td>33.3</td>
<td>33.3</td>
</tr>
<tr>
<td>Likely</td>
<td>48</td>
<td>48.0</td>
<td>50.0</td>
<td>83.3</td>
</tr>
<tr>
<td>Uncertain</td>
<td>14</td>
<td>14.0</td>
<td>14.6</td>
<td>97.9</td>
</tr>
<tr>
<td>Unlikely</td>
<td>2</td>
<td>2.0</td>
<td>2.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>96</td>
<td>96.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.23 Integration of Microfinance within Islamic banking is feasible because both have same guiding principles

The respondents were asked about the feasibility of integration of Microfinance into Islamic banking. Their responses are given in table 5.23, which shows that, most of the respondents replied in favor of the argument and 28 % strongly agreed. 18% respondents were uncertain and 4% disagreed to the statement.

Table-5.23: Frequency distribution of “Integration of Microfinance within Islamic banking is feasible because both have same guiding principles”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>28</td>
<td>28.0</td>
<td>28.6</td>
<td>28.6</td>
</tr>
<tr>
<td>Agreed</td>
<td>48</td>
<td>48.0</td>
<td>49.0</td>
<td>77.6</td>
</tr>
<tr>
<td>Uncertain</td>
<td>18</td>
<td>18.0</td>
<td>18.4</td>
<td>95.9</td>
</tr>
<tr>
<td>Disagreed</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.24 Integration of Microfinance within Islamic banking is feasible because both serve the same purpose

The purpose of Microfinance and Islamic banking are similar; therefore, it is possible to integrate them. Most of the respondents replied in favor of this argument. 34% of the respondents showed strong agreement to the statement, 40% agreed, 18% uncertain and only 6% disagreed to the statement about the integration of microfinance and Islamic banking on the basis of purpose.

Table-5.24: Frequency distribution showing “Integration of Microfinance into Islamic Banking is Feasible because both serve the same purpose”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>34</td>
<td>34.0</td>
<td>34.7</td>
<td>34.7</td>
</tr>
<tr>
<td>Agreed</td>
<td>40</td>
<td>40.0</td>
<td>40.8</td>
<td>75.5</td>
</tr>
<tr>
<td>Uncertain</td>
<td>18</td>
<td>18.0</td>
<td>18.4</td>
<td>93.9</td>
</tr>
<tr>
<td>Disagreed</td>
<td>6</td>
<td>6.0</td>
<td>6.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.25 Integration of Microfinance and Islamic Banking is feasible because both can have a special Niche Market

Another resemblance between Microfinance and Islamic banking is that, both have same niche market. Therefore, no disagreement was recorded to the argument. 44% of the respondents agreed, and 34 % strongly agreed whereas, 20 % uncertainty was also observed.

Table-5.25: Frequency distribution showing “Integration of Microfinance and IB is feasible because both can have a special Niche Market”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agreed</td>
<td>34</td>
<td>34.0</td>
<td>34.7</td>
<td>34.7</td>
</tr>
<tr>
<td>Agreed</td>
<td>44</td>
<td>44.0</td>
<td>44.9</td>
<td>79.6</td>
</tr>
<tr>
<td>Uncertain</td>
<td>20</td>
<td>20.0</td>
<td>20.4</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.26 Integration of Microfinance and Islamic Banking is feasible because there is a pressing need for Islamic Microfinance services

Islamic Microfinance is the need of the hour and it can be a probable rationale for integration. Table 5.26 is a presentation the results about this argument. It shows that 4 % of the respondents strongly disagreed and 4 % disagreed to this statement; there was an uncertainty of 4 % whereas the agreed respondents constituted 60 % whereas, strongly agreed were 26 % of the sample.

**Table-5.26: Frequency Distribution of “Integration of Microfinance and Islamic Banking is feasible because there is a pressing need for Islamic Microfinance services”**

<table>
<thead>
<tr>
<th>Valid</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agreed</td>
<td>26</td>
<td>26.0</td>
<td>26.5</td>
</tr>
<tr>
<td>Agreed</td>
<td>60</td>
<td>60.0</td>
<td>61.2</td>
</tr>
<tr>
<td>Uncertain</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Disagreed</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Strongly disagreed</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Missing</td>
<td>2</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.27 Implementing Microfinance within Islamic banking operations needs qualified workforce

Table 5.27 shows the need for qualified workforce for microfinance in the context of Islamic banking. Majority of the respondents (i.e. 64%) strongly agreed and 30% agreed that there should be a qualified workforce who are trained and well equipped in the areas of Islamic banking and microfinance, for the success of Islamic microfinance.

Table-5.27: Frequency distribution of “Implementing Microfinance within Islamic banking operations needs qualified workforce”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>64</td>
<td>64.0</td>
<td>65.3</td>
<td>65.3</td>
</tr>
<tr>
<td>Agree</td>
<td>30</td>
<td>30.0</td>
<td>30.6</td>
<td>95.9</td>
</tr>
<tr>
<td>Uncertain</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey

5.28 Implementing Microfinance within Islamic banking operations needs Training and Capacity building Programs for employees

Table 5.28 shows need of Training and Capacity building Programs for employees. Results show that the highest percentage of the respondents (i.e. 76%) strongly agreed and 20%
agreed that there may be Trainings and Capacity Building programs for improving the performance of Microfinance in context of Islamic banking.

**Table-5.28: Frequency Distribution of “Implementing Microfinance within Islamic banking operations needs Training and Capacity building Programs for employees”**

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valid</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>76</td>
<td>76.0</td>
<td>77.6</td>
<td>77.6</td>
</tr>
<tr>
<td>Agree</td>
<td>20</td>
<td>20.0</td>
<td>20.4</td>
<td>98.0</td>
</tr>
<tr>
<td>Uncertain</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td><strong>Missing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*

**5.29 Implementing MF within IB operations needs Special Task Force**

Table 5.29 shows the need for special task force for implementing microfinance in the context of Islamic Banking. The results show that, 70% of the respondents agreed and 20% strongly agreed to the statement. 2% of the respondents disagreed and 6% uncertainty was
also recorded. Thus, most of the respondents agreed to the argument that microfinance needs special task force for its success.

Table-5.29: Frequency distribution of “Implementing MF within IB operations needs Special Task Force”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Strongly agree</td>
<td>20</td>
<td>20.0</td>
<td>20.4</td>
<td>20.4</td>
</tr>
<tr>
<td>Agree</td>
<td>70</td>
<td>70.0</td>
<td>71.4</td>
<td>91.8</td>
</tr>
<tr>
<td>Uncertain</td>
<td>6</td>
<td>6.0</td>
<td>6.1</td>
<td>98.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.30 Implementing MF within IB operations needs Extensive Marketing and Awareness campaigns for introducing products of IMF in the market

Table 5.30 is a presentation of responses for the conducting extensive marketing and awareness programs for microfinance in the context of Islamic banking. The results show that, a high percentage of respondents (i.e. 48%) were in strong agreement and 38% agreed that, there may be an extensive marketing and awareness campaign to introduce Islamic Microfinance to the market. 8 % were uncertain and 4% disagreed to the statement.

**Table-5.30: Frequency distribution of “Implementing MF within IB operations needs Extensive Marketing and Awareness campaigns”**

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>48</td>
<td>48.0</td>
<td>49.0</td>
<td>49.0</td>
</tr>
<tr>
<td>Agree</td>
<td>38</td>
<td>38.0</td>
<td>38.8</td>
<td>87.8</td>
</tr>
<tr>
<td>Uncertain</td>
<td>8</td>
<td>8.0</td>
<td>8.2</td>
<td>95.9</td>
</tr>
<tr>
<td>Disagree</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.31 Implementing MF within IB operations needs to reach Rural and Suburban areas

The success of Islamic Microfinance in Pakistan, where majority of the population is living in rural and suburban areas depends upon the access to these markets. Table 5.31 shows the need for reaching the rural and suburban areas, for the success of Islamic microfinance. The results show that, 52% of the respondents strongly agreed that microfinance services may target the suburban and rural areas, 42% agreed whereas 4% were uncertain.

