AZKA-PPZ
AKADEMI ZAKAT

AZJAF
AZKA INTERNATIONAL JOURNAL OF ZAKAT & SOCIAL FINANCE ISSN : 2735-1890 e-ISSN : 2716-6643

azka.zakat.com.my

Vol. 4 No. 3 (2023)

DOI: 10.51377/azjaf.vol4no3.154

CHANNELIZING THE ZAKAT OF ISLAMIC BANKS PROFITS TOWARDS ISLAMIC MICROFINANCE INSTITUTIONS: A CASE OF PAKISTAN

MUSHTAQ AHMED
Hamdard University Pakistan & Islamic Business School, University Utara Malaysia
Email: mushtaq_acca@yahoo.com

ZAKI AHMAD (Corresponding Author)
School of Economics, Finance and Banking. University Utara Malaysia
Email: 94zakiahmad@gmail.com

MOHAMMAD ASHRAF AL HAQ
Islamic Business School, University Utara Malaysia
Email: mashraf.alhaq@uum.edu.my

A PEER-REVIEWED ARTICLE
(**RECEIVED** – 15TH MAY 2023: **REVISED** – 31ST AUG. 2023: **ACCEPTED** – 18TH SEPT. 2023)

ABSTRACT

The study proposes a modified microfinance model for Islamic banks (IBs) existing in Pakistan under worldwide accepted Shariah practice. The study is based on an in-depth review of microfinance literature with the ultimate objective of establishing a rationale model for Islamic banking to take part in a microfinance effort. The suggested framework contributes to the scant literature on Islamic microfinance in Pakistan and offers IBs beneficial implications for enhancing their social responsibility duties, promoting the financial inclusion of people with low incomes, and contributing to mainstream economic activities.

Keywords: zakat; Islamic banks profits; Islamic microfinance; Pakistan

INTRODUCTION

Access to finance at a practical and affordable cost is one of the main needs of not only enterprises but also individuals that strive to earn a sufficient income to sustain their daily lives and, in consequence, alleviate poverty (Park & Mercado, 2015). However, many people are denied this opportunity because financial institutions have stopped them from accessing financial services for several reasons. Such as high operational expenses as a result of low-income individuals living in rural places, as well as difficulty obtaining adequate security to get financing. Furthermore, many people refuse to engage in the banking system voluntarily since traditional banking organisations involve riba (interest) and gharar (extreme uncertainty), both of which are specifically prohibited in Islam. This voluntary exclusion has decreased as Islamic financial institutions have grown and been established around the world.

The issue of reducing poverty through microfinance initiatives is equally pertinent to Islamic banks. Islamic banks are expected to be governed by an Islamic economic philosophy, among other things, to ensure that wealth is distributed fairly (Ibn Ashur, 2006). Indeed, the Islamic banking sector has had double-digit annual growth rates for the past 30 years, thus being one of the fastest-growing sectors (Iqbal & Molyneux, 2005). In particular, total assets in Islamic finance topped USD 2.7 trillion in 2020 (IFSB, 2021), and Islamic banking makes up 70% of the Islamic finance industry, with 527 institutions/instruments in 57 countries (IFDI, 2021). However, Islamic banks have received harsh criticism for some reasons, one of which is their failure to support the fundamental objectives of the Islamic economy, or maqasid al-shari'ah (Asutay, 2007, 2012; Kamali, 1999; Asutay & Zaman, 2009). Similar to their traditional counterparts, Islamic banks prohibit the poor from accessing financial services due to asymmetric information, physical challenges from inadequate infrastructure, socioeconomic considerations, a lack of collateral, and high transaction costs (Ahmed, 2004).

Microfinance, which started in the 1970s, as did Islamic banking, showed that people with low incomes are also devoted to repaying their obligations. Microfinance institutions (MFIs) have supported many low-income people, especially in relatively less developed countries. As a result, the integration of Islamic microfinance into Islamic banking, which is the primary objective of this study, can assist Islamic banks in contributing to the accomplishment of Islam's fundamental goal. In other words, Islamic banks take into account not just legal and economic obligations, but also social advantages in their operations. Microfinance programs are one of the most effective means of achieving social benefit goals. Although the majority of Islamic banks in the world restrict the poor from financial services, Islamic microfinance is offered by a relatively limited number of Islamic banks. Only five of the 19 Islamic banks examined by Kamla and Rammal (2013) include disclosures relating to microfinance and the financial inclusion of the poor. Similarly, Kachkar et al. (2016) state that microfinance is not offered by Islamic banks.

