The Role of Islamic Microfinance in Poverty Alleviation: A Case of Esaar Microfinance Program of Helping Hand for Relief and Development (HHRD)-Pakistan

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Abstract
This theoretical study shows that Islamic microfinance has a significant role in poverty alleviation strategies. While conventional microfinance products have been successful in Muslim countries, Muslims/beneficiaries are not much satisfied with these products because of interest (Riba) which is prohibited in Islam. Although taking an impression of Islamic microfinance in Muslim countries, this Study commences a case of Esaar Microfinance program of HHRD, an Islamic microfinance Program operating in Pakistan. Critical financial analysis of Esaar Microfinance program shows that it is providing services for all the poor according to the three different classifications: Abject poor, below the poverty line, at the poverty line and Interest free loans, is operating through three different modes, i.e., Murabaha, Mudaraba, and Qard-e-Hasan. Islamic Microfinance can be used as a powerful tool to trim down the poverty of Muslims as well as other communities. It recommends that linkages of institution NGOs (Non Government Organization), NPOs (Non Profit Organization) and RSPs (Rural Support Programs) with the specialized resource mobilization institutions and capacity building centers will enhance the financial stability of organizations and will be supportive to achieve the targets of providing Islamic microfinance services to the poorest of the poor under the umbrella.

Key Words: Islamic Microfinance, NPOs, NGOs, Poverty Alleviation, Impression, Prohibited, Interest (Riba)

Introduction
Islamic microfinance is a financial service of small quantity provided by the financial organization to the poor according to the Islamic principles. The worldwide success of Islamic Microfinance sector has produced an increasing trend for a positive change in Islamic Microfinance towards poverty alleviation. The basic aim of this sector is to provide maximum social benefits as opposed to the maximization of profit. Shari’a compliant microfinance can be feasible to reduce the socioeconomic crisis. Although, Islamic microfinance organization has made a significant space into the sector of microfinance other than the fact that Islamic microfinance seeks to promote social justice, equity, an embodiment. Islamic microfinance has now grown in term of its products and also expand the geographical coverage, but mostly Islamic microfinance organization is offering microfinance products in compliance with Islamic principles and providing the un-bankable Muslims continues to lag behind. Islamic microfinance, a combination of two swiftly growing industries Islamic microfinance and microfinance, has the strength of providing financial access to those poor who reject the conventional microfinance products which do not exist according to Islamic law. Even though the Islamic microfinance sector has appeared as a niche market, the sector is still in its early stages.

In OIC member countries’ religious and cultural norms drive preference of Islamic microfinance over conventional microfinance (Haneef Md. et.all 2014). Microfinance refers to making small loans available to poor people (especially those traditionally excluded from financial services) through programmes designed specifically to meet their particular needs and circumstances (Khan. 2008; p.6). Microfinancing has a positive impact on improving the living standard of the borrowers through poverty alleviation. It makes financial services accessible. The needs of the poor in Islamic countries are no different from the poor in other societies except that these are conditioned and influenced by their faith and culture in a significant way. They need financial services because they are often faced with events that call for spending more money than might be available around the house or in the pocket (IRTL, 2007, p.20). Since the creation of the microfinance institution, studies have shown that the poor who have access to the services of the programs are able to improve their lives and family conditions (Morduch, 2002). Sources suggest that about 72 percent of people in Muslim countries do not use the formal financial services because the financial system is interest based which is prohibited in Islam (Karim, Tarazi and Reille, 2008). This Study tries to provide an overview development of Islamic microfinance in Muslim countries while specifying its operation in Pakistan. It takes a case study of Esaar Microfinance Program of HHRD, an Islamic microfinance organization. It was established in 2005, and
the objective was to help the people living in abject poverty with interest free loan. This research examines the financial performance of Esaar Microfinance Program for the period 2011 to 2016 and gives recommendations for the future potential of Islamic microfinance in the country. Micro financial services based on Interest (Riba) facilities do not fulfill the needs of most of the Muslim population in developing countries as well as in developed countries. The main cause is that Interest based micro financial organization charge interest on their credits provided to small and medium enterprises as well as women entrepreneurs. The most of the Muslim avoid availing the Interest based Micro financial services due to the element of Interest because Interest (Riba) is prohibited in Islam. The Muslim population of more than 470 million is living below the poverty line (less than $2 per day) in four largely populated Muslim countries: Pakistan, Bangladesh, Indonesia and India (IRTI, 2007). In this current situation, Islamic microfinance has great potential in the Muslim countries and could be used as an influential tool to fight against poverty. It can create a valuable base of human capital by satisfying the financial needs of the Muslim community and positively contribute towards the economic growth in the Muslim countries.

