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CREDIT COMFORTABILITY AND MICROFINANCE: A FIELD STUDY TO DETERMINE PEOPLES' PERCEPTION ABOUT CONVENTIONAL AND ISLAMIC MICROFINANCE IN PAKISTAN

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Abstract

This paper examines credit comfortability and the role of microfinance, based on a field study which determines the perceptions of Pakistani people regarding conventional (interest based) and Islamic (interest free) microfinance. Conventional microfinance is not naïve in poverty alleviation but an in-depth analysis is needed to assess its success in poverty hit countries like Pakistan. The goals of poverty alleviation through microfinance in Pakistan have not fully achieved as majority of population have been living at below poverty line for many years. The primary data has collected through questionnaire with street intercept method during July'2014 to October'2014, in Karachi, Pakistan

***Keywords**: Credit comfortability, Riba free microfinance, Poverty alleviation, Shariah*

KREDİ YARDIMI VE MİKRO FİNANS: PAKİSTAN'DA ANANEVİ VE İSLAMİ MİKRO FİNANS KONUSUNDA İNSANLARIN ALGISINI BELİRLEYENLER HAKKINDA BİR SAHA ÇALIŞMASI

Özet

Bu makale Pakistan'daki insanların ananevi (faizli) ve İslami mikro finans (faizsiz) konusundaki algılarını araştıran bir saha çalışmasına dayanarak kredi yardımı ve mikro finansın rolünü incelemektedir. Ananevi mikro finans fakirliği azaltma konusunda kusursuz değildir ve Pakistan gibi fakirliğin vurduğu ülkelerdeki başarısı derinlemesine incelenmelidir. Pakistan'da nüfusun ekseriyeti yıllardır fakirlik eşiğinin altında yaşadığından mikro finans ile fakirliği azaltma hedefleri tam anlamıyla gerçekleşmemiştir. Temel veri seti, Temmuz-Ekim 2014 arasında Pakistan'in Karaçi şehrinde rassal yüzyüze anket metoduyla toplanmıştır.

***Anahtar Kelimeler:** Kredi yardımı, faizsiz mikro kredi, fakirliği azaltma, şeriat*

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1. Introduction

Islamic banking and finance is an emerging field on financial canvas around the globe, especially in the Muslim world. The pace of growth has acknowledged in the Global Financial Development Report (2014) by stating that the assets of more than 400 Islamic financial institutions in 58 countries have peaked up to US$1.5 trillion in 2012 and the target for 2013 was set to US$1.7 trillion with the expected growth of 17.6% per annum (World Islamic Banking Competitiveness Report, 2013-14). In Pakistan, Islamic banking and finance was originated in 1975 (Ul-Hassan, 2007) and micro credits were started during the early 80s. Initially, the small loans were provided in rural areas to support poor farmers as an extension of pre-partition institutional credits of 'Taccavi' and cooperative societies' loans. The government-administered loans 'Taccavi' were managed by the then provincial governments under the regulations of Land Improvement Loans Act (1883) and Agriculturists' Loan Act (1884)[2] With the passage of time, these loans lost their effectiveness and packed-off completely in 1993-94 (Iqbal, Ahmad and Abbas, 2003). In contrast, loans provided by cooperative societies and banks, fall under the regulation of Cooperative Credit Societies Act (1904) are remain in operation (The Punjab Agriculturists' Loan Act, 1958).

1.1. History of Microcredit in Pakistan

In April 1980, the Orangi Pilot Project (OPP) was the first NGO in Pakistan who successfully launched small and medium credits in urban periphery of Karachi. The multi-dimensional project was covering different sectors like health, housing, technology, education support services, credit and income generation, social forestry and a rural project (OPP, 1995). After a couple of years, the Aga Khan Rural Support Programme (AKRSP) was started in 1982, under the Aga Khan Foundation. The first NGO who initiated microcredit services for the people of northern areas of Pakistan. In the beginning their services were limited to micro-savings only but after a significant income generation through interest earnings, the project was expanded to other micro products as well (IEG, 2014).

Presently, the microfinance in Pakistan have shown a notable growth as its worth reached to PKR 52.1 billion with 2.8 million borrowers with a tenfold growth in the last decade (Basharat, Arshad and Khan, 2014) but the large number of potential customers are still unapproached. According to the State Bank of Pakistan, a significant growth had achieved in 2007-08 at the rate of 43% per annum but in comparison to 2009-2010, it shows a declining trend. The Pakistan Microfinance Network reports that the growth of gross loans portfolio has reached to 36 percent per year and the microfinance industry achieved the annual growth of 20 percent. The microfinance growth was not subject to the economic growth of the country because the economy has deteriorated its growth to just 3.6 percent in 2013 as compared to 4.4 percent in 2012 (PMN, 2013). Surprisingly, the significant growth

[2] Later on replaced by the West Pakistan Agriculturists Loan Act of 1958.

of microfinance could not expand the outreach in a similar fashion. According to the State Bank of Pakistan, the estimated outreach remained at 2.8 million borrowers, covering only 7 percent of the potential market (SBP, 2011).

1.2. Reasons to Establish Interest Free (Islamic) Microfinance in Pakistan

One possible factor of underutilization of conventional microfinance in Pakistan might be the interest charges on loans because interest-bearing transactions are strictly forbidden in Islam. As a matter of fact, Pakistan is the only country in the world which came into existence in the name of Islam. The majority of population (96%) in Pakistan practice Islam as a religion. (CIA world fact book, 2014) and most of the religious people do not avail conventional microfinance services due to interest implications.

The Islamic principles prohibit '*Riba'* (interest) in all transactions. In fact, all divine religions forbid interest. For example, the Quran (Muslims' holy book) says "Allah has laid His curse on usury and blessed almsgiving with increase. He bears no love for the impious and the sinful (2:276) and "Believers, have fear of Allah and waive what is still due to you from usury, if your faith be true" (2:278). It also mentions that the "Believers, do not live on usury, doubling your wealth many times over. Have fear of Allah and you shall prosper" (4:130). The Quran clearly encourages the Muslims to provide loans in the form of benevolence loans (Qard-ul-hasna) to poor and needy people. It says "Who is he that will give Allah Qard-ul-hasna? For Allah will increase it manifold to his credit" (11:57), and "if you give Allah Qard-ul-hasna…He will grant you forgiveness" (17: 64).