Recent years have seen an upsurge in both the literature on Islamic microfinance and the practices used by Islamic MFIs. Few Islamic microfinance papers were published in the microfinance literature between 2000 and 2020, although more than 2200 conventional microfinance articles were published in journals with a Scopus index (Ahmad et al., 2023; Hassan et al., 2021). The majority of research evaluates microfinance institutions' financial performance, however, others (e.g., Alkhan & Hassan, 2020) study Islamic MFIs from the perspective of maqasid al-shari'ah. And several studies provide a new model for Islamic microfinance in specific countries by considering their existing conditions (e.g., Aliyu et al., 2017; Thaker & Thaker, 2016) or general models from different perspectives (Ahmad et al., 2020; Alam et al., 2015; Dusuki, 2008; Obaidullah, 2015, 2008; Raditya & Taqwa, 2015) that include structures such as zakah, waqf, and qard al hasan (Abdullah & Ismail, 2017; Haneef et al., 2015; Kaleem & Ahmed, 2010; Syed et al., 2020). As a result, several studies have been conducted in various countries to promote the role of Islamic finance in poverty reduction.

Based on the State Bank of Pakistan (SBP), the Islamic banking industry's assets have risen to Rs4.269 trillion, while deposits have risen to Rs3.389 billion by the end of December 2020. The financing of the Islamic banking industry has also increased by 16% in 2020. Given that the majority of Pakistanis dislike interest-based banking, Islamic banking has the potential to grow considerably, but doing so requires the assistance of the government. Being home to approximately 98% Muslims, Pakistan is one of the most promising markets for Islamic microfinance. Islamic microfinance, however, barely makes up 0.5% of the microfinance industry globally, and as a result, is still in its infancy. Islamic microfinance has the potential to be incredibly important in Pakistan, where 60% of the population is estimated to be living below the international poverty line. It is essential to give millions of underprivileged Muslims access to financing because they are unwilling to purchase conventional microfinance products that do not adhere to Islamic law (Nimrah Karimet.al., 2008). There is a need to develop more comprehensive models for the Islamic banking industry, which has contributed significantly to Pakistan's Islamic financial environment. As a result, this study offers a modified microfinance model for Islamic banks in Pakistan by focusing on extant literature and worldwide practices, particularly Islamic banks with microfinance programs.

This paper argues that given the impressive growth of Islamic banking over the past 30 years, it is time for the sector to be reoriented to place more emphasis on issues relating to the social and economic ends of financial transactions than just profits and meeting the bottom line. Furthermore, this paper intends to develop a case for Islamic banking's involvement without endangering its profitability and sustainability in the market. The proposed approach supplements the little literature on Islamic microfinance in Pakistan and offers practical implications for Islamic banks, which can help them increase their ability to fulfill their social responsibilities and contribute to low-income people's financial inclusion.

The rest of the paper is structured as follows: Section 2 summarises Pakistan's Islamic Banks (IBs) and Islamic Microfinance (IMFs) services to highlight the sector's shortfall in serving low-income customers. Section 3 comprises a review of the literature. Section 3 explores more of the study methods and data. Section 4 describes in full the suggested Islamic microfinance concept for Islamic banks. Section 5 finishes the study and makes suggestions for further research.

ISLAMIC BANK IN PAKISTAN

Islamic banking has been part of the global financial system for around four decades, starting as a niche industry for faith-sensitive customers. Islamic finance is gaining global trust because it is based on actual economic activity, discourages excessive leverage and risk-taking, encourages investment transparency, and sets stronger corporate governance norms. Pakistan developed Islamic banking to meet religious and constitutional demands. The worldwide growth of Islamic banking started in the 1960s and made significant progress in the 1980s in Pakistan. The Banking Companies Ordinance was amended, Modaraba Companies and Framework were enacted, and other historic legal developments occurred. However, a fast transition without an operational and legal foundation for industrial expansion hampered the 1980s experiment. Pakistan relaunched Shariah-compliant banking efforts in 2001-02. The new paradigm allowed Islamic banking to operate as an alternative and parallel system with three types of Islamic banks: full-fledged Islamic banks, Islamic banking subsidiaries of conventional banks, and Islamic banking branches of conventional banks.

In Pakistan, Islamic banking has experienced significant growth in the past few decades. Along with an increase in the number of branches, windows, and a range of Islamic banking products and services, the balance sheet size of Islamic banks has grown tremendously. During the 2020 fiscal year, Islamic banking assets and deposits increased by 21,4 percent and 22 percent, respectively. Due to substantial growth, Islamic banking has reached systemic significance, with 15.3 percent and 16.9 percent of total banking assets and deposits, respectively, by June 30, 2020. At the end of June 2020, the financing-to-deposit ratio (FDR) for Islamic banking was reported at 57.6 percent, which is much higher than the 46.3 percent advances-to-deposits ratio for all banks. Additionally, Islamic banking posted Return on Equity (ROE) and Return on Assets (ROA) after tax figures of 29.6% and 2%, respectively, which were higher than the global norms of aggregate banking. In terms of market infrastructure, Islamic banking has maintained an upward trend over the years. There are at present 22 Islamic Banking Institutions (IBIs), including five full-fledged Islamic banks, one specialized bank, and sixteen conventional banks with Islamic banking branches. Utilizing a network of 3,274 branches in 122 districts, IBIs provide Shariah-compliant products and services. To expand access to Islamic banking products and services, IBIs expanded their branch network by 361 locations in FY20. Two IBIs also provide Islamic microfinance services to meet the requirements of the population's lower-income segments: NRSP Bank and Islamic MCB.

