

Islamic Microfinance—An overview and Prospects in Pakistan

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Abstract

This paper will highlight the significance importance of the Islamic microfinance working in Pakistan as well as across the world. In 2007, the Great economic damage the global economy of the world including United States, European Union as well as Asia, it made the researcher to study about the alternate system in the replacement of Conventional Financial System, after that study and research they recognized that there is no concept of interest in Islamic Financial System, it is totally based on asset-based system, this recognition shift their area of interest from conventional financial system to Islamic financial system. Islamic financial System plays a significant role in economic growth of a country through accumulation of deposits and providing the plate form of financing to speed up economic activities. In the last two decades, the traditional microfinance is replaced by the Islamic microfinance in Pakistan as well as in the whole world. This paper will highlight the working methodology of Islamic microfinance models and institutions that how these Islamic microfinance institutions working as an interest free sector in Pakistan and in the world. The paper is also highlighting the difference between conventional micro financing and Islamic micro financing that what are the models and functions that differs the Islamic micro financing from the traditional micro financing.

Keywords: *Islamic microfinance, Conventional
Financial System, Pakistan*

Introduction

Among major religions of the world, Islam is getting swift pace in growth which affects the traditional Islamic countries located in Northern Africa and Middle East and not capturing very long Muslim history but having a very sizeable Muslim population in South Asia as well as few more countries in other world's continents. The 2nd largest religion of the world, when we consider followers, is Islam. The population of Muslims covers nearly one quarter of the world which is approximately 1.7 billion people.

S. NO.	REGION	POPULATION
1.	Asia-Pacific	985,530,000
2.	Middle East-North Africa	317,070,000
3.	Sub-Saharan Africa	248,110,000
4.	Europe	43,490,000
5.	Americas	4,320,000

<http://www.jewishvirtuallibrary.org/muslim-population-worldwide>

Islam is not only a religion but an absolute code of conduct which caters the need of all aspect of life, be it the existence of human beings, social life, material and moral, economic and political, national and international or legal and cultural aspects. It has economic system and commercial norms; it is a polity and contains governance's system; it has society and family conduct; it is spiritual and human entirety; thus worldly and other worldly.

Islamic Law is embodied in the codes named Shariah which are not rigid in nature. Shariah does not provide with general governing principles, rather it provides with specific cases or transactions and gives rules which can help it resolve.

Shariah has been driven from 2 primary resources in which first and most important one is Holy Qur'an (the transcription of God's message to the Holy Prophet Mohammad – PBUH) and the other one is Sunnah (the words and living pattern of the Holy Prophet Mohammad – PBUH). There are two more sources which are dependent over previous ones are Ijma and Qiyas. They both help to interpret further and provide ground to future development and implementations of Islamic judicial system.

Qiyas is a logical rendering of a case by which a law specialist inspects another case in relation to a prior examined case while Ijma is

the agreement of the Islamic researchers and scholars on the Islamic Laws.

The current trend of religious realizations has given a stimulus of implementing and adopting Islamic laws in trade dealings. As a result of this, a new sector has emerged; Islamic Finance. The whole idea revolves around the awareness and the practical manifestations of the rules of Shariah that aims to provide justice. Islamic researchers have concluded from the Shariah three standards which recognize Islamic money from its customary partner. These are quickly as takes after:

a) The Prohibition of Riba (Interest)

One of the most basic and important principles of Islamic Finance is the ban or prohibition of Riba. The literal translation of Riba (interest/usury) from Arabic to English is “an increase, accumulation or growth”. In Islamic Economic system, Riba is a major source of unjustified advantage. All Muslim Scholars show obduracy that this ban on interest enlarges to any and all forms of interest and that there is no difference between interest bearing funds for the purpose of consumption or investment, since in Shariah money is not believed to be a commodity for exchange rather money is a store of value and a medium of exchange.

Almighty Allah reveals clearly His orders about Riba (interest) in the following verses.