The Bible (the holy book of Christianity) prohibits interest at several places. Schwarz (2003:346) referred the Old Testament (Tenakh) which says that "If you lend the money to one of your poor neighbors among my people, you shall not act like an extortioner toward him by demanding interest from him" (Exodus, 22:24). It is also mentioned that "When one of your fellow countrymen is reduced to poverty and is unable to hold out beside you, extend to him the privileges of an alien or a tenant, so that he may continue to live with you (Leviticus, 25:35). At another place, the Bible says "Do not extract interest from your countrymen either in money or in kind, but out of fear of God let him live with you" (Leviticus, 25:36) and "You shall not demand interest from your countrymen on a loan of money or of food or of anything else on which interest is usually demanded" (Deuteronomy, 23:20).

Not only in Islam and Christianity, the interest is forbidden in the Judaism as well. Rapaport (2008:143) refers the Babylonian Talmud (the holy book of Judaism) which says, "Rabbi Abba said in the name of Rabbi Shimon, the son of Lakish: He who lends money is of a higher degree than the man who practices charity" (Tractate Shabbath 63a) and "He that putteth not out his money on interest, nor taketh a bribe against the innocent. He that doeth these things shall never be moved" (Psalms, 15:5) and also "He that is gracious unto the poor lendeth unto the Lord" (Tractate Bava Basra 10a).

The prohibition of interest is one of the main reasons that conventional microfinance could not enhance its outreach in the Muslim world because getting involved in interest-bearing loans is considered a sinful act and perceived negatively by most of the Muslims. On the contrary, the interest free or Islamic microfinance is achieving a parallel growth with the emergence of Islamic banking in the world. However, Islamic microfinance has some shortcomings that needs to be resolved like the lack of product diversification, inconsistency of '*Shariah'* (rules of Islamic jurisprudence) compliance and the disentanglement with conventional banking system. The Islamic *Shariah* provides a number of financial tools but most of the *Shariah-compliant* products are based on 'Murabaha' (cost-plus-markup) method. The table-1 shows selected tools of Islamic finance under the *Shariah* cover:

Table-1: List of Islamic financial instruments

Islamic financial instruments	Management	Type	Conditions
Musharakah	All partners are eligible in management decisions.	Investment on the basis of partnership shares.	Profits and losses are shared according to the ratios of investment shares.
Mudarabah	Capital provider is a sleeping partner	Investor provides capital while entrepreneur brings personal efforts.	Profits are shared according to pre-agreed ratios while losses are solely borne by the investor.
Murabaha	Purchases by the first party and transfers to the other party.	Cost-plus-markup.	Bank buys and sales to customer on installment.
Ijarah	Bank lease the equipment to its customer	Hire-purchase, Leasing	Bank buys and lease to customer on rental fee.
Qard-ul-hasna	Capital provider is uninvolved in management decisions	Interest free charitable loans.	Profits are shared according to pre-agreed ratios while losses are solely borne by the investor.
Wakalah	Business by bank on behalf of customer.	Business based on principal-agent terms.	Bank charges predetermined fee. Profits are shared according to mutual agreement.
Tawarruq	Tripartite sale.	Cost plus markup basis.	First party purchases and sales to other party on credit.
Hawalah	Liability transfer agreement.	Debt shifts from principal debtor to a third party.	First party takes debt/liability of second party from third party.
Takaful	Joint liability.	Insurance cover.	Money is pooled and invested.
Bai-Al-Salam	Advance purchases by first party for other party.	Sales contract.	Purchases are made on advance payment and goods are delivered in future.
Bai-Al-Istisna	Advance purchases of manufactured goods by first party for other party.	Sales contract for manufactured goods	Purchases are made on specifications on advance payment and goods are manufactured or delivered in future.

Murabaha is the only tool, frequently being used in Islamic micro-finance. According to a survey in Bangladesh, more than 70 percent of Islamic financing products are based on *Murabaha*. It is worthwhile to note that Bangladesh has a largest microfinance outreach covering about 8 million customers (Saad, 2012). *Murabaha* is a type of financial transaction in which the first party purchases the goods and sells to other party on the basis of original cost plus some markup. The payment can be made in cash or installments, depending upon the mutual agreement between the both parties. This phenomenon creates a curiosity why other financial instruments are not being practiced in Islamic microfinance. The prohibition of interest urges us to conduct a research on how people perceive conventional microfinance and Islamic microfinance, and what are the future prospects or potential of Islamic microfinance in Pakistan.

This paper is organized in a way that section 2 describes the literature view, section 3 explains methodological framework and section 4 exhibits conclusions.

2. Literature Overview

The concept of microfinance is tied up with poverty alleviation and its main objective is to help financially excluded, unbanked, poor entrepreneurs having capability to generate funds. However, the concept of financial inclusion is not limited to small credits only, it covers a broad range of financial products like deposits, payments services, money transfers and micro insurance as well (Conroy, 2003:2). The microfinance services provide some hopes in the lives of poor entrepreneurs who are usually away from formal banking services (Ledgerwood, 1999:5). Their innate inability to provide collateral against loans coerce them to live in deep poverty cycles. Despite the microfinance is committed to a noble cause, the modern commercialization effects raised a skepticism on conventional microfinance services because the recent trend in microfinance advances against the double bottom line (Drake and Rhyne, 2002).

It is worth noting that most of the modern microfinance practitioners agreed that existing microfinance could not achieve the double bottom line because the institutions focused on financial self-sufficiency lack social view of microfinance and the institutions concerned about poverty outreach outrightly ignore financial aspects. This unfilled gap in microfinance gives the ways to Islamic microfinance.

Broadly speaking, Islamic financial system comprises Islamic banking and finance including microfinance. The fundamental doctrine is same for both banking and microfinance in Islamic (*Shariah)* jurisprudence *(*set of divine principles revealed in the Quran). The *Shariah* emphasizes two main restrictions on all financial matters. The first one, interest (*Riba)* is forbidden in all transactions because of its exploitative nature, and the second, all transactions involving risk and uncertainty (*Gharar)* are prohibited such as gambling and speculation. Pollard and Sameers (2007) noted that the Islamic finance encourages asset-based investments, in order to connect financial and real sectors of the economy. Intuitively, the money has a tendency to concentrate at one point, which is why, the Islam does not consider money as a commodity because its value can't be increased until and unless used for productive activities. An alternative mechanism of profit-n-loss in Islamic finance envisages a circular channel of growth by enticing all the stakeholders on board. The fund providers are not merely considered money lenders (having fail safe return-on-investments) but the active investors who share risks and rewards (CGAP, 2008).