Table 1: Full-Fledged Islamic Banks in Pakistan (2022)

Sr.	Name of IBs	ROA	PAT (Mil)	PZAT (2.5%)
1	Bank Islami Pakistan,	1.75%	Rs 4,439.635	110.99
2	Dubai Islamic Bank Pakistan	.10%	Rs.3915.574	97.88
3	MCB Islamic Bank	1.65%	Rs.1,548.00	38.7
4	Meezan Bank	2.33%	Rs.61,785	1544.62
5	Al Baraka Bank Pakistan	0.47%	Rs. 4358.72	108.96

Sources: State Bank of Pakistan. ROA=Return on asset, PAT= Profit after tax; PZAT= Proposed zakat after tax.

Table 1 shows that Meezan Bank is leading in proposed distribution of Zakat with higher ROA, while MCB Islamic Bank is at the bottom of table with ROA of 1.65%. This indicates that along with the other source of Islamic microfinance funding, zakat on Islamic bank profits is also one of the sources for financial stability of IMFIs.

ISLAMIC MICROFINANCE IN PAKISTAN

Microfinance is a broader concept that comprises not only the offering of credit to the impoverished but also deposits, cash withdrawals, and insurance. Microcredit is therefore a component of microfinance. Since the 1990s, microfinance (MF) has gained relevance in Pakistan as an instrument for societal mobilization and poverty reduction. Indeed, the growing international focus, particularly the increased funding from Islamic financial institutions (IFIs) for MF, encouraged both the public and private sectors to develop the country's microfinance sector. The significant rise in international funding enabled non-governmental organisations (NGOs) to expand their operations and was an initial push for the establishment of microfinance institutions in the formal sector, i.e., MFBs. In Pakistan, the potential market for MF is generally estimated to be around 8 million households, or approximately one-third of the total number of households. Practitioners in the area explain that the potential market is the population below the poverty line; however, little is known about the methodology to estimate this market size. Pakistan is a low-middle-income nation, with a nominal GDP of $347 billion, a nominal GDP per capita of $1,666, and a PPP GDP per capita of $5,973. Combined with economic, governance, and security challenges, as well as Pakistan's vulnerability to natural catastrophes, economic growth is still a struggle. Statistics indicate that by the end of 2021, MFBs will have over 4,6 million borrowers and a loan portfolio of over Rs 290 billion. Families and enterprises with low incomes, particularly those owned by women, rely on these institutions. It is uncertain whether consumers can ever repay existing liabilities. Even if microfinance institutions can refinance loans or forgive debts for their hard-hit clients, their inability to recover will pose significant challenges. These institutions may face imminent insolvency, putting pressure on their capacity to repay investors and maintain operations. Their survival will depend on the tolerance and forgiveness of their creditors.

The State Bank of Pakistan (SBP) was instrumental in establishing the Islamic microfinance industry in Pakistan. By establishing a legal and regulatory framework for Islamic microfinance along with a set of guiding principles. Currently, there are approximately three Islamic microfinance institutions in Pakistan, and NRSP is the first Shariah-compliant microlending and deposit-taking products provider to obtain a license from the SBP in December 2016 to offer Islamic microfinance services. Intending to attain the United Nations' Sustainable Development Goals, Islamic microfinance institutions provide financial solutions to the poor. Once the lower class has escaped the clutches of poverty, there will be no starvation and consumers will have access to quality education and improved health care. To ensure that the Pakistani populace has affordable access to pure energy and water, as well as a more robust infrastructure, special financing is provided for green initiatives. Using asset-based transactions, risk-sharing models, and rigorous checks and balances to prevent unethical/non-Shariah-compliant practices, Islamic microfinance appears to have contributed significantly to the maximization of social benefits in Pakistan. There is tremendous potential for Islamic microfinance in Pakistan, and with the commitment of Islamic microfinance institutions, the sector can grow tremendously, not only from a business perspective but also from the angle of pursuing Maqasid al Shariah. (Erum, 2020).