Review of Literature and Previous Studies

Islamic microfinance is a financial service of small quantity provided by financial institutions to the poor. For the last few years, Islamic microfinance has been progressively recognized as an important tool in poverty alleviation strategies. Poor families face difficulty in regular and substantial earning to save for the future and are extremely vulnerable to economic, political, and physical slumps. A small drop in income or increase in expense can have a ruinous effect on their present low standard of living. They have limited access to basic health facilities; have a low literacy rate and poor living standards. Sickness, accident or death may force them to dispose of their property or some other productive assets, which in future impact to decrease in income and livelihood. The frequency of losses is also greater for the poor; many are regularly exposed to natural disasters (like a flood), fire, and theft with limited means of recovery (Patel, 2004; Ahmad, 2007; Obaidullah, 2008). Bolnick and Nelson (1990) find that microfinance financial institution participation had a positive impact on enterprises that were typically small, labor-intensive and growing, although the impact was far from uniform across sectors and target variables. They conducted surveys in Bangladesh and interviewed more than 1500 respondents. They concluded that the implementation of effective microfinance program has a significant impact on small enterprises. Dusuki (2006) has presented the idea of Islamic microfinance initiative in the perspective of Ibn Khaldun's concept of 'Asabiyah or social Solidarity that emphasizes group efforts and loyalty over self-interests of individuals. He argues that Islamic microfinance can be promoted through group lending to the poor who are normally denied access to mainstream banking services.

Littlefield, Murdock, and Hashemi found through various studies, that microfinance eliminated poverty, empowered women and enhanced education and health (taken from Wrenn, 2005:4). In addition, it improved beneficiaries income earning capacity, built their asset portfolio and reduced client susceptibility, with positive effects on poverty alleviation schemes in India, Indonesia, Zimbabwe, Bangladesh and Uganda (Wrenn, 2005:5). Microfinance also promotes consumption smoothening, economic growth and financial deepening (Ministry of Finance, 2003:81). Although Hulme and Mosley concluded that most present-day microfinance programs are not as effective as they could be (Wrenn, 2005:4).

Other estimates tell us that worldwide, there are 13 million microcredit borrowers, with USD 7 billion in outstanding loans, and generating repayment rates of 97 percent; growing at a rate of 30 percent annual growth. Despite all this, less than 18% of the world’s poorest households have access to financial services (Grameen Foundation, 2007). Ahmad (2007) points out that Microfinance initiative is widely acclaimed as a new approach to alleviating Poverty, to bring about economic development and to improve the living conditions of the poor.

Undertaking two seminal case studies in the use of Islamic finance instruments in MFIs: a) the Sanduq project in Jabal Al-Hoss, Syria; and b) the Hodeidah Microfinance Program (HMFP) in Hodeidah, Yemen (Frasca, 2008) concludes that Islamic MFIs can be both competitive with conventional MFIs in the region and meet the reported demand for religiously tailored financial services for lower income groups. The study argues that, if it is assumed that microfinance, in general, can improve the standard of living and alleviate poverty, then Islamic MFIs appear to be doing as well as their conventional microfinance counterparts. Frasca (2008, p.3) while focusing on the competitiveness of Islamic Microfinance, argues that Islamic finance could be potential ‘heaven’ for the investors who have become a victim of the current global credit crisis to relieve them from the speculative excess of the conventional system. Ahmad (2007) opines that contemporary Islamic finance has been largely disengaged from microfinance. On the one hand, most microfinance institutions (MFIs) are not Islamic as their financing is interest based. On the other hand, the Islamic financial system has been dominated mainly by Islamic banks. He further argues that MFI has to create various reserves to cover various risks arising due to the nature of its assets and

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liabilities. To protect from withdrawal risks, the MFI can use takaful and profit-equalization reserves to give depositors competitive returns. The paper shows that the proportion of waqf funds that can be allocated into microfinancing will depend on the takaful and economic capital reserves.