Though, both Islamic microfinance and conventional microfinance have the same objectives of financial inclusion for economic growth, but the methods of application are significantly different from each other. Conventional microfinance largely depends upon the interest charges on loans; whereas, Islamic microfinance is based on interest-free contrivance and rely mainly on charities like *zakat, sadaqat,* and, *almsgiving*. This point is also attributed by Rahman (2007) that Islamic microfinance maximizes social services through charities. The profit-n-loss method of Islamic microfinance uses other channels to fulfil the demand for funds without eyeing interest income. He concludes that *Shariah* compliant financing instruments can be used more efficiently if the risk mitigation techniques could be aligned with modern financial environment. The substantial growth of Islamic banking can be used to provide a financial backup to Islamic microfinance because both work under the same jurisdiction and fundamental principles. According to Abdouli (1991), Islamic banks can narrow the gap of income distribution which has been increasing due to conventional banking because they do not provide a financial assistance only but establish a long term business relationship with small and medium entrepreneurs through monitoring and guidance. The probability of project success surmounts when loans provided with proper guidance, technical assistance and supervisory skills. To explain rudimentary contracting practice of Islamic banks, Aggarwal and Yousuf (2000) assert that most of the Islamic banks lack a *Shariah-based* equity (PLS) financing because they are skewed towards debt-like instruments as a rational response to their operating environment. An intensified competition between Islamic banks and conventional banks can create more profit and loss contract opportunities. But at present, the way Islamic banks are operating is more alike incentive seeking than *Shariah* compliance because the significant portion of financial contracts consists debt-like financing (*Murabaha* and *Ijarah)* instead of profit-n-loss sharing based financing (*Mudarabah* and *Musharakah).* Dhumale and Sapcanin (1999) noted that there is a compatibility match between the practices of Islamic banks and microfinance. The former one grants loans on the basis of expertise and skills without physical collateral while the latter one uses entrepreneurial abilities and expertise in profit generating economic activities. Thus, these two can make the difference by working together. Ahmed (2002) considers that Islamic microfinance is still in infancy period and yet to develop a profound system that can compete existing microfinance. The conventional microfinance is facing some serious challenges such as serving ultra-poor, asymmetric information, high drop-out ratio and double dipping etc. Notwithstanding, Islamic microfinance yet to develop a solution set but it has the potential to cope such issues. He pointed out that a lack of (R&D) 'research and development' is a root cause of communication gap between the loan providers and poor entrepreneurs. To solve, he proposed that international agencies can provide financial training and assistance to both groups to align the existing system. The financial subsidization is also needed to enhance the outreach and efficiency of microfinance. Khan (2008) asserts that a distant gap between the demand and supply of loanable funds causes the limited success of conventional microfinance. The inconsequential subsidization from the international donors puts an extra burden on 'micro finance institutes' (MFIs) to become self-sufficient rather than merely dependent on external sources. A paradigm shift from the social welfare to financial sustainability coerces MFIs to charge exorbitant interests. This mission drift burgeons inconsistency of conventional microfinance. He proposed that Islamic microfinance can acquire funds through Islamic charities i.e. *Zakat*, *Sadaqat* and A*lmsgiving* to fill the demand and supply gap. However, his theoretical assertion doesn't provide a clear cut line of actions to make microfinance a substantial tool for poverty alleviation. In addition, other consequential factors are also undiscussed such as information asymmetry, concentrated outreach, loans from multiple sources and adverse selection etc. Ahmad and Ahmad (2008), in the context of microfinance in Australia, explain that Islamic Microfinance Service Providers (ISMPs) play a dominant role in welfare of Australian Muslim Community but their clientele base is limited and an expansion in outreach is needed to make it more efficient. Moreover, ISMPs should have to formulate Islamic financial products according to the needs of poor in Australia.

The review of above literature sheds light on the role of conventional and Islamic microfinance in poverty alleviation. Conventional microfinance has achieved a limited success due to integrated dysfunctionalities in the existing system. On the other hand, Islamic microfinance has the potential to cope the challenges but it requires a sound financial backup and product diversification. The consortium of Islamic banks and financial institutions could be used to establish a common pool, to cater the needs of poverty alleviation projects in an efficient manner.

3. Methodological Framework

3.1. Fieldwork Study

In consideration with exploratory nature of research, the street intercept survey method is used to collect data from all six districts of Karachi city in Pakistan. This field study was conducted during July-2014 to October-2014 as a part of my Ph.D. dissertation. Although, 332 out of 400 survey questionnaires are collected from six districts in Karachi Pakistan, it represents just an estimation of the entire population. Therefore, a caution must be placed while interpreting the results.

3.2. Key Objectives of the Study

The following are the main objectives of this study:

a). What are the main hurdles to get loans in Pakistan?

b). How people of Pakistan perceive conventional and Islamic microfinance? And what is the potential scope of Islamic microfinance in Pakistan?

d). How much the efforts of conventional (interest-based) microfinance be successful in poverty alleviation?

e). Did the conventional (interest-based) microfinance achieve the desired results of poverty alleviation?

3.3. Data Collection

A structured questionnaire was developed to collect primary data regarding credit comfortability and peoples' perception about conventional and Islamic microfinance in Pakistan. The survey consists five sections and each section contains questions related to the different parts of the study. The first three sections are based on close-ended questions and the last two sections contain five-level Likert scale questions. A simple random sampling with street intercept methods are used for the data collection in randomly selected locations of Karachi city.

Initially, the pilot study was conducted in the district central, Karachi, and after a careful scrutiny of the responses, a full scale survey was carried-out during July'2014 to October'2014. Preliminary target was set to conduct 400 structured interviews but the time and resource constraints did not allow us to achieve full target, therefore, 332 survey questionnaires could finally be conducted during the above stated time period.

4. Empirical Results

4.1. Analysis of Responses

This section contains the actual responses recorded through the survey questionnaires and recapitulated here for further empirical analysis.