- All forms of treaties and dealings ought to be free from riba. The holy Quran declares:
Allah has allowed trade and outlawed riba. (2:275)
- ‘O believers’ fear Allah and sacrifice the interest that owes, if you surely trust. (2:278)
- ‘O Muslims’ do not devour riba, expanding and renewing it and fear (the penalty) of Allah that you may be prosperous. (3:130)

Riba has been opposed strongly by Holy Quran and it clearly instructs the trade to be lawful for livelihood. It is general agreement among scholars that usury represents all forms of interest (Dhumale, Rahul, & Amelia, 1999) trade and the profit associated with it are therefore authorized and halal, but interest remains forbidden strictly. Islamic finance envelopes great other aspects as well along with prohibition of interest, as avoidance from the following:

Maysir(gambling), gharar(uncertainty), hoarding, and investing in non shariah compliant activities (pornography, gambling and alcohol), on the other hand, it encourages risk sharing, sanctity of contracts, social/economic via charity, entrepreneurship and in relation with money as potential capital (Sait & Lim, 2005).. Similarly, there were some claims made against the usage of interest for the most part from western hypotheses "historically, interest has been opposed on the grounds of the social divisions it creates and the hardship to borrowers" (Dar. & Presley, 2003). Prominently, Islam bans the interest (riba) charging on the advances which constrains a major system of potential Muslim customers from getting traditional microfinance (Segrado, 2005).

The Supreme Court of Pakistan in 1999 considered interest as: "any amount, big or small, over the principal, in a contract of loan or debt, is Riba, prohibited by the Holy Quran, regardless of whether the loan is taken for the purpose of consumption or for some production activity". Interest is the most noticeable instrument of microfinance which can be exploitive, particularly towards poor people.

b) Profit and Loss Sharing (PLS)

In Profit & Loss Sharing financing organization, business associates offer loss and gains on the premise of their capital share and exertion. No surety is given for fixed rate of return unlike conventional financing based on interest. Islam underpins the perspective that Muslims do not go about as ostensible leasers in any speculation, yet are real associates in business. Organization of this is like as equity-based financing. The legitimization for the PLS agent's offer in benefit is the individual's exertion and the fiscal risks he conveys, as his profits would have been inconceivable without the speculation. Correspondingly, if the invested share has gone through a loss, his share would bear that loss.

c) Gharar (Ambivalence and Speculation)

Any type of exchange that includes Gharar (Speculation) is for the most part denied in Islam. The parties who are considering an agreement must have a genuine and unequivocal learning of the agreement's topic and its suggestions. A case of an understanding befouled with Gharar is consent to offer merchandise which have been now misplaced or lost.

Global Economic Crisis and Islamic Financial System

After the emergence of global economic crisis in 2007, increasing research has been directed on Islamic financial system, with the view that it can overcome the shortcomings found in the traditional or conventional economic systems. The most critical factor for this shift in research is due to the ability of Islamic finance to work without interest using an asset-based model.

Both conventional and Islamic financial systems are vulnerable to macroeconomic crisis and global financial shocks. However, there is a rampant belief that Islamic financial system can relatively better protect the economy as its system is fully free from interest (Kassim & Majid, 2010).

Islamic Banking System--- backbone of Islamic Financial System

At the heart of Islamic financial system the Islamic banking lies in middle. It significantly helps a country's economic growth through its deposit mobilization and modes of financing. Malaysia, for example, offers a range of Islamic finance services and products through dedicated Islamic financial institutions. With these, the country has significantly boosted its economic growth. A wide amount of research links economic growth and capital formation of a country with its development in Islamic banking and finance. Thus, Islamic financial development has greatly served as a catalyst for economic growth and development of Malaysia.

Differences between Conventional and Islamic Microfinance

Now, the summary of possible differences in characteristics and objectives between the conventional and Islamic microfinance are under the table below;

ITEM	ISLAMIC MICROFINANCE	CONVENTIONAL MICROFINANCE
Liabilities (source of fund)	External Funds, Saving of Clients, Islamic Charitable Sources	External Funds, Saving of client
Asset (Mode of Financing)	Islamic financial instruments	Interest based
Financing the poorest	Poorest can be included by Integrating with microfinance	Poorest are left out