The microfinance sector is plagued by high financing costs and a lack of institutional sustainability. Due to its higher costs than conventional microfinance, Islamic microfinance in Pakistan faces a severe problem of sustainability. Therefore, Islamic microfinance institutions may be confronted with a significant issue of sustainability. When an MFI can cover its current, growing, and expansion costs, it is considered financially sustainable. (Johnson, 2006) Financial sustainability is a measurable parameter that can be monitored and measured via an ongoing set of indicators. Financial sustainability can be divided into four stages, beginning with the first stage, in which an MFI relies solely on grants for its operations, and ending with the fourth stage, in which an MFI relies solely on its resources mobilized from clients and funds raised from financial institutions at commercial rates. (Naveed , 2020)

Consequently, numerous studies have introduced viable Islamic microfinance models in various nations to promote Islamic finance's role in alleviating poverty. The suggested model contributes to the small body of research on Islamic microfinance in Pakistan and has practical implications for Islamic banks. These implications may assist Islamic banks in improving their capacity to meet their social obligations and contribute to the financial inclusion of individuals with low incomes.

LITERATURE REVIEW

In addition to the practices of Islamic MFIs, the amount of literature on Islamic microfinance has grown in recent years. Hassan et al. (2021) examine Islamic microfinance articles published in Scopus-indexed journals and discover 122 articles in 70 journals, of which 83 were published between 2015 and 2020. In the overall microfinance literature, few Islamic microfinance papers were published between 2000 and 2020, while more than 2200 conventional microfinance papers were published in Scopus-indexed journals (Hassan et al., 2021). Even though some journals are not included in the Scopus database, promising literature on Islamic microfinance has emerged in recent years, albeit much less than its conventional equivalent. Some papers (e.g., Alkhan & Hassan, 2020) examine Islamic MFIs from the perspective of maqasid al-shari'ah, whereas the majority of studies concentrate on the financial performance of these institutions. And several studies provide a new model for Islamic microfinance in specific countries by considering their existing conditions (e.g., Aliyu et al., 2017; Thaker & Thaker, 2016) or general models from different perspectives (Alam et al., 2015; Dusuki, 2008; Obaidullah, 2015, 2008; Raditya & Taqwa, 2015) that include structures such as zakah, waqf, and qard al hasan (Abdullah & Ismail, 2017; Haneef et al., 2015; Kaleem & Ahmed, 2010; Syed et al., 2020).

Obaidullah (2008) divides Islamic microfinance into mission-based and market-based models. Mission-based models are non-profit and serve the severely disadvantaged. The mission-based approach has two subcategories: Zakat (obligatory charity), Sadqa (voluntary charity), Waqf (charity with continuing benefits); and Qard-e-Hasana (interest-free loan). The market-based model is a for-profit model with several earning modes, including Ijarah (rental), Diminishing Musharkah, Musharkah, and Mudarbah (partnership-based modes), Murabahah (financial mode), Salam (advance payment deferred delivery sale), and Istina' (contract of manufacturing). Takaful mitigates risk.

Dusuki (2008) examined Islamic bank microfinance plans. His work designed an Islamic bank microfinancing model. He believes social intermediation and group-based financing may lower costs, particularly for the rural poor. He advised using deposits, equity, Zakat, contribution, and Waqf for this purpose.

Rashidah and Dean (2015) in Malaysia highlighted IMFI issues and proposed remedies. Penetration and sustainability were among the issues. They recommended boosting bank engagement in Islamic microfinance, diversifying their portfolio, training, and skill development, technical help utilizing Waqf and Zakat monies, and stronger regulation.

Habib (2001) provided theoretical, operational, and empirical support for the formation of IMFIs in his paper. The theoretical section of the paper demonstrates that IMFIs have enormous potential to meet the requirements of the impoverished. The inherent characteristics of IMFIs can mitigate a number of the issues confronted by conventional MFIs. In general, empirical evidence from three IMFIs operating in Bangladesh supports certain theoretical assertions. The case studies indicate, however, that IMFIs have not yet accessed certain funding sources nor utilized a variety of financial instruments in their operations.

Waheed et al. (2001) conducted a case study on the function of the Akhuwat Foundation as an IMFI contributing to the alleviation of poverty. The study revealed that loan portfolio development has slowed over the past five years. Consequently, they suggested that financial issues must be resolved. By incorporating non-profit organizations with Islamic microfinance, the issue of loan portfolios could be resolved.

Numerous authors, including El-Gamal (2006), Al-Harran (1990, 1996, 1999), Akhtar (1996, 1998), Dhumale and Sapcanin (1998), Ahmed (2001), and others, believe in the great potential of Islamic banking to be involved in microfinance programs to meet the needs of the poor, who are typically excluded from the formal banking sector.