4.1.1. Characteristic Features of Respondents

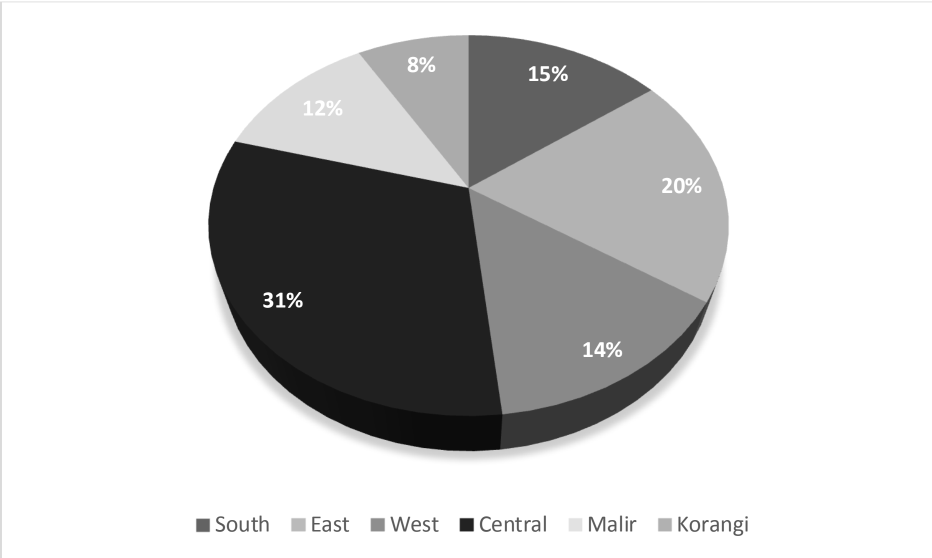
The demographics section includes age, gender, vicinity, marital-status, number of children, education, and religion. Although, respondents for this study were chosen randomly, we found a majority of respondents (43.34%) are young and belong to age group of 18-30 years. Respondents belong to age group of 31-45 years are 28.61%, and the percentage of respondents fall in age category of 46-60 years is 20.48%. The percentage of mature respondents is 6.93%, belong to age group (61 and above). The ratio of female respondents (55%) is higher than the male (45%). The table-2 shows the age distribution of respondents.

Table-2: Age cohorts of respondents

Age groups	18-30	31-45	46-60	61 and above	No Answer	Total
Frequency	144	95	68	23	2	332
Percentage	43.37	28.61	20.48	6.93	0.61	100
Cum. Freq.	43.37	71.98	92.46	99.39	100	

To observe the diversity of respondents, samples were drawn from randomly selected locations in all six districts of Karachi. The regional distribution shows that 14.8% respondent live in South district, 19.6% live in East district, 14.9% live in West district, 31% live in district Central, 12.3% live in Malir district and 8.4% live in Korangi district. The figure-2 below shows the regional distribution.

Figure-2: Regional Distribution of Respondents



Analysis of marital status reveals that 44% respondents were never married, 43% are married; divorced, separated and widowed are 3.3%, 2.4%, and 7.2% respectively. Academic qualifications exhibit that 2.1% have no education, 2.1% have basic education, 22.3% have tertiary level, 30.4% are graduate, 39.5% have master level education, 3.3% have doctorate and only 0.3% have vocational training. Regarding religious affiliation of respondents, 95.5% belong to Islam which reflects the fact that Pakistan is a Muslims dominated country. The representatives of Christian community are 2.1%, and 2.4% respondents practice Hindu religion (table-3).

Table-3: Demographics

		Marital status				
Marital Status	Never Married	Divorced	Married	Separated	Widowed	Total
Freq.	146	11	143	8	24	332
Per%	44	3.3	43.1	2.4	7.2	100
Cum%	44	47.3	90.4	92.8	100	

			Education level						
Education	No Education	Basic Education	Secondary	Intermediate	Graduation	Masters	Ph.D.	Others	Total
Freq.	7	7	14	60	101	131	11	1	332
Per%	2.1	2.1	4.2	18.1	30.4	39.5	3.3	0.3	100
Cum%	2.1	4.2	8.4	26.5	56.9	96.4	99.7	100	

	Religious affiliation			
Religion	Muslims	Christian	Hindu	Total
Freq.	317	7	8	332
Per%	95.5	2.1	2.4	100
Cum%	95.5	97.6	100	

4.1.2. Financial Position

This section covers the analysis related to financial position of respondents. The table-4 shows the source of earnings. In addition, some respondents have auxiliary sources of earnings. 158 out of 332 respondents mentioned additional income sources i.e. income from farm land (4), capital investment (45), share market investment (26), remittance from abroad (27) and others sources (56). Respondents were also asked about the ownership of any transportation vehicle. 3.9% have bicycles, 29.5% have motorbikes / scooters, 5.2% have Rickshaw / Qinqi, 2.4% have tractors, 29.2% have a car, 1.5% have other mode of transportation, and 26.5% do not own any transportation.

Table-4: Source of earnings

Occupation	Un-employed	Student	Govt. Service	Private Service	Business	House wife	Others	Total
Freq.	14	100	39	108	18	37	16	332
Per%	4.2	30.1	11.7	32.5	5.4	11.1	4.8	100
Cum%	4.2	34.3	46.1	78.6	84	95.2	100	
Income	No income	< Rs.6000	Rs. 6001 ~ Rs. 15000	Rs. 15001~ Rs. 30000	Rs. 30001~ Rs. 60000	> Rs.60000	No Answer	Total
Freq.	7	8	23	61	120	101	12	332
Per%	2.1	2.4	6.9	18.4	36.1	30.4	3.7	100
Cum%	2.1	4.5	11.4	29.8	65.9	96.3	100	

Regarding the access to formal financial services, a majority have formal bank accounts (78.6%) and 21.4% do not have account in any bank. 61.4% operate their accounts in commercial banks, 10.2% use Islamic banks, 5.1% use foreign banks and 1.8% use other banks. Regarding the type of bank accounts, 36.7% have current accounts, 33.4% have profit-n-loss (PLS) accounts, 5.1% have interest free accounts and 3.3% have other type of accounts.