Fund Transfer	Goods transferred	Cash given
Deduction at Inception of	No deduction at inception	Part of the Funds Deducted as
Contract		Inception
Target Group	Family	Women
Objective of Targeting Women	Ease of Availability	Empowerment of Women
Liability of the Loan (Which given to Women)	Recipient and Spouse	Recipient
Work Incentive of Employees	Monetary and Religious	Monetary
Dealing with Default	Group/ Center/ Spouse Guarantee, and Islamic Ethic	Group/Center pressure and Threat
Social Development Program	Religious (includes behavior, Ethics and social)	Secular (Non-Islamic) Behavioral, ethical, and social development

(Differences between Conventional and Islamic Microfinance Source: (Ahmed, 2002)

Islamic Microfinance and MSMEs

Entrepreneurship is a dynamic force of economic growth, in today modern economies. It is a mechanism through which human creativity, skills and energy can be employed into substantial outcomes for the enhancement of human welfare (Baron, 2012). Entrepreneurship has a lot of contribution in the promulgation of business cycle (Parker, 2011). Entrepreneurship is the most vital factor in supporting regional economic growth (Karlsson, 2012).

Small and micro enterprises are significantly contributing in economic development by generating employment in rural and urban population, providing flexibility and advancement through entrepreneurship (Mahmood). MSMEs make an impressive help with achieving GDP, pay era, encouraging business enterprise legacy, potential outcomes for paid jobs, lifetime employment, capacities improvement of human resources, poverty reduction, and propelling the benchmark of abiding and way of life (Quraishi, 2012).

By providing appropriate Islamic Micro finance resolves many problems and gains the trust of the community, who are short in credit, by not only providing them with the Shariah Compliant products but also supplying them the broad range of services like savings, money transfer facilities and insurance (Obaidullah, 2008).

Islamic Microfinance in Pakistan

Pakistan's Islamic Ideology Council (PIIC) has authorized the removal of Riba from a modern economy of our country. Islamic banking and finance systems are needed to be reformed into a Islamic model in which the equity based system is well-matched with the Muslim and non-Muslim countries financial needs of middle class segment. According to (Khaf, 1999) Islamic Economic System is a market system which follows an Islamic legal code and their transactions are carried out on mutual negotiations. Khan and Phillips (2010) studied on the START, a loan advancing microfinance program, which is primarily based on the influence of religious course on the performance of the Microfinance programs of the Islamic Finance Industry.

It has more advantages for Pakistan's mainstream of the society. It can possibly enhance the nation's economy and be socially dependable by helping individuals who are in frenzied need of budgetary help, yet have a few sources to swing to and along these lines have the capacity to produce income and vocation. The development cycle in Microfinance can be highlighted from existing development rates of 15% for each annum for microfinance and for as far back as five years for Islamic account it has accomplished 25-30% development around (Ferro, 2005). It is built up actuality that both Islamic finance and microfinance can be trying and in addition endeavors connected with increasing profitability, precise execution of the joint endeavor could give astounding results

By analyzing current situation one can hope that Pakistan have a potential of to become a world leader in establishing microfinance institutions; that are both commercially profitable and in compliant with Shariah alternatives for developing micro entrepreneurs, elimination of poverty and economics prosperity.

Over the years in Pakistan, Islamic Microfinance has attained a great sense of recognition amid the masses of Pakistan as it has a capacity to generate valuable human capital base by fulfilling the financial needs of the Muslim population and contributing in country economy in a positive and dynamic way as pointed by Akhter.et.al (2009) . Many microfinance and Islamic banks as well as the traditional conventional banks, with Islamic window, are working under such arrangement and have nourished and developed over the past few years.

Few banks are at an early phase of improvement also and their beginning expense has not yet possessed the capacity to achieve the equal to the initial investment point. They have been struggling to put their abundance of fluid stores with other money related foundations to deal with their liquidity position.

Islamic Microfinance Models in Pakistan

Micro financing is relatively a new concept in the economy of Pakistan especially Islamic Micro financing. In Pakistan, this concept is yet only in the building stages and it will take some time when the institutions involved in micro financing and people are well aware of this concept and then the models of microfinance will be adopted properly. However, in the current practices, only a few Islamic models of microfinance mentioned below can be observed as applied:

- Qarz-e-Hasana
- Musharakah
- Mudarabah
- Salam
- Ijarah
- Takaful

Proposed Models

In the current scenario of Islamic Microfinance in Pakistan, it is observed that this sector is yet in the stage of formative years. The products involve are much limited with only credit products being offered.