RESEARCH METHODOLOGY

Given that Islamic microfinance is not a relatively recent phenomenon in Pakistan, the study proposes a microfinance model for IBs. Therefore, the qualitative research method is adopted. Islamic microfinance is extremely popular and well-accepted around the world despite its innovative product line and system, but a lack of funding could limit its ability to expand in the future and have an impact on the strategy for financial inclusion because Islamic microfinance serves as an effective alternative to conventional microfinance for Muslims who shun it for religious reasons because interest is strictly forbidden in Islam. Unfortunately, western donors are hesitant to support the Islamic microfinance sector, which limits its growth potential. Without adequate funding sources, the Islamic microfinance sector faces many difficulties in providing communities with better financial and non-financial services, so there is an urgent need to address these pressing problems by introducing and developing an alternative source of funding for Islamic microfinance institutions. To address the 44% of global poverty that is concentrated in the Muslim world, which is served by the majority of Islamic microfinance institutions, we also need to develop Commercial Islamic Microfinance MFIs/Banks with generous financing sources.

To propose a model for zakat allocation, study uses the profit after tax from five full-fledged Islamic banks from annual reports published by State bank of Pakistan,2022. These five banks are Bank Islami Pakistan, Dubai Islamic Bank Pakistan, MCB Islamic Bank, Meezan Bank and Al Baraka Bank Pakistan. The proposed amount Zakat is calculated on the criteria described by shariah and the amount deducted is to be provided to microfinance institution to enhance their social and financial performance. Following are some examples of financing structures and topic criteria for Islamic microfinance institutions:

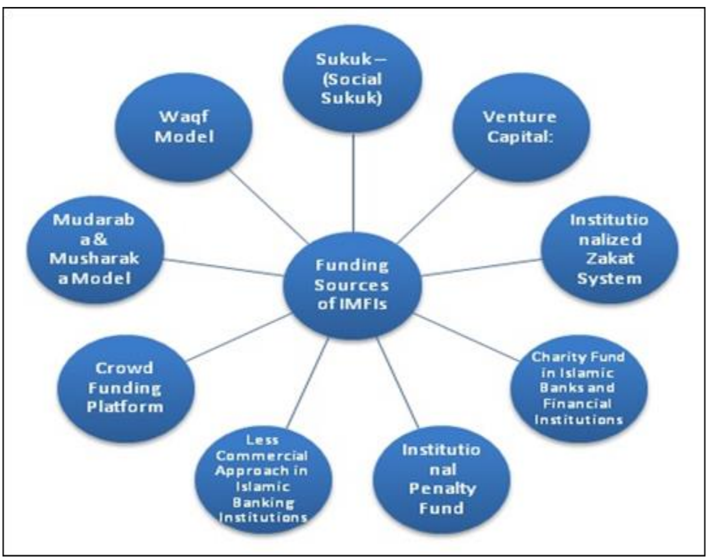

Figure 1: Sources of Funds

Sukuk – Social Sukuk

According to financial sector trends and standards, Sukuk is regarded and used in the corporate world mainly for large projects but never experienced in Islamic microfinance business to give financing source where it may be efficiently used. Sukuk may provide Islamic microfinance with Shariah-compliant funding for both its asset and liability sides.

Crowd Funding Platform

Crowdfunding is an interlinked advanced online system that can be used to generate funding opportunities for Islamic microfinance institutions and overcome funding deficiencies. It links the institution and several donors from around the world to transmit funds to the beneficiary. Crowdfunding platforms may assist IMFIs raise cash and promote Islamic microfinance and related services.

Venture Capital and Equity Financing

Developed financial organizations use spare cash to create venture capital for investment and profit. Islamic Microfinance Institutions may start out using Shariah-compliant venture funding. Venture capital may be used in Islamic microfinance to support IMFIs so they can provide IMF goods and services and expand institutionally and share profits with capital sources. Equity financing is when a corporation sells stock and gets money or invests in a business. Venture capital is popular equity financing. Islamic microfinance organizations may use Mudaraba or Musharaka to obtain equity or venture capital. We can also see that the Islamic financial sector has a lot of Shariah-compliant equity funds, which motivates us to create an equity fund for Islamic microfinance, which needs capital.

Donor Grants, Soft Loans & Govt. Subsidies

Donor grants, soft loans, and government subsidies are vital to the development of the microfinance sector, but unfortunately, international donor agencies are reluctant to Islamic microfinance, so Islamic microfinance institutions are limited and facing expansion problems. However, multilateral donor agencies are now promoting Islamic microfinance as a tool for financial inclusion and social inclusion. Pakistan recently gave Islamic microfinance organizations Qarz-e-Hassan (Soft Loans), as did Yemen, Sudan, Indonesia, and others.

Institutionalized Zakat System

Islamic microfinance institutions (IMFIs) that are non-profit can use Zakat to supplement their other programs, such as Micro Takaful, Health, Education, and

Capacity Building, to alleviate poverty and empower financially neglected segments of society. However, if Zakat is centrally institutionalized and collected in a pool/account, it may be used to enhance Islamic microfinance organizations.