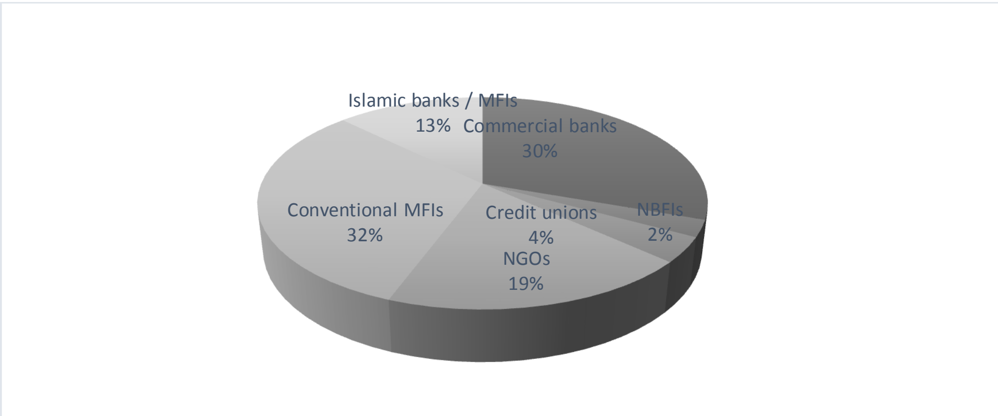
4.1.3. Credit Comfortability

This section analyzes the existing financial environment which is suitable for borrowing. Pakistan has a broad range of banks but acquiring loan is a quite clumsy. Presently fifty six banks are in operation in the country (Pakistan & Gulf Economist, 2013) and most of the banks have either headquarters or main branches in Karachi. This paper aims to reveal the major constraints in borrowing especially in the presence of major banks. According to our field surveys, 128 out of 332 respondents have availed the facility to obtain loans in their life time. Out of the total 7% have obtained a loan of Rs. 6000/- or less, 10% have obtained loans between Rs. 6001/- to Rs. 15000/-, 19% have obtained loans between Rs.15001/- to Rs. 30000/-, 36% have acquired loans between Rs. 30001/- to Rs. 60000/- and 28% have acquired a loan of Rs. 60001/- and more.

Another issue that makes microfinance borrowers dubious and viability of microfinance at stake, is the usage of loans in inappropriate manners particularly for purposes other than economic activity or income generation. Our survey results indicate that a major proportion of the borrowing had used for non-productive activities and only 23.44% loans were used for business purpose. The loans used for other purposes includes funeral ceremony of a relative (6.25%), accident, injury or illness of a family member (17.19%), catastrophes (3.91%), marriage of a family member (25.78%), other purposes (13.28%), and consumption purpose (10.16%). A high percentage of loans were used for non-income generation that could be a startling sign for lenders as their investments would be considered highly risky with the assumption of a high default. This leads to a high monitoring cost at the lenders' end.

Regarding the formal source of borrowing, conventional MFIs is a major source of borrowing (32%) followed by commercial banks (30%), NGOs (19%), Islamic banks/ MFIs (13%), credit unions (4%) and non-bank financial institutions (2%). Interestingly, it seems that commercial banks and conventional (interest-based) MFIs have better networks and systematic methods for a formal lending. On the other hand, Islamic banks or MFIs are still in growing phase and they need time to get the customers' confidence, necessary to attract the potential borrowers. The figure-3 below shows the share of lending by various financial institutions.

Figure-3: Formal Sources of Borrowing



A significant portion (62%) of our respondents acquired loans from the formal sources and 32% obtained the loans from informal credit sources. Interestingly, there is a big difference between the interest charges on loans, provided by informal sources and formal lending sources. It shows that informal source of lending is very attractive for borrowers because informal sources charge lesser interest on loan than formal sources. The table-5 shows the comparison of interest paid on loans.

Table-5: Interest paid on loans to formal and informal source of lending

Interest charges on loans	Formal lending sources	Informal lending sources
No interest	10.13%	71.43%
10% or below	7.59%	8.16%
Between 11% to 20%	25.32%	6.12%
Between 21% to 30%	21.52%	4.08%
Between 31% to 40%	18.99%	10.20%
40% or more	16.46%	-

4.1.3.1. Main Constraints In Borrowing

This paper aims to reveal the major constraints in borrowing. A significant portion (65%) of our respondents reported that they had faced problems while acquiring loans. The table-6 shows the main hurdles borrower faced for their loan sanctioning.

Table-6: Hurdles in borrowing

Type of problems	Freq.	Per%	Cum%
Access to loan provider is far	18	21.43	21.40
Collateral requirements	27	32.14	53.60
Inordinate delays in loan processing	14	16.67	70.20
Exorbitant interest charges on loan	25	29.76	100.00
Total	84	100.00	

One of the main issues in borrowing was the collateral requirement that contextualized the inception of microfinance. This survey revealed that 32% respondents had severely faced this constraint while borrowing. The other borrowing issues include exorbitant interest charges on loans as about 30% respondents consider it a devastating experience. The lack of outreach is also a burning issue for loan providers, because 21% respondents think that accessibility constraint causes the wastage of time and resources. Procedural lapse in formal borrowing is an issue that catalyzes inordinate delays in loan sanctioning and disbursement; about 17% respondents faced this problem in borrowing.

4.1.3.2. Repayment Issues

Regarding the problems in repayment, a majority of respondents could not save enough to repay on time due to some unforeseen events. As 44% respondents reportedly consumed the loans because of catastrophic problems or marriage of a family member. The second main reason for nonpayment or delay in payment was exorbitant interest that made the borrowers bankrupt. Some of the borrowers (14%) purposely used the loans to nonproductive activities. The table-7 shows the bifurcation of problems, respondents faced in regular repayments and in some cases led to a default.

Table-7: Repayment constraints

Repayment constraints	Freq.	Per%	Cum%
Used loans for consumption purpose	9	14.06	14.10
No savings left due to catastrophes, accident, injury and illness	14	21.88	35.90
No savings left due to marriage of any family member	14	21.88	57.80
High interest rates made it difficult to repay	21	32.81	90.60
Others	6	9.38	100
Total	64	100	

4.1.4. Analysis of Responses on Perception towards Conventional (Interest Based) Microfinance

4.1.4.1. Exorbitant Interest Charges

This section analyzes research responses regarding the performance of conventional (interest based) microfinance. The first set of questions reveals peoples' perception about existing microfinance's role in poverty alleviation efforts in Pakistan.

The issue of charging high interest rate has been under a strong criticism since the inception of microfinance but in the last couple of decades it became a burning issue (CGAP, 1996). The main reason for the growing concerns is the transformation of some MFIs into private commercial corporations (CGAP, 2009). A significant majority of respondent have viewed that existing microfinance charge distortionary interest as 65.35 percent respondents agreed and 15.06 percent disagreed, while 16.27 percent were undecided and 4.22 percent gave no answer to this question (table-8). It reflects that conventional microfinance in Pakistan charge exorbitantly, ranging from 30 percent to 50 percent (Munir, 2012). The conspicuous reasons MFIs always put forward for charging distortionary interest rates include high administrative and operational costs of loans, risks of default, and an excessive demand with relatively a short supply of loans. Nevertheless, as a guideline for loan pricing, Ledgerwood and Earne (2013:218) assert that a balanced approach is required because charging too high will eventually reduce the loan demand that can hurt the sustainability of microfinance and charging too low will not allow to cover the costs of loan.