Waqf Model

In Islam, the waqf means giving away of the resource in the name of Allah. The type of resources can vary which can be the services, time or the agricultural land. If these resources are dedicated in the name of Allah, they can be called as waqf. The other model of waqf is the “sadqa-e-jaariya”, which means self-prolonging, in easier words doing those deeds whose positive consequences are enjoyed by the generations still to come.

Insurance model “Boli”

Boli is the insurance method which is the alternate of the committee system used in Pakistan. The committee system is a method common in Pakistan where all the members of committee contribute a

fixed amount of money every month which forms a pool of fund. The fund is then given to a member every month by drawing. It is ensured that every member gets only one turn and this cycle is repeated at each month till the decided time by consent of every member. The system is not for profit generation and is used to pay the needs of the members and the amount is usually that cannot be earned by the member at a time.

Islamic Microfinance Institutions in Pakistan

Pakistan has emerged as one of the largest market for Islamic Microfinance. The population of the country is 196 million of which 98% are Muslims. Pakistan is making effort to make a large market for the Islamic Microfinance in the country. In Pakistan, many MFIs have launched the Islamic Microfinance products but only two MFIs are completely following Islamic Shariah in their offered products which are as follows:

Akhuwat --- Pakistan

The Akhuwat was formed in 2001 with a primary objective to reduce the poverty level and increase the growth level in Pakistan by offering Islamic Microfinance products. The gross loan portfolio of the organization in April 2016 was of PKR 25.066 billion which was offered to 1,323,586 families (Akhuwat, 2016). The company has targeted the urban areas of the province of Punjab mainly however, its regional offices are operational in KPK and Baluchistan also which are not very well penetrated. The company has developed a good model of the Shariah Compliant products which constitutes certain unique features cited below:

- **Primary product**

The chief Islamic product that Akhuwat is offering is its Qarz-e-Hasna service that is the interest free loans offered with easy installments to the people in need. The company offers the loans to the individual basis instead of groups. The collateral is required for the loan but the offices as they are operating in the communities hence people from same community take guarantees of the borrowers.

- **Funds**

The funds have many sources that include the donations given by the individual and the different organizations that are backing the company's cause of formation. The company has coped to create its

own funds but still to cover the costs incurred, donations are accepted willfully.

- **Beneficiaries**

The main people who are targeted to offer the loans are the potential micro entrepreneurs who have skills, ideas, ability and enthusiasm to set up their own enterprises but lack capital. The chief aim of the Akhuwat is to provide finance to setup the enterprises.

- **Roles of stakeholders**

The meaning of Akhuwat is brotherhood that means the concept is for communities. The method of loans issuance and receipt and the role of stake holders is distinguished in the company. The branches are operating in the community mosques and churches. The loans are issued to promote brotherhood. Hence, the community take guarantee of it's all the members. The same communities also play their part in the pooling of funds for the Akhuwat.

Wasil Foundation

The Wasil foundation started up as formerly Centre for Women Co-operative Development (CWCD) in 1992 to operate as microfinance institution. The organization have grown continuously from then and in June 2012 had a gross loan portfolio at Rs. 112.05 million. The total active borrowers at that time were 7,433 active borrowers. (Wasil F. , 2016)

- **Primary product:**

Following are the 5 main products offered by the Wasil Foundation.

- Salam
- Istisna
- Murabahah
- Diminishing Musharakah
- Ijarah

- **Recipients**

The micro entrepreneurs that need finance to increase their business size are the prime target of the Wasil Foundation. They however, follow societal norms and values and gender equality but their main focus is the enterprises.

- **Policy**

The Wasil Foundation aims to promote the entrepreneurial activity and hence it lends more loans to the individual than to the group of people. The products are designed to give advantage to the micro and small businesses of entrepreneurs.

Islamic Microfinance Programs across the Globe

The Islamic Finance and the microfinance field of study completely changed with the increasing interest of people in the Islamic microfinance, being a combination of microfinance and Islamic finance. It encourages people to provide the people with loans and donations (zakat, sadaqah and waqf) that can remove the unappreciable trend of the conventional financial system.