Charity Funds or Penalty in Islamic Banking and Financial Institutions
Islamic banks and financial institutions worldwide gather vast amounts of donations for various charitable causes but never use them to support IMFIs. Institutional Penalty Fund refers to Islamic financial institution penalties for Shariah violations in goods and arrangements. This statute protects the banking industry against deliberate failures and delays.

Mudaraba and Musharaka Mode
Islamic banks or financial institutions provide Mudaraba funding to Islamic microfinance institutions. The Islamic Bank/Financial Institution is the financier/investor "Rabul Mal" and IMFI acts as investment manager "Mudarib" and does microfinancing according to Shariah principles and shares the profit with the investor (Islamic Bank/Financial institution) as per the agreed ratio but suffers the loss until the ignorance of Fund Manager (IMFI) is proven. In the Musharaka model, both parties (IMFI and Islamic Bank/ Islamic Financial Institution) provide funds for Islamic Micro Financing and share the profit, if any, according to the agreed ratios, but if there is a loss, both parties share it. The Mudaraba model is suitable for financing Islamic microfinance organizations, maintaining both asset and liability Shariah compliance. Some Islamic banks do it without damage.

Waqf Model
Islamic microfinance institutions can use the concept of waqf to endow a property, asset, wealth, or income for socioeconomic development programs like poverty alleviation, health, and education for the poor. Waqf allows effective Islamic microfinance through trade-based, partnership-based, and rental-based products to generate income for institutional sustainability and social development.

Based on the above literature on different funding sources, this study tries to find an additional and proposed source for the financial sustainability of Islamic microfinance institutions. This source is related to corporate zakat on the profit after tax of the Islamic banking industry which is hitherto unearthed and proposed in the Islamic banking industry of Pakistan. Figure 1 demonstrates the profit of five full-fledged Islamic banks working in Pakistan. Data is taken from annual reports of all Islamic banks and using the percentage of zakat on the distributed profit to shareholders. With the help of this derived funding, the study reached to develop a model justified by the annual reports of some abroad Islamic Banks such as Dubai Islamic Bank (UAE). The construction of the framework is represented as under:

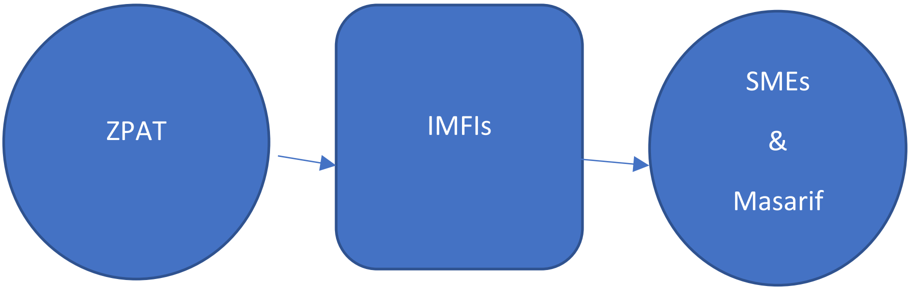

Figure 2: Proposed Model for Islamic Microfinance Institutions

ZPAT= Zakat on Profit After Tax, IMFIs= Islamic Microfinance Institutions, SMEs=small &medium sized enterprises

The Small and Medium Enterprise (SME) sector is critical to the country's economic development. This industry is regarded as the backbone of any economy. According to the Small and Medium Enterprise Development Authority (SMEDA), there are Pakistan has almost 5 million SMEs. SMEs generate 40% of Pakistan's GDP and 25% of total exports. After agriculture, the SME sector employs the greatest proportion of the working population in the country. The SME sector employs 78% of the nonagricultural workforce. SMEs are a major source of poverty reduction, national economic expansion, and job creation. SME finance began to rise in 2013 as a result of numerous regulatory initiatives and the SBP's facilitative involvement. Compared to Rs 284 billion in December 2013, the amount of outstanding SME financing rose to Rs 524 billion in December 2021. However, there are also structural impediments that prevent banks from lending to SMEs, including information asymmetries, high transaction costs, and a lack of real security for loan applications from SME owners and business owners.

CONCLUSIONS

This report offers a thorough examination of the viability of microfinance for the benefit of IB stakeholders. As a result, we discover that IBs offer tremendous potential in terms of funding sources and financing diversification. As previously said, IBs should include microfinance in their operations to play a part in development. There are considerable financial opportunities available, particularly from Zakat on corporate earnings, for supporting microfinance initiatives as a form of corporate social responsibility (CSR), and these facilities do not place a large burden or expense on IBs. After a successful run of the pilot program, the microfinance initiative may transition to a business model, which will include a variety of funding options and financing strategies. In addition, the implementation of microfinance via the imposition of zakat on corporate profits may help these institutions by expanding their client base through the transformation of microenterprises into small and medium-sized businesses (SMEs).