Table-5.31: Frequency distribution of “Implementing MF within IB operations needs to reach Rural and Suburban areas”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>52</td>
<td>52.0</td>
<td>53.1</td>
<td>53.1</td>
</tr>
<tr>
<td>Agree</td>
<td>42</td>
<td>42.0</td>
<td>42.9</td>
<td>95.9</td>
</tr>
<tr>
<td>Uncertain</td>
<td>4</td>
<td>4.0</td>
<td>4.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.32 Implementing MF within IB operations needs the use of modern Technology such as mobile banking and e-banking

Table 5.32 contains responses regarding introduction and use of new and advanced technology such as mobile banking and e-banking for the success of microfinance in the context of Islamic Banking. It shows that, 52% respondents agreed and 32% strongly agreed to the statement. Whereas 10% were uncertain; 2% disagreed and 2% strongly disagreed.

Table-5.32: Frequency distribution of “Implementing MF within IB operations needs the use of modern Technology”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>32</td>
<td>32.0</td>
<td>32.7</td>
<td>32.7</td>
</tr>
<tr>
<td>Agree</td>
<td>52</td>
<td>52.0</td>
<td>53.1</td>
<td>85.7</td>
</tr>
<tr>
<td>Uncertain</td>
<td>10</td>
<td>10.0</td>
<td>10.2</td>
<td>95.9</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>98.0</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>2</td>
<td>2.0</td>
<td>2.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.33 Implementing MF within IB operations needs Support from Government and Civil society

Table 5.33 is a summary of the responses that, the success of Islamic Microfinance needs the support from Government and civil society. There was no disagreement in the respondent’s views about this proposition. Whereas 10% of the respondents were uncertain, 42% agreed and 46% strongly agreed that, the success of microfinance in the context of Islamic Banking need the support from government and civil society.

Table-5.33: Frequency distribution of “Implementing MF within IB operations needs Support from Government and Civil society”

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly agree</td>
<td>46</td>
<td>46.0</td>
<td>46.9</td>
<td>46.9</td>
</tr>
<tr>
<td>Agree</td>
<td>42</td>
<td>42.0</td>
<td>42.9</td>
<td>89.8</td>
</tr>
<tr>
<td>Uncertain</td>
<td>10</td>
<td>10.0</td>
<td>10.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>98</td>
<td>98.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>2</td>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.34 Major Problems of Islamic Microfinance

According to 20% respondents, complexity of procedures is the 1st major problem of IM. These respondents are of the view that, customers of Islamic microfinance need to go through a complicated procedure to avail this facility.

High rate of mark up is one of the reasons to discourage customers from using Islamic microfinance services. Therefore, 16% of the respondents are of the view that, high rate of markup is the next major problem of Islamic microfinance.

Some of the respondents are of the view that, terms and conditions for obtaining Islamic microfinance loans are not supportive, which discourage customers to use this facility. Therefore, according to 16% respondents, terms and conditions of the loan is the third major problem of Islamic microfinance.

Every organization needs running finance for their basic business needs. To avail this facility, customers are required to provide collateral to the financial institutions. The customers of Islamic microfinance are usually fragile in this respect; therefore, 12% of the respondents are of the opinion that, running finance is the 4th major problem of Islamic microfinance.

Although the government of Pakistan is encouraging Islamic microfinance, further efforts are needed on part of the government to explore the potential of this facility. According to 18% respondents, lack of government support is the 5th major problem of Islamic microfinance.
Table-5.34: Major Problems of Islamic Microfinance

<table>
<thead>
<tr>
<th></th>
<th>$F$</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>1</td>
<td>20.0</td>
<td>24.4</td>
<td>24.4</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>16.0</td>
<td>19.5</td>
<td>43.9</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>16.0</td>
<td>19.5</td>
<td>63.4</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>12.0</td>
<td>14.6</td>
<td>78.0</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>18.0</td>
<td>22.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>82</td>
<td>82.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td>System</td>
<td>18</td>
<td>18.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey

5.35 Proposed Products for Islamic Microfinance

Respondents were asked about the proposed products for Islamic microfinance, based on their experience in Islamic banking. The results are shown in table 5.39. 24% of the respondents proposed *Musharakah, Ijarah* and *Istisna* as the proposed products or Islamic Microfinance whereas 26% proposed loans. Serial approval was proposed by 18 % and *Murabahah, Ijarah, Salam, Istihna* by 12 %, whereas, *Ijara* was proposed by the lowest number of respondents i.e. 2%.
<table>
<thead>
<tr>
<th>Valid</th>
<th>Serial approval</th>
<th>18</th>
<th>18.0</th>
<th>22.0</th>
<th>22.0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Musharakah, Ijarah, Istihna</td>
<td>24</td>
<td>24.0</td>
<td>29.3</td>
<td>51.2</td>
</tr>
<tr>
<td></td>
<td>Ijarah</td>
<td>2</td>
<td>2.0</td>
<td>2.4</td>
<td>53.7</td>
</tr>
<tr>
<td></td>
<td>Murabahah, Ijarah, Salam, Istihna</td>
<td>12</td>
<td>12.0</td>
<td>14.6</td>
<td>68.3</td>
</tr>
<tr>
<td>Loan</td>
<td>26</td>
<td>26.0</td>
<td>31.7</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>82</td>
<td>82.0</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td>System</td>
<td>18</td>
<td>18.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.36 Is organizational Transformation of IB for Integrating IMF essential?

The respondents were asked, whether transformation of IB for integrating Islamic Microfinance is essential. 26% responded positively that, it is essential to transform Islamic banking for integrating Islamic microfinance as a separate setup. 2% of the respondents are of the view that organizational transformation of Islamic banking for integrating Islamic microfinance needs financial support. 14% of the respondents are against the statement. According to these respondents, transformation of IB for Integrating IMF is not essential. However, a similar percentage was of the view that, it is essential in the form of pure IB (Table- 5.36)

Table-5.36: Frequency Distribution of “Is transformation of IB essential for
Integrating IMF?”

<table>
<thead>
<tr>
<th></th>
<th>f</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes for separate setup</td>
<td>26</td>
<td>26.0</td>
<td>46.4</td>
<td>46.4</td>
</tr>
<tr>
<td>financial support</td>
<td>2</td>
<td>2.0</td>
<td>3.6</td>
<td>50.0</td>
</tr>
<tr>
<td>Yes for pure IB</td>
<td>14</td>
<td>14.0</td>
<td>25.0</td>
<td>75.0</td>
</tr>
<tr>
<td>No</td>
<td>14</td>
<td>14.0</td>
<td>25.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>56.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>44</td>
<td>44.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: survey*
5.37 Benefits derived from Transformation of IB into IMF

According to 4 % respondents, transformation of IB to IMF is important because, it will result in economic and financial growth and development, 34 % were of the opinion that, it may generate more jobs and reach more people in the society. Whereas, according to 12% respondents, implementation of Islamic banking procedures may become easy. 2% of the respondents were of the view that, no benefit can be derived from transformation of IB into IMF. These statistics are shown in table 5.37.