4.1.4.2. Complex Calculations for Repayment Installments

The microfinance is often criticized for being too complicated in calculation of repayment installments. The table-8 shows the opinions regarding complex calculations microfinance often use for the estimation of repayment installments which mostly difficult to understand for poor people. Given that most of the microfinance customers live in rural areas and do not contain basic education. As per the survey 71.69 percent agreed with this point, 13.25 percent disagreed, 11.75 were undecided and 3.31 percent did not answer to this question (table-8). It is worth noting that presently, two methods are frequently being practiced for the calculation of interest rates i.e. flat rate method and declining balance method. Both these methods differ in their calculation and give different effective interest rates. The declining balance method is much easier to calculate but could be confusing for borrowers (Ledgerwood & Earne, 2013:219).

4.1.4.3. Empowerment of Poor through Microfinance Loans

The microfinance practitioners claim that poor are being empowered through loans and financial inclusion because the microloans are considered the ways to gender equality and empowerment (Armendariz-de-Aghion & Morduch, 2005:184). To test this claim, we attempt to get peoples' perceptions about the role of MFIs in the empowerment of poor. The responses clearly indicate that majority of people do not agree (56 percent), only 22.59 percent people agreed, while 17.47 percent were undecided and 3.01 percent did not answer (table-8). While refuting the claim of empowerment, Armendariz-de-Aghion and Morduch (2005:195) argued that gender empowerment was seen with a suspicious eye by the microfinance practitioners who were focused on strong financial institutionalization. That is why, this self-proclaimed myth has not get much attention by the critics of microfinance.

4.1.4.4. Serving Ultra-Poor (Poorest of the Poor)

The goal of serving ultra-poor (poorest of the poor) is an utmost consideration of microfinance because it scales down poverty in the long run. The responses regarding the ultimate goal of microfinance i.e. to serving poorest of the poor, are summarized in table-8. It shows that 66.16 percent respondents were not agreed, while 15.96 percent gave the vote in favor of above statement, and about 20 percent did not reply. On the same note, Ghosh (2013) asserts that just in the last few years "from being lauded as the silver bullet to solve the problems of development and poverty reduction, to being derided as the progenitor of financial instability and enhanced vulnerability among the poorest people who can ill afford to take this additional burden." Navajas et al. (2000) found that five major microfinance providers in Bolivia do not reach to poorest of the poor but just above and below the poverty line. Apart from the success stories, results of this research contradict the overemphasized and self-proclaimed saga of microfinance regarding poverty eradication in Pakistan.

4.1.4.5. Role of Conventional (Interest-Based) Microfinance in Poverty Alleviation

The next question was being asked about the role of microfinance in poverty alleviation. The microfinance has been acclaimed in the world for many years, but some of the critics raised their fingers on its application and viability. A couple of recent randomized studies could not find the proofs that microcredits have raised the income and consumption of the poor people, at least during the term of studies (CGAP, 2009). Accordingly, this research revealed that almost 62 percent of our respondents do not agree that microfinance really lift the poor out of poverty, only 20 percent were agreed, 15 percent were remained neutral and 3 percent did not answer to this question (table-8).

4.1.4.6. Conventional (Interest-Based) Microfinance and Unethical Recovery Practices

Another important issue in hand is the use of forceful measures in recovery proceedings. A non-discriminatory practice demands that each and every borrower should be treated fairly with due respect and dignity. But, unfortunately it is not being practiced specially if borrowers are ultra-poor or loan officers have workload. Because of such manhandled pressures, loan officers often make mistakes and behave inappropriately. Sarkar (2013) notes that in such situations, loan officers adversely select borrowers and use unethical practices for repayment that sometimes lead to create chaos in borrowers. One prime example of such indecent behavior of loans officers is microfinance in India. Hudon (2011, pp:127) states that in India, the microfinance often use unethical and aggressive recovery practices. However, the scope of this research is limited to the case of Pakistan; therefore, we get the views regarding the unethical practices used by microfinance in Pakistan. It seems that a majority of our respondents have the views reflective of the actual scenario as about 67 percent respondents were agreed that microfinance use unethical practices for repayment and merely 11 percent respondents disagreed, rest of the 20 percent were either undecided or did not reply to this question (table-8).

4.1.4.7. Conventional (Interest-Based) Microfinance and Commercialization

The final question of this section is focused on the perceptions of commercialization in microfinance. About 70.48 percent respondents were agreed that microfinance is skewed towards business view rather than the aspect of social welfare. In contrast, about 11.75 percent respondents do not see any mission drift in microfinance, 14.16 percent were undecided and just 3.61 percent remained unanswered to this question (table-8).

Table-8: Descriptive statistics and analysis of responses about conventional (interest-based) microfinance

Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	No Answer	Mean	SD
1. Do you agree that existing (interest based) microfinance charge exorbitant interest rates?	16 (4.82)	34 (0.06)	54 (31.33)	119 (67.17)	95 (28.61)	14 (4.22)	3.76	1.139
2. Do you agree that existing (interest based) microfinance use complex calculation of repayment instalments that is not understandable?	12 (3.61)	32 (9.64)	39 (11.75)	130 (39.16)	108 (32.53)	11 (3.31)	3.90	1.090
3. Do you agree that existing (interest based) microfinance is empowering the poor people despite high interest charges?	53 (15.96)	136 (40.96	58 (17.47)	57 (17.17)	18 (5.42)	10 (3.01)	2.54	1.127
4. Do you agree that existing (interest based) microfinance is serving poorest of the poor people in the society?	71 (21.39)	142 (72.77	54 (16.27	44 (13.25)	9 (2.71)	12 (3.61)	2.31	1.050
5. Do you agree that existing (interest based) microfinance lift the poor out of poverty?	65 (19.58)	141 (42.47	50 (15.06)	53 (15.96)	12 (3.61	11 (3.31)	2.40	1.097
6. Do you agree that existing (interest based) microfinance use unethical practices for the recovery of loans?	7 (2.11)	31 (9.34)	60 (18.07)	85 (25.60)	138 (41.57)	11 (3.31)	3.98	1.097
7. Do you agree that existing (interest based) microfinance is more business-oriented?	8 (2.41	31 (9.34)	47 (14.16)	110 (33.13)	124 (37.35)	12 (3.61)	3.97	1.072