According to IDLO Report (2009), microfinance remains less developed in the Arab world than, for example, in Asia, Africa or Latin America and, although it seems to have taken hold in many Middle Eastern and North African (MENA) countries, it remains largely undeveloped in Saudi Arabia and in its infancy in the UAE. However, since 2006, the UAE has staged several high profile microfinance conferences showcasing microfinance initially as an alternative business model, in which participants might like to engage, and subsequently as an alternative asset class, in which participants might like to invest. On 17 January 2008 Noor Islamic Bank announced its commitment to serving the “unbankable” segment of the UAE population and, on 20 January 2009 at the Arab Economic, Social and Development Summit in Kuwait City, the League of Arab States announced the formation of a US$2 billion fund run by the Arab Development Fund that is set to include a microfinance programme that is aimed at helping small businesses through the credit crunch, extending credit to cottage industries and reducing unemployment across the Arab world.

The Table 1 shows the outreach of Islamic micro-finance CGAP global survey in 2007 as referred by Frasca (2008, p. 12) in which information was collected from over 126 Islamic MFIs and MFI experts in 19 Muslim countries. The survey reveals that Islamic MFIs have a total global outreach of 380,000 clients (or an estimated one-half 1% of total microfinance outreach), 80,000 of the above clients are served through a network of Indonesian cooperatives, and another 100,000 of the total clients are served by two large MFIs in Bangladesh. It must be stressed that the MENA region is particularly underserved as CGAP’s survey revealed that Islamic MFIs were concentrated in three countries—Indonesia, Bangladesh, and Afghanistan, accounting for 80% of the global outreach.

Frasca (2008) undertakes two seminal case studies in the use of Islamic finance instruments in MFIs: a) the Sanduq project in Jabal Al-Hoss, Syria; and b) the Hodeidah Microfinance Programme (HMFP) in Hodeidah, Yemen. He concludes that Islamic MFIs can be both competitive with conventional MFIs in the region and meet the reported demand for religiously tailored financial services for lower income groups. If we are to assume that microfinance, in general, can improve the standard of living and alleviate poverty, Islamic MFIs appear to be doing as well as their conventional microfinance counterparts. Karim et al. (2008) conducted a survey, which includes 125 institutions in 19 Muslim countries. It shows that Islamic microfinance providers still reach only 300,000 clients, one-third of them in Bangladesh alone. They argue that to reach more people and build sustainable institutions, it is essential to focus on designing affordable products, training and retaining skilled loan officers and administrators, improving operational efficiency, and managing overall business risk.

In Pakistan, the condition of people is pathetic as compared to other Muslim counties. Almost 80 percent of Pakistanis are poor according to the Economic Survey 2005-06 (defined as ‘extremely poor,’ ‘ultra poor,’ ‘poor,’ ‘vulnerable’ and ‘quasi-non poor’). The number of people in the lowest three of these income categories is over 36 million, yet according to a USAID study, only 600,000 people in Pakistan received microfinance in 2005. Although this is significant growth from 60,000 in 1999, it leaves many people out. While some people not using microfinance are just not interested in it, many may opt out of conventional microfinance due to its reliance upon interest-based financing, prohibited by Islam as riba (Goud, 2007). Apart from the banks, there is famous Islamic microfinance institution (IMFI) in Pakistan: Esaar Microfinance Program of Helping Hand for Relief and Development-Pakistan. This research paper takes an overview of functions and operations of Esaar Microfinance in the country and attempts to see its contribution towards poverty alleviation in the country based on its past for 2011 to 2016 performance.

**Esaar Microfinance Operations and Functions: An Overview**

Esaar Microfinance Program (HHRD) was started in 2010 with the objective of providing interest free micro loans to the poor so as to enhance their living standard. The fundamentals of Esaar Microfinance is based on three Principles.
Esaar Microfinance Program (HHRD) is committed to improving the lives of the poor; those who are financially abused, abandoned and overlooked by society. Esaar Microfinance has categorized Poverty into three levels. Level one which consists of very poor people who have barely anything to eat and to live. They are helped with safety Net system of Esaar Microfinance which is Qard-e-Hasana. This loan is basically for consumption purpose, but one can also use it for income generation purpose. When an individual is out of that miserable situation, and his consumption needs are over, he requires a permanent source of income so that he cannot fall into the same situation again. At this stage, he is provided (Murabaha) financing for Income Generating Activities. Most frequently financed activities include SMEs, Agriculture and Services Sector. After this stage, when a beneficiary desires economic sustainability, Esaar Microfinance is there with Partnership modes of financing (Mudaraba) for the growth in his business or economic activity. Esaar Microfinance program has developed a unique community-based lending structure. It has some very unique characters which are as follow:

Esaar Microfinance adopts a Union Council/District and mobilizes different communities within that Union Council/District. The program is operating through a verity of Islamic Financial Products which are based on Islamic Shariah. It provides services at the doorstep and sends the applications directly to Head office through an online Management Information System. At every step of Esaar Microfinance program implementation local community is given participation, whether it is social mobilization, Community Meetings or Disbursement. The community is given most importance in this program. Due to the uniqueness and simplicity of this program, it can be deployed in any part and environment of the world.