Table-5.37: Frequency Distribution of “benefits derived from Transformation of IB into IM”

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth and development</td>
<td>4</td>
<td>4.0</td>
<td>7.7</td>
<td>7.7</td>
</tr>
<tr>
<td>Jobs and more outreach</td>
<td>34</td>
<td>34.0</td>
<td>65.4</td>
<td>73.1</td>
</tr>
<tr>
<td>to general public</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Islamic procedures can</td>
<td>12</td>
<td>12.0</td>
<td>23.1</td>
<td>96.2</td>
</tr>
<tr>
<td>be implemented</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No benefit</td>
<td>2</td>
<td>2.0</td>
<td>3.8</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>52.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System</td>
<td>48</td>
<td>48.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.38 Suggestions for the proposed Co-Integrated System

Most of the respondents (22%) suggested training the employees. 2% respondents were of the view that, IB should be separated from microfinance. According to 8% respondents, the profit margin may not be less than 7% and finances may be provided by Government. Advancing loans was suggested by 6%.

Table-5.38: Frequency Distribution of “Suggestions for the Proposed Co-integrated system”

<table>
<thead>
<tr>
<th></th>
<th>f</th>
<th>%</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Separate IB</td>
<td>2</td>
<td>2.0</td>
<td>5.3</td>
<td>5.3</td>
</tr>
<tr>
<td>Profit atleast 7% and funds invested from government</td>
<td>8</td>
<td>8.0</td>
<td>21.1</td>
<td>26.3</td>
</tr>
<tr>
<td>Loan</td>
<td>6</td>
<td>6.0</td>
<td>15.8</td>
<td>42.1</td>
</tr>
<tr>
<td>Training for staff</td>
<td>22</td>
<td>22.0</td>
<td>57.9</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>38</td>
<td>38.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing System</td>
<td>62</td>
<td>62.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: survey
5.39 Chi-Square test for the Significance of the Statements Variables

The statistical tool used to test the significance of different statement variables was the non-parametric test of chi-square statistics. According to table 5.39, the values of test statistics for period of organization in Islamic banking (significant at $\chi^2 = 56.980$), organizational grade ($\chi^2 = 34.353$ significant at .000 level), offer of micro finance services by the organization ($\chi^2 = 13.520$ at $p = .000$) and reasons that Islamic banks did not explore the potential ($\chi^2 = 24.947$ at $p = .000$) are all significant in their effects. It shows that time span of working in present position, the experience of serving the organization, the grading of the organization, whether or not they offer such services, and the reasons for not exploring the potential of Islamic microfinance, are all significant. Similarly, it is obvious from the table that, the ownership status is not affecting the objectives insignificantly, as shown by the chi-square value of 0.947.

### Table-5.39: Chi-Square test

<table>
<thead>
<tr>
<th></th>
<th>Period in Islamic Banking</th>
<th>Status of the Organization</th>
<th>Organization Grading on the basis of success</th>
<th>Offerings of any Microfinance service by Org</th>
<th>Reasons that I. Banks has not explored the potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>56.980&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.471&lt;sup&gt;b&lt;/sup&gt;</td>
<td>34.353&lt;sup&gt;b&lt;/sup&gt;</td>
<td>13.520&lt;sup&gt;c&lt;/sup&gt;</td>
<td>24.947&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
<tr>
<td>Df</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.000</td>
<td>.790</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
</tbody>
</table>

*Source: survey*
Similarly, table 4.40 demonstrates that, alongside persuasion of Islamic baking, which may alleviate poverty, all other variables are statistically significant in their effect. Introducing new accounting procedures is effective with a chi-square value of 26.00 (p = .000) which indicates that, such move may probably enhance the achievement of the objective.

The need of awareness programs for integrating microfinance operations ($\chi^2 = 22.840$ at $p = .000$), technological change ($\chi^2 = 12.2640$ at $p = .007$) and assistance from other MFIs are all significant in their effect to reinforce microfinance service within Islamic banking practices for improved outcome.

Table 5.40: Chi-Square test

<table>
<thead>
<tr>
<th>Need of New Accounting Procedures</th>
<th>Need of Awareness Programs</th>
<th>Technological Change</th>
<th>Assistance from other MFI's</th>
<th>Pursuing IMF Result in Poverty Alleviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>45.800$^a$</td>
<td>22.840$^b$</td>
<td>16.061$^c$</td>
<td>12.240$^d$</td>
</tr>
<tr>
<td>Df</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.001</td>
<td>.007</td>
</tr>
</tbody>
</table>

Source: survey

Table 5.41 contains test statistics for other study variables. According to this table, pursuing IMF will result in increased employment opportunities ($\chi^2 = 26.000$ at $p = .000$), improve standard of living of poor ($\chi^2 = 22.840$ at $p = .000$), equitable distribution of wealth ($\chi^2 = 23.5510$ at $p = .009$). All these results are statistically significant in this regard. In the same way, Integration of IMF and Islamic banking may produce significant effects with $\chi^2$ value of 27 and $p$ value of .000. According to the results, integration of Islamic microfinance within Islamic banking is feasible because both follow the same principles and are significant in their effects.
Table 5.41: Chi-Square test

<table>
<thead>
<tr>
<th></th>
<th>Pursuing IMF will Result in</th>
<th>Pursuing IMF will Result in</th>
<th>Integration of IMF into Islamic Banking</th>
<th>Integration of IMF into I.B is Feasible because both have same guiding principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pursuing IMF will Result in</td>
<td>Increased Employment</td>
<td>Improved Standard of Living of Poor</td>
<td>Equitable Distribution of Wealth</td>
<td></td>
</tr>
<tr>
<td>Chi-Square</td>
<td>26.000&lt;sup&gt;a&lt;/sup&gt;</td>
<td>20.633&lt;sup&gt;b&lt;/sup&gt;</td>
<td>13.551&lt;sup&gt;c&lt;/sup&gt;</td>
<td>27.000&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Df</td>
<td>3</td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.009</td>
<td>.000</td>
</tr>
</tbody>
</table>

*Source: survey*

Table 5.42 is presenting the significance of feasibility and need to integrate IMF within Islamic banking. According the table, ($\chi^2 = 15.660$ at $p = .001$ for feasibility of integration on the basis of similarity of purpose and $\chi^2 = 58.660$ at $p = .000$ for feasibility of such integration because there is a pressing need for IMF), these results are statistically significant. Similarly, the effect of, Islamic banking can have a special niche market, is statistically significant at $\chi^2$ value of 5.08 at p value of .079. The need for training and capacity building programs are significant in their effect on microfinance in Islamic banking ($\chi^2 = 28.09$ at $p = .000$ and $\chi^2 = 47.320$ at $p = .000$)
Table 5.42: Chi-Square test

<table>
<thead>
<tr>
<th>Source: survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 5.43 shows that, implementing microfinance within Islamic banking needs a special task force, extensive marketing and awareness campaigns. Similarly, reaching the suburban and rural areas, use of modern technologies and support from the Government, will add to the successful implementation of microfinance within Islamic banking. All these variables are significant in their effect as shown in table 5.43 with $\chi^2$ value of 62.48, 29.68, 20.440, 51.200 and 12.280, respectively.</td>
</tr>
</tbody>
</table>
Table-5.43: Chi-Square test

<table>
<thead>
<tr>
<th>Source: survey</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Microfinance Needs Special Task Force in IB</th>
<th>Microfinance Needs Extensive Marketing and Awareness Campaign in IB</th>
<th>Microfinance Needs to Reach the Rural and Suburban Areas in IB</th>
<th>Microfinance Needs use of modern Technology such as Mobile Banking etc in IB</th>
<th>Microfinance Needs Support from the Government and Civil Society in IB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>62.480&lt;sup&gt;a&lt;/sup&gt;</td>
<td>29.680&lt;sup&gt;a&lt;/sup&gt;</td>
<td>20.440&lt;sup&gt;b&lt;/sup&gt;</td>
<td>51.200&lt;sup&gt;c&lt;/sup&gt;</td>
<td>12.280&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Df</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.002</td>
</tr>
</tbody>
</table>
Table 5.44: Chi-Square test