The function of Islamic Microfinance is using the same method as conventional system, objective of which is to create employment opportunities, reduce poverty and provide women of the society with more funds. They also use group financing method as an alternative to the guarantees.

The interest (riba) is prohibited in Islam hence, the Muslim countries should avoid to charge any interest on the debts from the poor of the society but in reality, it has yet not been made possible to not to charge any interest from the poor. To make the microfinance program successful, the countries should make efforts to reach the black box of the people and the social environment so that the benefits like promoting entrepreneurship as well as reducing poverty can be achieved (Segrado, 2005).

Middle East North Africa (MENA)

In the region of Middle East North Africa, Egypt stood at first to start the micro financing project. The project of MitGhamr in Egypt was the first project which started the modern era of Islamic banking in the country. In Lebanon the Mu'assasatBayt Al-Mal project, in Syria the Sanadiq project at Jabal al-Hoss and in Yemen the Hodeidah Microfinance Program are the few recent examples of successful implementation of Islamic Microfinance.

South Asia

In South Asia, Bangladesh is the country with the most organizations implementing the Islamic financial principles that

include financial institutions for examples Islamic Bank Bangladesh, the Social and Investment Bank and the Al- Fallah and Rescue.

India being the country carrying the 2nd largest population of Muslims has also observed some Islamic financial system along with the conventional system of banking running in the country which includes organizations like AICMEU and Bait-un-Nasr.

Pakistan has also implemented the Islamic principles of carrying business activities where Akhuwat is the organization that is on the top with its distinguished mosque-based models.

South East Asia

In South East Asia, Malaysia was the very first to implement the Islamic system of financing. The financial system of Malaysia based on the Islamic principles is very well established. Indonesia has also developed the Islamic Microfinance structure after the success of the Malaysian Islamic Microfinance programs. The projects of Islamic Microfinance have also been started in the country of Philippines, Brunei and Thailand in the South East Asia.

Sub-Saharan Africa

In the region of Sub Saharan Africa, the Islamic Microfinance application is very limited up till now. The only official program running under Islamic Microfinance is in Northern Mali. The program was initiated after the civil war in the areas affected by the GTZ (German Technical Cooperation) and KFW (German Financial Cooperation). This program had an objective to provide a financial service to the affected tribes that includes the Tuareg, the Moors and many other black African tribes.

Central Asia

In Central Asia, the Muslim countries include the Afghanistan, Azerbaijan, Kazakhstan, Tajikistan, Uzbekistan and Kirghizstan. Among these countries, only Uzbekistan and Kirghizstan have tried Islamic Microfinance. Afghanistan is the only country from Central Asia where Islamic Microfinance method has been implemented successfully operated by FINCA. The FINCA is running a Village Banking program where the working poor are targeted for issuing the loans.

Australia, Canada, UK & USA

The MCCU and the MCA (Muslim Community Credit Union Ltd, Muslim Cooperative Australia Ltd.) are considered as the founding adapting institutions of the Islamic principle. The Mirza studies on Australia (2003) have also showed that the Musharakah Mustanaqisah (MM) based on sharing the equity is used for the home financing. The main benefit of the MM is that it ensures the control of inflation and the only issues are the problem of determining the amount of rent and taxes. The MM is applied globally by the financial institutions like ISNA Housing Cooperative Limited, in UK the Amanah Home Financing, in USA the American Finance House LARIBA (AFHL) and in Canada the Ansar Cooperative Housing Corporation. In USA, the AFHL is working on the Islamic principle of lease to purchase (Ijarahwaiqtina).

Future Outlook of Islamic Microfinance in Pakistan

In Pakistan, it is highly obvious that there is an acute need for shariah compliant financial services particularly at the micro level where the compliance of financial services with shariah is viewed as almost mandatory prior to obtain any such service. Even though, there is a dire need of such services and a wide gap to be filled in this area. Islamic microfinance can be the best gap filler as the majority of population is Muslim and Islamic microfinance establishes a foundation for the organization of a fair and free economic system under Islamic teachings.