4.1.5. Analysis of Responses on Perception towards Islamic Microfinance

4.1.5.1. Islamic Microfinance Work within The Shariah Boundaries

The analysis in this section is based on the responses of people on Islamic microfinance. As noted above, the prohibition of interest (*Riba)* in Islam does not permit Islamic microfinance to charge any form of interest on lending. The views presented in table-9 below show the perception whether Islamic microfinance work within the *Shariah* boundaries or not? About 42 percent respondents have given the vote against it and merely 39 percent respondents agreed that Islamic microfinance work under the Islamic jurisprudence called *Shariah*. From rest of the 19 percent 17 percent were undecided and 2 percent did not reply (table-9). The responses look quite rational as the *Shariah-compliant* product in Pakistan is scarce. This point is also highlighted by Karim (2013), who asserts that despite the considerable growth of Islamic microfinance in the last few years, the *Shariah-compliant* products represents less than one percent in Pakistan. Moreover, the State Bank of Pakistan has also urged the Islamic banks to improve their investment for the expansion of outreach to meet the overwhelming demand of *Shariah-based* banking products (SBP-KAP Report, 2014).

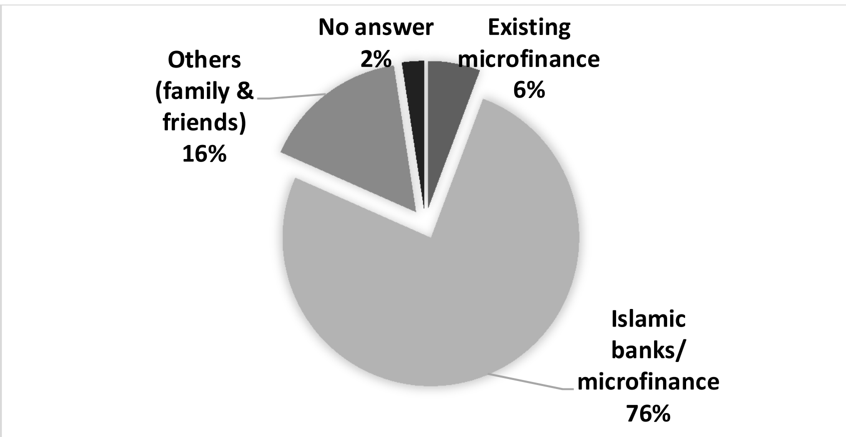
4.1.5.2. Core Objectives of Islamic Microfinance

We get the perceptions regarding the core objectives of Islamic microfinance. A majority of respondents believe that the primary objective of Islamic microfinance is to help poor as about 62 percent respondents agreed and 17 percent were disagreed to this view, while 19 percent were undecided and 2 percent were unanswered (table-9). In fact, Islamic microfinance can serve the goal of poverty alleviation more effectively than other form of microfinance because the innate objective of *Shariah* is to build a strong community capacity. In the same context, Abdul-Rahman (2007) asserts that the primary goal of microfinance is to assist poor in economic endeavor to get them out of poverty trap and Islamic microfinance take one step ahead by providing them interest free loans.

4.1.5.3. Respondents' Choice of Potential Borrowing

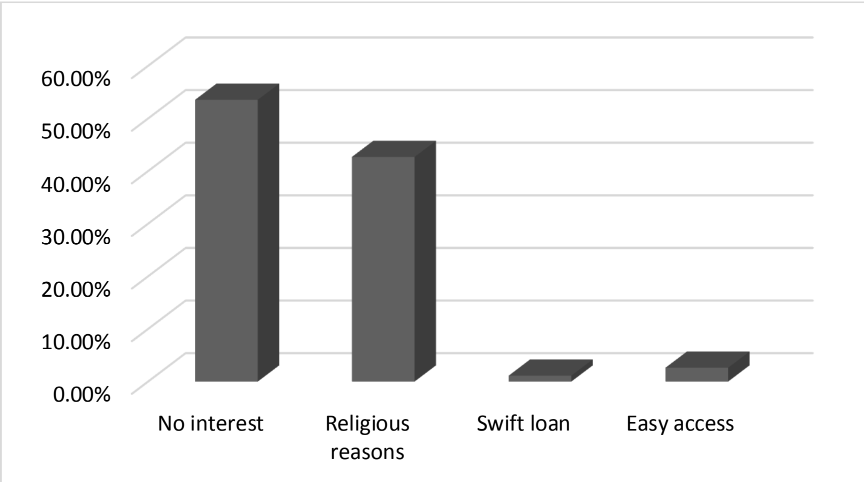
The analysis on the choice of borrowing revealed that a significant majority of borrowers (76%) like to borrow from Islamic financial sources, the second largest choice was informal sources i.e. friends and family (16%), and merely 6 percent trust on existing microfinance. The figure-4 below shows the choice of potential borrowings

Figure-4: Choice Of Borrowing



About 54% among those who chose Islamic banks / microfinance prefer due to its impeccability of repayment without the imposition of interest. About 43 percent want to borrow due to religious reasons because involving in interest-bearing financial transactions is considered a big sin and against the basic ideology of Islam. Just 2 percent respondents think that getting loans by Islamic sources is a way of an easy access. The figure-5 below shows the reasons to choose Islamic finance for borrowing.

Figure-5: Reasons to Choose Islamic Banks / Microfinance



4.1.5.4. Is Islamic Microfinance a better Tool for Poverty Alleviation?

The difference between Islamic microfinance and existing microfinance is not just the imposition of interest charges but Islamic microfinance is considered a better tool for poverty alleviation, based on *Shariah* principles that distinguish it from other microfinances (Onakoya and Onakoya, 2013). On the same note, Hassan (2010) asserts that Islamic microfinance is based on social justice which is a core element of Islamic principles. A majority of respondent (73%) view Islamic microfinance a better tool for poverty alleviation. Only 7 percent were against this view, 17 percent were remained neutral and 2 percent did not reply (table-9)

4.1.5.5. Islamic Microfinance and Coercive Recovery Practices

Another important criticism that conventional microfinance always face, is coercive practices for recovery in case of default. Nevertheless, Islamic microfinance shuns unethical practices for repayment. The following table-9 shows the analysis of perceptions, regarding recovery practice of Islamic microfinance. The responses revealed that 45 percent respondents agreed that in case of default, Islamic microfinance do not use coercive practices, about 20 percent respondents were disagreed, 32 percent were indifferent and 2 percent did not reply (table-9).