<table>
<thead>
<tr>
<th>Major Problem of IMF is Complexity of Procedures</th>
<th>Major Problem of IMF is High Rate of Markup</th>
<th>Major Problem of IMF is Terms and Conditions of Loan</th>
<th>Major Problem of IMF is Running Finance</th>
<th>Major Problem of IMF is Lack of Government Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>1.073&lt;sup&gt;a&lt;/sup&gt;</td>
<td>6.683&lt;sup&gt;a&lt;/sup&gt;</td>
<td>12.537&lt;sup&gt;a&lt;/sup&gt;</td>
<td>9.610&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>Df</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.899</td>
<td>.154</td>
<td>.014</td>
<td>.048</td>
</tr>
</tbody>
</table>

Source: survey

Table 5.44 shows the results of major problems, faced by Islamic microfinance. The complexity of procedures with $\chi^2$ value of 1.073 is statistically insignificant at $p = .889$. Similarly, high rate of markup, running finance and lack of government support is also insignificant with $\chi^2$ values 6.683, 9.610 and 3.024, respectively. While the terms and conditions of loan is statistically significant in its effect on IM.
Table 5.45: Chi-Square test

<table>
<thead>
<tr>
<th>Source: survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 5.45 shows that the proposed products for Islamic microfinance and the co-integrated system have a statistically significant effect for IB ($\chi^2 = 11.571$ at $p = .021$ and $\chi^2 = 11.947$ at $p = .008$). Similar, the transformation of Islamic banking for integrating Islamic microfinance and the benefits derived from such a transformed system of Islamic banking are both statistically significant with chi-square value of ($\chi^2 = 10.268$ at $p = .016$) and affect ($\chi^2 = 24.769$ at $p = .000$), respectively.</td>
</tr>
</tbody>
</table>
5.40 Salient Themes of the Interviews

Interviews were conducted with the experts, practitioners, and academicians in the field of Islamic banking and microfinance. The results and main themes of their responses are summarized in the following table:

Table- 5.46: Summery of the interviews conducted

<table>
<thead>
<tr>
<th>Interview 1</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Different Concepts of poverty, in Islam there is no concept of poverty. Islam provides avenues for eradication of poverty.</td>
<td></td>
</tr>
<tr>
<td>• Current banking is based on interest which is not allowed in Islam. Micro finance in Islamic banking is aimed towards the eradication of poverty.</td>
<td></td>
</tr>
<tr>
<td>• Lack of awareness and the interest based banking system are the main reasons of weaknesses of Islamic banking.</td>
<td></td>
</tr>
<tr>
<td>• Microfinance provides benefits to individuals and groups. Small enterprises can also get funds for financing its operations from microfinance banks.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interview 2</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Poverty is the lack of access to basic necessities.</td>
<td></td>
</tr>
<tr>
<td>• Islamic banks should be fair just and free of usury.</td>
<td></td>
</tr>
<tr>
<td>• All efforts in Islamic banking are directed to help poor.</td>
<td></td>
</tr>
<tr>
<td>Islamic bank serves everyone, regardless of religion.</td>
<td></td>
</tr>
<tr>
<td>If not implemented properly, it will affect reliability.</td>
<td></td>
</tr>
<tr>
<td>Islamic banks help in providing expertise. It needs effective leadership training and customer support to serve better.</td>
<td></td>
</tr>
</tbody>
</table>

**Interview 3**

| Islamic perspective about bank is based upon participation to decrease risk. |
| Combination of micro finance and Islamic banking will have multiple positive impacts such as free interest loans and services to low income groups. |
| Islamic banking is facing various problems such as in-effective marketing and lack of support from the government and the dependency of Islamic banking on conventional banking. |
| Microfinance varies from Islamic banking because other banks also offer this and various modes for micro financing are offered in Islamic banking. |
| IMF will have multiple positive inputs on individuals and government and provide help to small enterprise owners. |
The concept of poverty in Islam is different from that of other religions. Islamic concept of banking is about participation to decrease risk. Combination of microfinance and Islamic banking will have multiple positive impacts such as provision of non-interest based loans. Customized products and marketing to increase the penetration and acceptability of Islamic microfinance is also emphasized. But this requires deepening of the culture of microfinance in the current banking industry.

Currently the low income and religious minded clients prefer to use the *Shariah* compliant products for microfinance in Pakistan. *Ijarah* and *Murabah* are the proposed products, which can help microfinance in the context of Islamic Banking take off. High default rates can be controlled, if the backgrounds of the clients are properly investigated and clusters are necessary. All of this can be effectively tied together with a multidimensional banking infrastructure, which can market the products of Islamic microfinance and provide in depth expertise to clients.

**Interview 4**

- Microfinance should be fully Islamic.
- Customized products.
- Default rate is high.
- More chances of Fraud.
- Lack of awareness in the poor.
- Time needed to deepen roots in Pakistan.
- Low income religious minded clients.
- *Ijarah* plus and *Murabah* can be the proposed products.
- Investigate backgrounds.
- Clusters to reduce default rate.
5.41: Conclusion from the Interviews Conducted

Interview with director Islamic centre, University of Peshawar provided with some information regarding Islamic ideology about Banking. According to him, Islam does not allow interest based-banking. He was of the opinion that, interest is responsible for inflation and poverty. There are alternatives for interest in Islamic banking but the system needs to be transformed. He proposed the development of Bait-ul-Mal. In an answer to a question, he said that microfinance is a good source of alleviating poverty and Sharia is conscious about it. He declared it impossible to integrate microfinance services in Islamic banking due to their linkage with IMF. If they have to be integrated, mind-set of the people should be changed first. Similarly, the interviewee said that our banking system is not completely Islamic. He also named some weaknesses in Islamic banking which have an impact on Islamic microfinance services and suggested the use of Murabaha, Musharaka and Mudaraba as the proposed Islamic microfinance products. These products can benefit the poor and low-income groups of the society. Similarly, small and medium enterprises will also get benefits from it. He recommended sound training for employees, who are working in Islamic banks. The staff of the Islamic banks must be well educated with the principles of Sharia, to develop a pure Islamic banking system; otherwise the present system based on commercial banking principles, with a brand name of Islamic bank will not work.

Another interview with Manager of AL-ZAMIN Investment Bank Limited showed the views of a banker about the role of microfinance in context of Islamic banking. According to the interviewee, the Islamic perspective of all financial institutions including banks is to provide services which are interest-free. Presently, the Islamic banking is not completely interest-free. He provided the information that microfinance was firstly initiated by NGOs in Pakistan and then by TAHMEER Bank in the banking sector. He declared the high cost of funds and high operational costs as the major problems with microfinance. Similarly, most of the people who take these loans have an intention of not returning it back. Pakistani banks followed GRAMEEN bank of Bangladesh for microfinance but they could not succeed like that bank and their default rate in Pakistan turned out to be high. Both Islamic banking and microfinance are at an early stage of their life-cycle in Pakistan. They have not rooted firmly as individual entities and their merger may not be fruitful. The merger would be very
effective in Pakistan when both entities grow up to a desired level. He recommended that, the success of Islamic banking and microfinance rests in the fact that, the source of funds should have minimum cost and there is a need to change the attitude of the people about Islamic banking. We should stop following the conventional banking system. For the success of Islamic banking, modern and innovative products should be devised for Islamic microfinance and keep innovating it with the passage of time. And these products should in conformity with Islamic banking rules. The most important thing is to focus on the client. If our client is not aware of the importance of Islamic banking and the products of Islamic microfinance, the success of Islamic microfinance is difficult.