Islamic law permits space for monetary advancement, and a few Islamic contractual courses of action can be consolidated. Islamic Microfinance model can work at two levels: Qard-Hasana loans offered to the poor with a specific end goal to give them a driving force to supportable living, or monetary items for customers, particularly rising business visionaries, on a benefit sharing premise. The Waqf model makes it doable for MFPs to give out Qard-Hasana loans while the benefit sharing items are economical endeavors all alone.

Before being made fruitful, Takaful (Islamic Insurance) at the microfinance level would oblige much to be done. Supporting administrations, for example, legitimate medicinal offices and viable checking should be set up so that the cases made by the customers can be paid out immediately and there is no doubts between customers and the Takaful suppliers. Since all Islamic microfinance models require a

component of trust between the professionals and the general population, it is basic that the working of the MFP is smooth and this trust is produced with no hindrance.

The integration of microfinance institutions with the professional training and endowment structuring institutions in Pakistan can surmount trials such as providing Islamic microfinance services to the underprivileged. Ethical and moral motivational programs have to be undertaken by both field supervisors and the clients thereby, ultimately fortifying the monitoring and supervisory modules. Also, the Islamic financial processes need to be simplified according to the client segmentation and the products should be diversified at lower cost with minimum risk for the prosperity of the product market. For example, the incorporation of the model of Qard ul Hassanain the Islamic microfinance system will boost the confidence of the general public in the registered Islamic financial institutions due to the wealth being distributed properly among established networks and individuals.

Islamic microfinance institutions ought not concentrate on people alone but rather additionally broaden their administrations towards families and nearby groups. Islamic banks ought to specifically manage the business people and focus on dealing with major drawbacks appeared because of abuse of Islamic items and administrations by corrupt vendors. Islamic microfinance organizations are required to have the knowledge of present group's financial foundation and difficulties keeping in mind the end goal to show signs of improvement of the requests and necessities of the people residing in rural areas. This understanding would therefore help them to ad lib their planned case particular preparing projects and models focused on customers who could then be presented and taught by holding workshops and professional; training, preparing projects all the time to develop consciousness of Islamic regulations. Shariah committees which are well reputed required incorporating individuals who are specialists in the field of Islamic budgetary foundations and have specialization in Fiqh for credibility.

Besides, the effective operation of Akhuwat and Wasil Foundation like numerous others Islamic MFIs in Pakistan for the last over 10 years demonstrated that Islamic microfinance organizations are feasible and supportable even without charging interest from their customers. Along these lines, the rich segment of the general public ought to redirect their philanthropy, sadaqat, and Zakat to these

microfinance establishments to have the capacity to help the individuals who really require monetary help.

Conclusion

The concepts of societal benefits, the low employment level, high public debt and the globalization are reviewed under the Islamic principles and values. The Islamic banking has grown significantly from the last decade in the Muslim countries. However, the share of Islamic Banking in the economy of the world is still very low in comparison with the Western Banking System that shares a large part in the global economy. It is still to be found that whether the Islamic system of economy will be able to make its place in the global economy. The hybrid approaches for instance the micro financing is now applied also where the combination of Islamic and Western Economic Systems are used under the theory of modern human development. It must be noted that the Islamic Financial System is very wide and have large spaces to be filled up with the innovations in the financial system that can be integrated to form new hybrids.

In the era of globalization, the financial and lending institutions cannot manage to deal with the financial exclusion. There is an opportunity for the financial institutions to target the segment of the population that are excluded from the previously targeted markets. The excluded group from the financial markets includes poor of the developing countries along with the immigrants who want to send the remittances, the entrepreneurs that lack capitals but have ideas and enthusiasm. Exclusion sometimes results into the issues like high pricing due to negative experiences but targeting the excluded ones will result into positive social externalities.

To sum it up, it has observed that there are a lot of studies being conducted on the Islamic banking working for the growth of the micro entrepreneurs whereas little data has been seen on the Islamic microfinance institutions working for the advancement of the micro entrepreneurs using the models in compliance with the Shariah. Therefore, the Islamic microfinance institutions are still on a critical stage of analysis. Regardless, this is an incredible chance for specialists to take advantage of another business sector where the interest for Islamic items is significantly high. As of now, the quantity of organizations investigating Shariah agreeable product offerings has expanded, particularly as MFPs look to enter locales where such contemplations are vital to clients.

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