In addition to its practical implications, the study makes a substantial contribution to the body of knowledge. In other words, the study proposes models for Islamic institutions in Pakistan and links them to MFIs via a naive model, constituting an original contribution to the literature. In the next research, both the potential demand for Islamic microfinance in Pakistan and the opinions of existing conventional microfinance users towards Islamic microfinance will be investigated via surveys. This will take place in the context of future studies. In addition, it is possible to do effect studies by conducting Islamic microfinance programs outlined in the study on a modest scale and putting them into action.

REFERENCES

Abdullah, R., & Ismail, A. G. (2017). Taking stock of the waqf-based Islamic microfinance model. *International Journal of Social Economics*, 44(8), 1018–1031. https://doi.org/10.1108/IJSE-06-2015-0176

Ahmad, Z., Mokal, M. N., al-Amatullah, I., & Mafaz, M. N. A. (2023). An Evaluation of Bitcoin From Shariah Perspective. *Review of Applied Management and Social Sciences*, 6(2), 459-480.

Ahmad, Z., Zahir, F., Usman, A. M., Muneeza, A., & Mustapha, Z. (2020). An exploratory study on the possibility of replacing tawarruq based Islamic banking products using other alternatives. *International Journal of Management and Applied Research*, 7(2), 147-164.

Ahmed, H. (2001), "Financing microenterprises: an analytical study of Islamic microfinance institutions", paper presented at the *9th Intensive Orientation Seminar Islamic Foundation, Leicester*.

Ahmed, H. (2002). Financing microenterprises: An analytical study of Islamic microfinance institutions. *Islamic economic studies*, *9*(2).

Ahmed, H. (2004). Frontiers of Islamic banking: A synthesis of social role and microfinance. *European Journal of Management and Public Policy*, 3(1), 118–138.

Akhtar, M.R. (1996), "Practice and prospects of musharaka financing for small enterprises in Pakistan", *Journal of Islamic Banking and Finance*, Vol. 13 No. 3, pp. 7-27.

Akhtar, M.R. (1998), "Islamic microfinance: credit where credit is really due", *Islamic Banker*, October, pp. 8-9.

Alam, M. M., Hassan, S., & Said, J. (2015). Performance of Islamic microcredit in perspective of Maqasid Al-Shariah: A case study on Amanah Ikhtiar Malaysia. *Humanomics*, 31(4), 374–384

Al-Harran, S. (1995), "Proposal for an integrated marketing model of musharakah financing to help disadvantaged fishing people in Malaysia", paper presented at the *International Workshop on Islamic Partnership Financing for Small Enterprise*, Enterprise Development Centre, Cranfield School of Management, Cairo.

Al-Harran, S. (1996), "Islamic finance needs a new paradigm", *New Horizon*, Vol. 48, February, pp. 7-9.

Al-Harran, S. (1999), "Islamic partnership financing", *Arab Law Quarterly*, Vol. 14 No. 3, pp. 193-202.

Aliyu, S., Yusof, R. M., & Naiimi, N. (2017). The role of moral transaction mode for sustainability of banking business: A proposed conceptual model for Islamic microfinance banks in Nigeria. *International Journal of Social Economics*, 44(12), 2238–2256. https://doi.org/10.1108/IJSE-07-2016-0205

Alkhan, A. M., & Hassan, M. K. (2020). Does Islamic microfinance serve maq¯asid al-shari'a? *Borsa Istanbul Review*. https://doi.org/10.1016/j.bir.2020.07.002

Asutay, M. (2007). Conceptualization of the second-best solution in overcoming the social failure of Islamic banking and finance: Examining the overpowering of HomoIslamicus by Homoeconomicus. *IIUM Journal of Economics and Management*, 15(2), 167–195.

Asutay, M. (2012). Conceptualizing and locating the social failure of Islamic finance: Aspirations of Islamic moral economy vs. the realities of Islamic finance. *Asian and African Area Studies*, 11(2), 93–113. http://www.asafas.kyoto-u.ac.jp/en/publications/2011_2.html.