The interviewees in other departments have almost similar opinions. Poverty was termed as the breeding factor for all the other evils according to the Islamic view of poverty. The concept of Islamic bank would have been derived from Bait-ul-mal. An Islamic banking system should be transparent and fair. Although in Islam, personal honesty plays an important role in any dealing, financial affairs must be based on justice and equality. These dealings should be free from usury and exploitation, and should be based on the concept of partnership in profit and loss.

The integration of Microfinance will be easier as a devising tool of measurement. Check-and-balance can be simple and easy to record for small loans, which will make it more feasible to implement. Micro financing is more pertinent to Islamic mode of banking because, it is very simple and can be devised easily to ensure transparency in profits and loss declaration. Therefore, its integration with Islamic banking will be easier and feasible.

Islamic point of view regarding finance and different modes of financing is quite different from the commercial banking because, there is no concept of loan-financing in Islam, as compared to the conventional banks and other financial institutions. The Islamic financing is based on the principles of dealing in the heterogeneous commodities only. Therefore, pure Islamic modes of financing are based on the concept of partnership or shirakat. This will result in mitigating the financial and market risk prudently, minimizing the conflicts, sharing the profit and loss as per equity participation. This will also eliminate the concept of fixed returns and eliminating the penalties and hidden charges. In general, the
present Islamic banking is being considered as not purely Islamic and based on conventional banking principles, which ultimately affects its services including microfinance.
Chapter-6

RECOMMENDATIONS

The proposed recommendations, based on the results of the study are as given below:

1. Islamic banking is an emerging concept that has been adopted by many countries in the world specially the Islamic countries, to provide pure interest free banking facilities to its customers. It was found that, the main reasons for, not exploring the potential of Islamic microfinance in Islamic banking is, the lack of awareness in the society and poor management of these organizations. Similarly, employees working in these Islamic banks are not properly trained. Therefore, it is recommended to train the employee at organizational level, for the success of Islamic Banking. For this purpose some special on the job training programs, workshops and seminars can be arranged. Moreover, the educational institutions and Islamic banks may work in collaboration with each other. The educational institutions may offer specialized educational programmes for the employees of Islamic banks.

2. In many Islamic countries, substantial market share can be gained through the development of small and medium businesses. These businesses cannot afford the high transaction cost, involved in their operations. Integration of Islamic Banking and Microfinance is possible and this will multiply the effects of IB and MF in a positive way. This will bring the idle money, which many religious minded Pakistanis do not invest in conventional banks due to interest (riba), in circulation. This will result in boosting of economic activities. Therefore, it is recommended to integrate both the institutions to have a substantial share in the market.

3. In Islamic countries like Pakistan, people are reluctant to invest their savings in the interest based conventional banks and MFIs. Therefore, substantial part of money remains idle. However, Islamic banks can attract these savings from the masses and will result in increasing the economic activities. This will open avenues for new businesses and will produce new entrepreneurs. This will result in creating new jobs, and lead to equitable distribution of wealth in the society. Therefore, it is highly
recommended, to integrate both Islamic banking and microfinance in Pakistan to achieve the desired results.

4. Islam has guided the humanity in every sphere of life. The Sharia has provided a complete set of principles about the conduct of economic and business activities. The current Islamic banking operations are partially Islamic, which are influenced by the conventional banking system. Therefore, it is strongly recommended that, the Islamic banking system should be purely Islamic and based on the principles of Sharia. For this purpose the services and expertise of those scholars can be hired, who have full knowledge of Islamic economics and Sharia.

5. Employees working in Islamic banks should have full knowledge of Islamic economic practices. It can be made a condition for the job in Islamic banks, to have some special course in Islamic banking and finance, a certificate or diploma in the principles of Sharia and Islamic economic practices. Adequate knowledge in Islamic Economic Practices can help in developing a successful Islamic banking system.

6. Islamic banking and microfinance are new and emerging concepts, and both have the potential to achieve the desired goals, i.e. social justice and assist in eradicating poverty from the society. Both the concepts are at their infancy stage and need some time to be fully explored. Therefore, it is suggested to develop microfinance and Islamic banking as separate entities initially, for formulating their own models and rules to achieve their objectives and get popularity and acceptance among members of the society. After their growth to a desired level, they may be merged.

7. Innovation is the key element in the success of any business organization and its products or services. Therefore, the microfinance products, offered by Islamic banks, should be innovative and may have the capacity to adjust according to the needs of members in the society. These products should be free of any commercial banking practices.

8. Many people do not invest their savings in Islamic banks because they are not aware of the fact, that the products offered by these banks are purely Islamic and according to the principles of Sharia. Therefore, it is recommended to change the attitude of the members of society through rigorous awareness programmes. Special marketing campaigns can be launched for bringing positive change in behavior of the people
towards the products of Islamic microfinance. For this purpose, the services of the print and electronic media can be used. Moreover, religious scholars (Ulema) can also play a vital role in this regard. It is also recommended to make the customers aware of the Islamic aspects of the products in microfinance, offered by Islamic banks. Complete knowledge about the Islamic aspects of these services, will strengthen their faith in Islamic banks. This will raise their confidence level, and will help in developing the desired Islamic banking system.

9. Recoveries of outstanding loans is one of the most important and difficult tasks in the banking sector. It is recommended to facilitate the customers in Microfinance as well as Islamic banking for accelerating recoveries of loans from them. Special concessions and expert opinions can be offered to them for smooth functioning of their business. This will result in the success of their businesses and they will be motivated to repay their loans in time.

10. Based on the analysis and findings of this study, it is only rationally expected that adopting micro-financing in the context of Islamic Banking will successfully lead to optimized social entrepreneurship and profit maximization/cost minimization in the domains of newly emerging/existing businesses, especially, small and medium sized businesses.

11. Although the government of Pakistan is encouraging Islamic banking practices in the country and already has formulated some guidelines through State Bank of Pakistan, further efforts on part of the government is needed, to make it a success.
Chapter-7

CONCLUSION

This study explains the role of microfinance in the context of Islamic banking. Microfinance and Islamic banking are emerging concepts and both have same objectives. Despite this similarity, the relationship between the two concepts is still an unexplored area. This study focused on using microfinance products in Islamic banking operations. This can help in developing new small and medium size business, which can be helpful in using the idle savings of many religious minded Pakistanis, who do not invest due to interest-based banking. The study shows the significance of Islamic banks as a potential candidate for integrating microfinance in its operations.

This was an extensive study in which mixed methods procedures was used, to collect data. It has a sample of one hundred (100) respondents who have responded to questions related to various issues of microfinance and Islamic banking. The results have been tested with chi-square statistics which show that, the time span of organization in Islamic banking, organizational success, offerings of micro finance services by the organization and reasons for not exploring their potential in microfinance are all significant in their effects. Similarly, the need of awareness programs, technological change and assistance from other MFIs are all statistically significant in their effect to reinforce microfinance products of Islamic banking for improved results. The introduction of new accounting procedures is also significant. Moreover, the chi-square statistics also show that, pursuing IM may result in increasing employment, improved standard of living of poor and equitable distribution of wealth are all statistically significant. Similarly, Integration of IMF within Islamic banking operations has a significant effect, because both have the same guiding rules. The feasibility of integrating Islamic microfinance within Islamic banking, based on purpose, niche market and pressing need for Islamic microfinance services were also statistically significant in their effects.

The need for training and capacity building programs, special task force, extensive marketing and awareness campaigns, to reach suburban and rural areas and introducing
modern technologies are all significant variables in their effects. The complexity of procedures, high rate of markup, and lack of government’s support are insignificant. Whereas, terms and conditions of loan, the proposed products and co-integrated system are statistically significant in their effects. Similarly, transformation of Islamic banking for integrating Islamic microfinance and benefits derived from such transformation are both statistically significant.