**Figure 1:** Principles of Esaar Microfinance-HHRD

**Figure 2:** Characteristic of Esaar Microfinance-HHRD
This Islamic Microfinance program provides loan with no any additional charges in a spirit of Islamic brotherhood. For the funding, purpose Donations are generated by Muslim families living in the USA and Local financial institution Pakistan poverty alleviation fund (PPAF). Whatever Donation is generated it is distributed among the most deserving segment of the society through different models of income generations. After disbursement, the amount is recovered back in a well-organized manner. The recovered amount is put back in the donation pool and is once again distributed among deserves. All activities revolve around the community and involve close interaction with the community. It uses social collateral group and individual financing based on mutual guarantees.

**Sustainability**

Many studies which have been written on the significance of sustainability issues of MFIs. The thing that comes to mind about sustainability is its financial aspect - operational self-sufficiency (OSS) and financial self-sufficiency (FSS). Actually financial and operational sustainability is only one major dimension. After seeing the Figure 3, Critics would argue that Esaar Microfinance is not operationally sustainable with the given standards. Esaar Microfinance is not covering 100% of its operational cost. Yes, it is true in financial terms, but there are some other dimensions of sustainability where Esaar Microfinance is performing better. These different dimensions of sustainability are:

1. To enable economic wellbeing and resilience for people with low incomes, especially suffering the disaster through interest free microfinance.

2. Provide social assistance, capacity building and integrated development ingredients to support the poor break the poverty cycle by creating the spirit of brotherhood.

3. To provide social benefits as opposed to profit maximization.

4. To institutionalize the Esaar Microfinance regarding sustainable, growth-oriented and replicable one.

This program is based on brotherhood, mutual help, and principles of Islam. Interest is strictly prohibited in Islam. Figure 4 indicates that portfolio growth declines with the sharp decline of equity growth over the last six years. Constant growth in a loan portfolio would be challenging for the Esaar Microfinance and need to be tackled in an effective manner.

**Conclusion**

This study shows that Islamic microfinance has a significance role in poverty alleviation strategies. On the other hand, the product of conventional microfinance has been a fruitful impact in Muslim countries, but those products do not fulfill the requirement of all the Muslim clients. Integration of Islamic social values of caring for the less privileged with microfinance power to deliver financial services to the poor has the potential to cover the millions more needy people, many of them prefer Islamic products over conventional microfinance due to Interest (Riba). This research paper undertakes a case study of Esaar Microfinance Program of Helping Hand for Relief and Development, an Islamic microfinance program operating in Pakistan. After the critical financial examination of Esaar Microfinance shows that it is providing services for all living below the poverty line including the “extremely poor” and Interest free loans can be used as a powerful tool against poverty. Yet Loan portfolio growth of Esaar Microfinance declines with the sharp decline of equity growth over the last six years that might pose some constraints on its financial stability in future. This challenge could be overcome by combining Islamic microfinance with NGOs (Non Government Organization), NPOs (Non Profit Organization) and RSPs (Rural Support Programs) with the specialized resource mobilization institutions and capacity building centers will enhance the financial stability of organizations and will be supportive of achieving the targets of providing Islamic microfinancial services to the poorest of the poor under the umbrella. It will also help to uplift the living standard of people and ultimately contribute towards the economic development and enriched prosperity of the country.

**References**


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Table 1: Country Wise Outreach of Islamic Microfinance

<table>
<thead>
<tr>
<th>Region</th>
<th>No. of Included Institutions</th>
<th>% Female (Avg.)</th>
<th>Total Clients</th>
<th>Total no. of Portfolio Balance (US$)</th>
<th>Avg. Loan Balance (US$)</th>
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<td>22</td>
<td>53,011</td>
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<td>302,303</td>
<td>197,891,882</td>
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Source: CGAP Survey, 2007 as referred by (Karim et al., 2008)

Figure 3: Operational Sufficiency of Esaar Microfinance-HHRD

Source: Author collation (Data taken from annual reports (2016) of Esaar Microfinance-HHRD

Figure 4: Equity and Loan Portfolio Growth of Esaar Microfinance-HHRD

Source: Author collation (Data taken from annual reports (2016) of Esaar Microfinance-HHRD