4.1.5.6. Government Support and Participation of Islamic Microfinance in Poverty Alleviation Efforts

The government support can increase the participation of Islamic microfinance in poverty alleviation. This view is being asked to our respondents. A vast majority (70 percent) have agreed that government can play a vital role in poverty alleviation efforts through Islamic microfinance. It can provide subsidiaries and soft loans that can be channelized through Islamic microfinance. However, 15 percent respondents reject the idea of government assistance in microfinance matters. The possible reasons for the rejection of government's role in poverty alleviation might be the track record of poor performance and bad governance of democratic governments in the history of Pakistan.

4.1.5.7. Emergence of Islamic Microfinance due to an Emergence of Islamic Banks

The term 'financial inclusion' is frequently being used in microfinance literature which refers to the inclusion of financially excluded poor into a formal banking system. This concept tacitly acknowledges the role of microfinance as a sub part of formal banking system and conscientiously asked the banks to provide financial support to microfinance. We get the perceptions of people about cointegrating link of Islamic banking and Islamic microfinance. About 70 percent respondents think that the emergence of Islamic microfinance is caused by the emergence of Islamic banking. About 9 percent were not agreed and 21 percent did not reply (table-9). It is worth noting that Pakistan is always considered a pioneer in Islamic banking. In addition, the Islamic banking industry in Pakistan has been growing with an enormous pace (about 30 percent) for the last few years (SBP-IBB, 2014).

Table-9: Descriptive statistics and analysis of responses about Islamic (interest-free) microfinance

Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	No Answer	Mean	SD
8. Do you agree that Islamic (interest free) microfinance operate under the *'Shariah'* boundaries?	40 (12.05	98 (29.52	55 (16.57	84 (25.30	47 (14.16	8 (2.41)	3.00	1.281
9. The main objective of Islamic (interest free) microfinance is to help poor people?	12 (3.61)	46 (13.86	61 (18.37	128 (38.55	77 (23.19	8 (2.41)	3.65	1.101
12. Do you agree that Islamic (interest free) microfinance is a better tool for poverty	7 (2.11)	18 (5.42)	56 (16.87	179 (53.92	63 (18.98	9 (2.71)	3.85	0.875

alleviation?								
13. In case of default, Islamic (interest free) microfinance do not use unethical practices for recovery?	20 (6.02)	47 (14.16	107 (32.23	104 (31.33	46 (13.81	8 (2.41)	3.34	1.082
14. Do you agree that through government support Islamic (interest free) microfinance can be used more effectively in poverty alleviation efforts?	7 (2.11)	41 (12.35	43 (12.95	164 (49.40	69 (20.78	8 (2.41)	3.76	0.996
15. Do you agree that Islamic (interest free) microfinance is emerging in Pakistan due to an emergence of Islamic banking and finance?	7 (2.11)	23 (6.93)	55 (16.57	184 (55.42	55 (16.57	8 (2.41)	3.79	0.882

5. Conclusions

This research has tested a number of perceptions regarding credit comfortability and the role of conventional and Islamic microfinance in poverty alleviation. On the basis of response-analysis the following conclusions can be drawn:

i) A majority of people have a strong reliance on commercial banks as 61% respondents operate bank accounts in commercial banks. On the other hand, Islamic banking and microfinance is still in infancy period and could not get mass attention as just 10% respondents have bank accounts in Islamic banks.

ii) Although, interest is forbidden in Islam, a one-third majority of respondents purposely use interest-bearing accounts and merely 5% respondents have interest-free bank accounts.

iii) Regarding credit comfortability, presently, a large number of banks are operating in Pakistan but acquiring loans can be considered a cumbersome task. A significant number of borrower (30%) complaints that the formal lending sources charge exorbitant interest on loans. Other issues of serious nature include collateral requirements, inordinate delays in loan sanctioning and the accessibility constraints.

iv) Informal source of lending is a preferred way of borrowing because it charges either very low or no interest as 72% respondents who borrowed from informal sources have paid no interest on loans. In contrast, 66% borrowers of formal sources paid the annual interest between 11% to more than 40% (refer to table-5 above).

v) The main reason for repayment default is a lack of saving ability, catalyzed by unforeseen events like catastrophes or marriage of family member(s). Other relevant issues include exorbitant interest charges that make it hard to save, and the use of loans for consumption purpose instead of income-generating activity.

vi) In comparison of two mode of microfinance, our research revealed that the respondents rightfully perceived the fundamental differences between conventional (existing) microfinance and Islamic (interest-free) microfinance. The former one charges exorbitant interest on loans, uses harsh practices for the recovery, and became a more business oriented than merely the social welfare providers. On the other hand, the latter one does not charge interest, lenient in loan recovery, and keep welfare goal at up front than a commercialized business. Nevertheless, to be more welfarist, the implied cost Islamic microfinance bear is the lack of financial self-sufficiency which their counterpart easily achieve by generating funds through interest income. In addition, the overly emphasized claims of conventional microfinance i.e. empowering poor, serving poorest of the poor, and lifting out poor from poverty abyss, have conclusively been rejected by respondents of this research.

vii)The people of Pakistan consider Islamic microfinance as a better tool in poverty alleviation because of its welfarist genre and working boundaries of Islamic *Shariah.* In case of default, the scheduled repayments are extended without using the coercive practice for recovery which provides an additional time to poor people to accumulate sufficient funds. If the borrower is completely deprived than the loans are considered as write-off (Qard-e-hasna loans). That is why, majority of respondents (76%) choose Islamic finance as a source of potential borrowing in future because it works within the *Shariah* boundaries and charge no interest on loans.

viii) According to peoples' perception, the Islamic microfinance could be used effectively in poverty alleviation efforts if it is aligned with modern financial environment. The emergence of Islamic banking in Pakistan is providing a baseline to Islamic microfinance that can favorably be used to garner the Islamic financial products in an integrated compendium.

ix) The Islamic microfinance is perceived positively by the people of Pakistan, its scope can be enhanced through a two-way approach. First, the banking industry could be used to channel the funds through Islamic microfinance; and second, the government can support such programs through constant monitoring and regulations and by providing the subsidies and swift loans to catalyze the poverty alleviation efforts in Pakistan to rapidly achieve the millennium development goals (MDGs) of poverty eradication.

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