The study concludes that, the variables identified are significant and can be used for the successful implementation of microfinance products within Islamic banking operations. It was observed that, those Islamic banks, which started their functions earlier, are more successful. They are ranked as high in performance and are enjoying good reputation in the public. The effectiveness of microfinance products offered by Islamic banks has a strong relationship with the time duration. One reason for the ineffectiveness of Islamic banking is, its underutilization, due to lack of awareness in general public.

To overcome these problems of Islamic banking and its microfinance services, certain remedies have been suggested, which include the awareness programs, use of modern banking technologies and assistance from other microfinance institutions. The introduction of Islamic microfinance within Islamic banking can lead to increase in employment, improve living standards of the poor and help in equitable distribution of wealth. To achieve efficiency, MF and IB can be integrated, keeping in view their similar needs and interests. All these institutions need to train their employees for the current jobs and capacity building, and Islamic banking can also benefit from it. Although Islamic banking and its microfinance services has not yet attained any ideal achievements, however, it has all the potential to be a real success.
Annexure 1

Figure-5.1.: Bar chart representation of “Gender”

Source: survey

Figure-5.2.: Bar chart representation of “Position held in Organization”

Source: survey
Figure-5.3.: Bar chart representation on the basis of “Education”

Source: survey

Figure-5.4: Chart representation of “Duration on current post”

Source: survey
Figure-5.5: Bar chart representation of “Work experience in Organization”

Source: survey

Figure-5.6: Bar Chart Representation of “Training in Islamic Banking”

Source: survey
Figure-5.7.: Bar chart Representation of Organization’s “Status in IB”

Source: survey

Figure-5.8: Bar chart Representation of “Products Offered by Islamic Banking”

Source: survey
Figure-5.9: Bar Chart Representation of “Time-span in Islamic Banking”

Source: survey

Figure-5.10: Bar Chart representation of “Nature of Organization on the basis of ownership”

Source: survey
Figure-5.11: Bar Chart representation of “Organizational success”

Source: survey

Figure-5.12: Bar chart Representation of Organizations on the basis of “offerings of MF service”

Source: survey
Figure-5.13: Bar chart representation of “why Islamic banks have not explored the potential of Islamic microfinance services”

Source: survey

Figure-5.14: Bar chart representation showing “integrating MF and IB operations need new accounting procedures”

Source: survey
Figure-5.15: Bar chart representing “Integrating MF and IB operations need awareness Programs”

Source: survey

Figure-5.16: Bar chart representation of “Integrating MF and IB operations need technological change”

Source: survey
Figure-5.17: Bar chart representation of “Integrating MF and IB operations need assistance from other MFIs”

Source: survey

Figure-5.18: Bar chart representation of “pursuing Islamic Microfinance will result in poverty alleviation”

Source: survey
Figure-5.19: Bar chart representation of responses about “Islamic Microfinance persuasion will Increase Employment Opportunities”

Source: survey

Figure-5.20: Bar chart representation of “Pursuing Islamic Microfinance will Result in Improving the Standard of Living of Poor”

Source: survey
Figure-5.21: Bar chart representation of responses about “Pursuing Islamic Microfinance will Result in equitable distribution of wealth”

Source: survey

Figure-5.22: Bar chart representation of the “possibility of Integrating Microfinance and Islamic Banking”

Source: survey
Figure-5.23: Bar chart representation of “Integration of Microfinance within Islamic banking is feasible because both have same guiding principles”

Source: survey

Figure-5.24: Bar chart representation showing “Integration of Microfinance into Islamic Banking is Feasible because both serve the same purpose”

Source: survey
Figure-5.25: Bar chart representing the “Integration of Microfinance and IB is feasible because both can have a special Niche Market”

Source: survey

Figure-5.26: Bar chart representation showing “Integration of Microfinance and Islamic Banking is feasible because there is a pressing need for Islamic Microfinance services”

Source: survey
Figure-5.27: Bar chart representation of “Implementing Microfinance within Islamic banking operations needs qualified workforce”

Source: survey

Figure-5.28: Bar chart representation of “Implementing Microfinance within Islamic banking operations needs Training and Capacity building Programs for employees”

Source: survey
Figure-5.29: Bar chart representation of “Implementing Microfinance within Islamic Banking operations needs Special Task Force”

Source: survey

Figure-5.30: Bar chart representation of “Implementing MF within IB operations needs Extensive Marketing and Awareness campaigns”

Source: survey
Figure-5.31: Bar chart representation of “Implementing MF within IB operations needs to reach Rural and Suburban areas”

Source: survey

Figure-5.32: Bar chart representation of “Implementing MF within IB operations needs the use of modern Technology”

Source: survey
Figure-5.33: Bar chart representation of “Implementing MF within IB operations needs Support from Government and Civil society”

Source: survey

Figure-5.34: Bar chart representation of “Major Problems of IMF”

Source: survey
Figure-5.35: Bar chart representation of “Proposed Products for IM”

Source: survey

Figure-5.36: Bar chart of “Is transformation of IB essential for integrating IMF?”

Source: survey
Figure-5.37: Bar chart representation of “Benefits derived from Transformation of IB into IM”

Source: survey

Figure-5.38: Bar chart showing “Suggestions for the Proposed Co-integrated system”

Source: survey
Annexure 2

INTERVIEWS CONDUCTED

Interview No. 1:

Q1: What is the Islamic view of poverty? How would a person be regarded as poor or needy?

Ans: Arabic word for poverty is “Faqr”. It is not meant as we are taking in our day to day life. In Islam Faqr is defined in another way. Holy Prophet (P.B.U.H) said, “Poverty is my proud”. Holy Prophet (P.B.U.H) took Faqr in a way that what he got, would distribute to poor. If any needy person came to him The Holy Prophet (P.B.U.H) never returned him empty handed. Holy Prophet said, “The real richness is richness of heart”.

The Holy Prophet (P.B.U.H) said, “Poor is that person who does good virtues in this world, do backbiting of his brothers and after this world all his good virtues are shifted to that person”.

Islamic Point of View of Poverty:

Every human being have some basic needs i.e. food clothes and shelter. For fair distribution of these things law is made called “Shariah”. It says that there will be social justice. So poverty will never prevail in Islamic system. Islam gives right to every person to earn how he can but there are some limitations on each and every person. Means you have to earn Halal. E.g. Muslims can’t sell wine, pig etc. but in un-Islamic world there are no such limitations. Islam also puts limitations on how to use your own money.

Poverty comes because wealth remains in few hands due to illegal earning. Islam persuades you to give in the path of Allah. You have to pay 2.5% Zakat per year. When there was the system of Bait-ul-mal, no one was poor. Nobody was allowed to
exploit others for few coins. *Bait-ul-mal* was responsible for compensating people for their day to day activities.

*Bait-ul-mal* addresses the needs of people and people would give *Zakat* to *Bait-ul-mal.* *Zakat* can be given to non-Muslims who don’t have hatred towards Islam. Islam never permits to concentrate money in accounts. If someone has money, he/she should do business. In this way, unemployment will be reduced and he/she will also earn profit. In Islam, three sources are used to eliminate poverty. These are:

1. *Zakat*
2. *Virasat*
3. *Bait-ul-mal*

Although Pakistan is very rich in natural resources, but they are not properly utilized. A famous religious scholar said, “Pakistan is *tafseer of Surah Rehman*”.

**Q2: What are the Islamic perspectives of banks and other financial institutions?**

**Ans:** In current times, banking services are interest-based. But in Islam, there is no provision for these banks because interest is strictly prohibited in Islam. Prophet (P.B.U.H) said, “Today all the ignorance of ignorant period is under my feet”.

Due to interest, inflation rate increases due to which poverty also increases. Alternative for interest is Islamic Banking.

