

## **Abstract**

Microfinance programs are largely focused on income-generation for the poor as well as the creation of social capital. Like many countries in the developing world where poverty is prevalent, Pakistan has adopted microfinance as a major means of poverty alleviation. Microfinance achieved enormous success in Bangladesh and led to the awarding of the Nobel Peace Prize to Muhammad Yunus in 2006 for microfinance projects. However, unlike in Bangladesh where it has succeeded, the viability and usefulness of microfinance for poverty alleviation in Pakistan remain unclear. The main objective of this study is to investigate the limits and prospects of conventional and Islamic microfinance for poverty alleviation in Pakistan. To address this objective, the study undertakes a multipronged analysis. First, it assesses the performance of conventional microfinance in terms of financial sustainability and social outreach. Second, it examines the perceived differences between conventional and Islamic microfinance, based on a sample survey. Third, it proposes a mosque-based Islamic microfinance model to overcome the shortcomings of existing microfinance. Lastly, it tests the successful implementation of Islamic microfinance model through Linear Probability Model (Binary Dependent Model).

The study found that conventional microfinance has some limitations and it has not been able to achieve the “double-bottom line” objectives of financial sustainability and social outreach. The performance evaluation of the microfinance showed that some MFIs are financially sound and efficient but less efficient at social development, while others have social efficiency but lack financial self-sufficiency. A number of cultural and socio-political factors, e.g. domestic violence, terrorism, unfriendly business circumstances, and strict religiosity, can account for the underserving of conventional microfinance. From the financial performance view, microfinance

in Pakistan performed below the par value of microfinance in South Asia. The average for the depth of outreach is 11.97% which shows that on average, the percentage of serving the poorest is around 12% in the gross loan portfolio. The results thus support our hypothesis that conventional microfinance is skewed towards financial commercialization rather than social value creation.

The survey of peoples' perceptions regarding conventional and Islamic microfinance revealed that a majority of people in Pakistan understand the fundamental differences between these two types of microfinance. Also, the respondents expressed disagreement with the overly emphasized claims of conventional microfinance, i.e. empowering the poor (57% disagree), serving the poorest of the poor (94% disagree), and lifting the poor out of the poverty abyss (62% disagree). A majority of respondents (76%) choose Islamic microfinance as a source of potential borrowing in future because it works within the *Shariah* boundaries and charges no interest on loans. Islamic microfinance is considered a better tool for poverty alleviation because of its Welfarist genre as it works within the boundaries of Islamic *Shariah*. In sum, Islamic microfinance is positively perceived by the people of Pakistan. According to peoples' perception, Islamic microfinance could be used effectively in poverty alleviation efforts if it is aligned with modern financial environment.

The study also investigated whether or not Islamic microfinance can be used as a replacement of existing microfinance given the significant concomitant growth of Islamic banking and finance throughout the world. It proposed a new model of Islamic microfinance based on religious principles with the inclusion of the mosque (the Muslims' prayer place). A mosque-based system integrates financial services with religious practice and addresses a number of existing

issues of conventional microfinance. It is elaborated that the Islamic microfinance model can break the vicious circle of poverty with the injection of funds through entrepreneurial loans and consumption loans. Finally, the study tested the probability of successful implementation of Islamic microfinance in Pakistan by using the binary probability model (Probit) after recoding the peoples' responses into dummy variables. The analysis showed some significantly positive probabilities for the implementation of Islamic microfinance in Pakistan for poverty alleviation. Based on these findings, the study provides several recommendations for policy and further research.