Asutay, M., & Zaman, N. (2009). Divergence between aspirations and realities of Islamic economics: A political economy approach to bridging the divide. *IIUM Journal of Economics and Management*, 17(1), 73-96.
bridging the divide. *IIUM Journal of Economics and Management*, 17(1), 73–96.
Dhumale, R. and Sapcanin, A. (1998), An Application of Islamic Banking Principles to Microfinance, United Nations Development Program, *Regional Bureau for Arab States*, New York, NY.
Dusuki, A. W. (2008). Banking for the poor: The role of Islamic banking in microfinance initiatives. *Humanomics*, 24(1), 49–66. https://doi.org/10.1108/08288660810851469
El-Gamal, M.A. (2006), Islamic Finance: Law, Economics and Practice, *Cambridge University Press*, Cambridge.
Erum, S. (2020). Islamic microfinance: A success story from Pakistan. *SPECIAL REPORT*. Islamic Finance news 16 December 2020.
Haneef, M. A., Pramanik, A. H., Mohammed, M. O., Bin Amin, M. F., &Muhammad, A. D. (2015). Integration of waqf-Islamic microfinance model for poverty reduction: The case of Bangladesh. International *Journal of Islamic and Middle Eastern Finance and Management*, 8(2), 246–270. https://doi.org/10.1108/IMEFM-03-2014-0029
Hassan, M. K., Alshater, M. M., Hasan, R., & Bhuiyan, A. B. (2021). Islamic microfinance: A bibliometric review. *Global Finance Journal*, 49(100651), 1–14. https://doi.org/10.1016/j.gfj.2021.100651
Ibn, A. (2006), Treatise on Maqasid al-Shari'ah, (translated by El-Mesawi, M.E.-T.), *The International Institute of Islamic Thought*, London.
IFDI. (2021). *Islamic finance development report 2021*: Advancing economies.
IFSB. (2021). *Islamic financial services industry stability report 2021*. Malaysia: Kuala Lumpur.
Iqbal, M. and Molyneux, P. (2005), *Thirty Years of Islamic Banking: History, Performance and Prospects*, Palgrave Macmillan, New York, NY.
Johnson, S., Malkamaki, M., & Wanjau, K. (2006). Tackling the'frontiers' of microfinance in Kenya: the role for decentralized services. *Small Enterprise Development*, *17*(3), 41-53.
Kachkar, O., Fares, D., & ve bin Noordin, K. (2016). Application of microfinance in selected Islamic banks in Malaysia: Challenges and prospects. *Middle East Journal of Business*, 11(2), 12–18
Kaleem, A., & Ahmed, S. (2010). The Quran and poverty alleviation: A theoretical model for charity-based Islamic microfinance institutions

(MFIS). *Nonprofit and Voluntary Sector Quarterly*, 39(3), 409–428. https://doi.org/10.1177/0899764009332466

Kamali, M. H. (1999). "Maqasid Al-Shari'ah": The objectives of Islamic law. *Islamic Studies*, 38(2), 193–208. http://www.jstor.org/stable/20837037

Kamla, R., & Rammal, H. G. (2013). Social reporting by Islamic banks: Does social justice matter? *Accounting, Auditing & Accountability Journal*, 26(6), 911–945. https://doi.org/10.1108/AAAJ-03-2013-1268.

Karim, N., Tarazi, M., & Reille, X. (2008). Islam micro finance: an emerging market niche.

Naveed Aslam, M. (2020). Challenges of Islamic Microfinance and MSME during COVID-19. *Muhammad, Challenges of Islamic Microfinance and MSME during COVID-19 (November 4, 2020).*

Obaidullah, M. (2015). Enhancing food security with Islamic microfinance: Insights from some recent experiments. *Agricultural Finance Review*, 75(2), 142–168. https://doi.org/10.1108/AFR-11-2014-0033

Obaidullah, M., & Mohamed-Saleem, A. (2008). Innovations in Islamic microfinance: Lessons from Muslim Aid's Sri Lankan experiment.

Park, C.-Y., & Mercado, R. J. (2015). Financial inclusion, poverty, and income inequality in developing Asia. *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.2558936

Raditya, S., & Taqwa, K. Z. (2015). Developing programs based on Maqasid Sharia by Islamic microfinance institution to support financial inclusion. In Proceedings of *INTCESS15-2nd International Conference on Education and Social Sciences* (February) (pp. 919–924)

Rahman, R. A., & Dean, F. (2013). Challenges and solutions in Islamic microfinance. *Humanomics*.

Syed, M. H., Khan, S., Rabbani, M. R., & Thalassinos, Y. E. (2020). *An artificial intelligence and NLP based Islamic fintech model combining*.

Thaker, M. A. B. M. T., & Thaker, H. B. M. T. (2016). Adopting zero interest financing model (ZIFM) in Islamic microfinance institutions: The case of Shariah People Credit Bank (BPRS), Indonesia. In R. Rainis, M. N. B. AbuBakar, & J. E. Shafii (Eds.), *PSU-USM-NSTRU 2014 International conference on arts and sciences 2014 arts and sciences research 2014*: Spot of change for tomorrow, 23. https://doi.org/10.1051/shsconf/20162302003

Waheed, S., & Hamid, A. I. (2001). Analysis of Issues on Micro Credit—The Case of Two Villages in Punjab [with Comments]. *The Pakistan* *development review*, 723-750. Zakat and Qardh-Al-Hasan for countering the adverse impact of COVID 19 on SMEs and individuals. International Journal of Economics and Business Administration, 8(2), 351–364.