**Is it Possible?**

Yes, but we have to change the entire economic system. We have to teach our generation to earn through legal sources. We should develop *Bait-ul-mal.*

**Q3: What are the provisions of Shariah regarding the microfinance services? Can it be used for providing a source of earning for the poor/needy?**
Ans: Yes, microfinance is a good source for eliminating poverty. Shariah is very conscious about microfinance. Islam gives dignity to every person. Islam is against slavery.

Q4: How will you analyze the integration of microfinance services in Islamic Banking operations? Can such a system be deemed feasible?

Ans: In the present scenario, it’s not possible because we are linked with IMF by force. But yes, Islamic Banking system can be deemed feasible but for that purpose we have to change the mind-set of people.

Q5: What are the pertinent weaknesses in the present day Islamic Banking operations?

Ans: Finance is just a component of life. Our way of living is not Islamic, therefore our banking is also not Islamic. We have to create awareness about Islamic Banking. The world is changing, it has seen the curse of capitalism and it is trying to get rid of this curse.

Q6: Will the weaknesses in Islamic Banking operations impact the Islamic Microfinance services? How?

Ans: Yes, the weaknesses in Islamic Banking operations have an impact on the Islamic Microfinance services. Islamic Banks take guarantees on loans.

E.g. if someone purchases car through Islamic Bank, the banks purchases it or 10 lacs but the borrower pays installments of 12 lacs. The difference, 2 lacs, is guarantee of the bank.

Q7: What Islamic modes of financing may be employed for Islamic Microfinance service?
Three types of Islamic modes of financing can be employed for Islamic Microfinance services. These are

1. **Murabiha**
2. **Musharika**
3. **Mudariba**

**Q8: Who could be the potential beneficiaries of Islamic Microfinance services?**

**Ans:** Microfinance is a general term to describe financial services to low income individuals or to those who do not have access to typical banking services. A microfinance institution (MFI) is an organization that provides microfinance services. MFI’s range varies from small non-profit organizations to large commercial banks. So poor people and common people could be the potential beneficiaries of Islamic microfinance services.

**Q9: How will the Small and Medium Enterprises benefit from the Islamic Microfinance setup within Islamic Banking operations?**

**Ans:** Small and Medium Enterprises benefits from the Islamic Microfinance setup within Islamic Banking operations in a number of ways.

E.g. we can start a business by taking funds from the Islamic Banks and purchase our required materials i.e. handicrafts from households. We will then sell these handicrafts in open market; if we earn profit then half of this will be given to them.

**Q10: Any changes or recommendations would you like to share for Islamic Microfinance within Islamic Banking operations?**

**Ans:** There are so many recommendations for the setup of Islamic Microfinance within Islamic Banking operations.

Some of them are;

1. People should change their own mind set.
2. We have to change our state’s infrastructure.
3. Islamic Banking can’t be built in theories, it needs practical implications.
4. For Islamic Banking we need trained staffs who believe in Shariah.
Interview No. 2:

1. **What is the Islamic view of poverty? How would a person be regarded as poor or needy?**

   **Ans:** Poverty in any society whether religious or non religious can be viewed as not being able to afford the basic necessities of life, mainly food, clothing, health and education. Islam terms it as one of the breeding factors to fuel all other evils in the society as now we can see it happening.

2. **What are the Islamic perspective of banks and other financial institutions?**

   **Ans:** The concept of an Islamic bank would have been derived from a Bait-ul-mal. An Islamic banking system should be transparent and fair. Although in Islam, personal honesty plays an important role in any dealing; especially financial affairs must be based on justice and equality, free from usury and exploitation and based on the concept of partnership in profit and loss.

3. **What are the provisions of Sharia regarding the Microfinance services? Can it be used for providing a source of earning for the poor/needy?**

   **Ans:** Why not, anything that isn’t harmful and helps the poor and the needy- from any sect of the society whether Muslim or Non Muslim, should be appreciated. All efforts and resources should be directed to uplift the condition of the poor and the needy. The concept of Microfinance is more pertinent to the Islamic mode of banking as simple and easy tools can be devised to ensure transparency in profit and loss declaration.

4. **How will you analyze the integration of Microfinance services in Islamic banking operations? Can such a system be deemed feasible?**

   **Ans:** The integration of Microfinance will be easier as devising tools of measurement and check-and-balance can be simple and easy to record the small loans and hence, makes it more feasible to implement.

5. **What are the pertinent weaknesses in the present day Islamic banking operations?**
Ans: The present day Islamic system is mostly based on conventional banking system of fixed interest. There is a lack of awareness in the public and the society about the concept of Halal or Islamic banking and also a lack of clear distinction between modern day conventional banking systems and at the same time a modern day Islamic banking system. The customer needs to be aware of the benefits of the Islamic banking system and its basic concept of being based on clear and just system, free of exploitation and not as a marketing and selling tool.

6. **Will the weaknesses in Islamic banking operations impact the Islamic Microfinance services? How?**

Ans: Just like any other operations, it will also have an impact on the Microfinance and not only will it affect the confidence of its customers but the very base of Islamic Banking of transparency, reliability and honesty are also affected. So, overall Islamic banks have to improve but as such I don’t see any specific threats to Microfinance if done properly.

7. **What Islamic modes of financing may be employed for Islamic Microfinance services?**

Ans: It can be based on *Musharakah, Mudarabah*, Mark up and Mark down financing etc.

8. **Who could be potential beneficiaries of Islamic Microfinance services?**

Ans: All individuals, whether Muslims or non Muslims; who have skills and need primary capital to establish a small business, entrepreneurs, students and even housewives and other enthusiastic people who don’t work at the moment but can start if get assistance.

9. **How will the small and medium Enterprises benefits from the Islamic Microfinance setup within Islamic banking operations?**

Ans: The Small and Medium Enterprises will be benefited more as they will be motivated to perform better to increase their capabilities and share their profits rather than losing
and showing deficits. They may get expert help and advice from the bank as the bank should also provide assistance in this area.

10. **Any changes or recommendations you would like to share for the setup of Islamic Microfinance within Islamic banking operations?**

**Ans:** They definitely need a proper reliable and sound system. Some Islamic Banks have brought a bad name by providing poor services, going bankrupt and looting people’s hard-earned money. Leadership with a vision, embedding Islamic values and pride in staff and their training and coaching are very necessary. Strong international presence and marketing campaigns to raise awareness are also required. Exceptional customer services and support should be provided to gain goodwill of new and potential customers and also not only lip-servicing but providing Islamic Banking system in reality following the Sharia’s way of Banking will help to setup I.M within I.B.
**Interview No. 3:**

1. **What is the Islamic view of poverty? How would a person be regarded as poor or needy?**

   **Ans:** No Reply

2. **What are the Islamic perspective of banks and other financial institutions?**

   **Ans:** Islamic point of view regarding finance and different modes of financing is quite different from the conventional banking system as in Islam there is as such no concept of loan financing like the conventional banks and other financial institutions do. The Islamic financing is based upon the principle of participation dealing in the heterogeneous commodities directly and not the homogenous one. That is, the reason almost all of the pure Islamic modes of financing are based upon the concept of partnership or *shirakat* in order to:
   - Mitigate the financial and market risk prudently
   - Minimizing the conflicts
   - Sharing the profit and loss as per equity participation
   - Eliminating the concept of fixed returns
   - Eliminating the penalties and hidden charges concept

3. **What are the provisions of Sharia regarding the Microfinance services? Can it be used for providing a source of earning for the poor/needy?**

   **Ans:** No Reply

4. **How will you analyze the integration of Microfinance services in Islamic banking operations? Can such a system be deemed feasible?**

   **Ans:** In reality, microfinance services are one of the features of Islamic banking. If Islamic banking and micro financing services are integrated, it would become more feasible for the Islamic banks to make their operations smooth and effective. It will help Islamic banks to:
   - Attract the low-income group of people
People availing the microfinance facility free of Riba will help Islamic banks to educate their customers.

Will increase the customer portfolio and other pure Islamic products could be in operation as well.

5. What are the pertinent weaknesses in the present day Islamic banking operations?

**Ans:** Present day Islamic banking in reality is based upon conventional banking principles. Some of the weaknesses in present day Islamic banking include:

- Poor marketing practices i.e. unable to educate target audience about the real difference between conventional and Islamic banking.
- Islamic Modes of financing are based upon difficult and complex documentation as compared to conventional banks.
- Difference in operational mechanism of different Islamic banks.
- Less public and government support.
- Lack of proper Code of Conduct.

6. Will the weaknesses in Islamic banking operations impact the Islamic Microfinance services? How?

**Ans:** I don’t think the weaknesses in Islamic banking would impact microfinance services as the micro financing activity is already been under practice by the conventional banks in a successful manner.

7. What Islamic modes of financing may be employed for Islamic Microfinance services?

**Ans:** Islamic microfinance banks can go for:

- *Mudariba*
- *Musharika (Diminishing Musharika)*
- *Ijarah*
- *Bai-Mujhal*
- Mark up mode of financing
- Mark down mode of financing

8. **Who could be potential beneficiaries of Islamic Microfinance services?**

**Ans:** Muslim individuals and families,
- Businessman
- Governments of Islamic and non Islamic states
- Students interested in Islamic field of financing

9. **How will the small and medium Enterprises benefit from the Islamic Microfinance setup within Islamic banking operations?**

**Ans:** Getting financial assistance free of *Riba*
- No penalties no financial charges
- Easy methods of repayments
- Financial advisory services

10. **Any changes or recommendations would you like to share for the setup of Islamic Microfinance within Islamic banking operations?**

**Ans:** Training the staff of Islamic banks
- Educating customers to create awareness
- Strong marketing campaign
- Strong international partnerships
- Adopting three major pillars of Islamic banking

*Al-Murhabah*

*Al-Musharika*

*Al-Modarba*
Interview No. 4:

Q1: What is the Islamic view of poverty? How would a person be regarded as poor or needy?

Ans: Islamic perspective of banks and financial institutions is that they should provide services free of interest (riba) which is strictly forbidden in Islam. But Islamic banks are not completely interest free as it is taken or provided in some manner but it will take time to establish services that are completely interest free and according to the sharia.

Q2: What are the Islamic perspectives of banks and other financial institutions?

Ans: To support those whose earning is limited, the concept of microfinance was introduced. Microfinance is financing for very short period of time usually without any collateral. Firstly microfinance was done by NGOs in Pakistan to help people establish their business. SMEDA played huge role in this regard. There are certain difficulties that are associated with micro financing.

1. High cost of funds

2. Operational cost is also high

Q3: What are the provisions of Sharia regarding the microfinance service? Can it be used for providing a source of earning for the poor/needy?

Ans: Because of which interest (rate) charged is high but default ratio in micro financing is high because of illiteracy as people do not think about the benefits of microfinance rather they take the loan with the intention of not returning it. Similarly, most debtors do not properly utilize it and use it for the purpose of clearing other liabilities which is further increasing default ratio as they are unable to generate profits earnings from the better utilization of loan. As the conventional banker, they do not mostly want to do micro financing except with very good reputation.
In Pakistan, TAHMEER bank took initiative of micro financing. In Bangladesh, GRAMEEN bank was the pioneer of micro financing that grew rapidly with great success in Bangladesh. Similar micro financing concept is followed by Pakistani banks but it’s not that successful and default ratio is much high in Pakistan.

Q4: **How will you analyze the integration of microfinance services in Islamic Banking operations? Can such a system be deemed feasible?**

**Ans:** In Islamic banking operations, cost is very high. Similarly, high operational cost is associated with the micro financing. The integration of both will result in high operational cost. The factor of operational cost is important to both Islamic banking and micro financing and cannot be reduced. Some time should be given to Islamic banking sector that it can deepen its roots in Pakistan at the same time microfinance will also grow and later both can be merged to get fruitful results. Islamic branch of Bank of Khyber started the housing scheme but the property prices declined reducing the profit margin for the bank so the scheme was a failure. Islamic banking is not that established, its concepts of products yet have to take shape that is both profitable as well according to SHARIA’H.

Q5: **What are the pertinent weaknesses in the present day Islamic Banking operations?**

**Ans:** The most important weakness of Islamic banking is that it is not completely according to Sharia i.e. its services cannot be reduced, therefore, resulting in high cost of Islamic funds. Greater risk is also associated with Islamic funds. The funds are still conventional.

Q6: **Will the weakness in Islamic Banking operations impact the Islamic Microfinance services? How?**

**Ans:** All these weaknesses will further increase the cost of micro financing. High operational cost is also linked with micro financing as banks form teams to continuously keep checks on those to whom microfinance is forwarded. Associated
with micro financing is also another types of risk, no proper reporting is done to SBP as these are small loans, no collateral exists, only guarantee is taken as security that usually turn out to be fake. No proper documentation is involved in micro financing, monitoring cost is very high, proper system for it exists but it is not implemented, every bank operates on profit including Islamic banks. Having greater default ratio associated with micro financing, it is not feasible for Islamic banking to introduce this since Islamic banking is not itself yet established.

Q7: What Islamic modes of financing may be employed for Islamic Microfinance service?

Ans: Financial leases (Ijarah) and Murabahah are the modes that could be employed for Islamic microfinance services. Assets purchasing for the microfinance client is done in which profit margin is set in the cost by the banks, guarantor is only taken from the client, no collateral exists, only charge on asset can be created but as the problem with the charge is that it can only be registered on corporations with SECP but not in case of SME’s and micro financing which is usually done on small basis to low income class.

Q8: Who could be the potential beneficiaries of Islamic Microfinance services?

Ans: The potential beneficiaries of the Islamic microfinance will be low-income group that is very religious minded and condemn haram conventional services. They would be benefited as haram conventional services are only barrier to their business prosperity by undertaking microfinance that is made according to accepted Islamic principles which will make them grow their business.

Q10: Any changes or recommendations would you like to share for Islamic Microfinance within Islamic Banking operations?

Ans: Firstly, analyze and judge the client in case of micro financing to get the most genuine clientele. Genuine clients can be mostly found in clusters. By cluster I mean that we select one area and its shopkeepers are selected as a whole for micro
financing so each shopkeeper can investigate about the other and can report about their competitor’s business conditions to the bank. Ask from the clients and suppliers about the reputation and personal information about the person to whom micro financing is advanced.

Secondly, separate products under Islamic microfinance, different from conventional products, should be designed, keeping in mind the customer.

Thirdly, source of funds should have minimum cost but no compromise should be done on operational cost.
REFERENCES


Consultative Group to Assist the Poor (CGAP) Official Webpage (2009) [http://www.cgap.org/p/site/c/about/]


Hulme, David and Paul Mosley (1996a), Finance Against Poverty, Volume 1, Routledge, London.


Khandkar, Mubina (1998), Women’s Access to Credit and Gender Relations in Bangladesh, Ph. D. Thesis, University of Manchester.


Ledgerwood, J. (1999), Microfinance Handbook: An Institutional and Financial Perspective (Sustainable Banking with the Poor), The World Bank, Washington, DC.


Maurer, K. (1999). “Bank Rakyat Indonesia (BRI); Indonesia (Case Study).” Eschborn, Germany: Consultative Group to Assist the Poor (CGAP) Working Group on Savings Mobilization - GTZ – BMZ.

Mirakhor, Abbas (2002) Hopes for the Future of Islamic Finance (Lecture at the Institute of Islamic Banking, London)


