

Fighting Poverty with Islamic Finance

Poverty in developing countries can be attributed to a variety of interrelated factors, mostly due to a lack of education and skills, unemployment, underemployment, economic instability, lack of access to financial services, lack of industrialization, etc.

Poverty in Pakistan is a complex issue, interrelated with education, labor market dynamics, the average population growth rate, and other socio-economic challenges. According to the latest reports from the Pakistan Bureau of Statistics, the poverty rate in Pakistan is estimated to be around 24%. Over time, the phenomenon of begging has increased significantly in urban areas.

Due to the lack of proper educational and vocational training centers, unskilled and semi-skilled labor, street workers, and daily wage or seasonal workers are unable to utilize their potential to the fullest in order to earn a better living. Therefore, per capita income in Pakistan is marginal compared to similar economies in neighboring countries.

Poverty is not only an economic issue but also a social one that affects individuals' quality of life, opportunities, and dignity. Eliminating poverty can significantly enhance workforce productivity by enabling individuals to focus on performance and professional development rather than mere survival.

Islamic banking offers various tools and frameworks based on Shariah-compliant mechanisms—such as risk-sharing instead of risk transfer, promoting equity investment, sustainable development, asset-based financing, zakat and Sadaqah, community development, and microfinance including Qard-e-Hasna (interest-free loans). Islamic banking can play a supportive role in reducing poverty through these tools.

Microfinance can support various business ventures like small retail shops, food and beverage services, barber shops, laundry businesses, tyre repair shops, handicraft production, agricultural ventures, service-based businesses, home-based freelancing, online businesses, IT-based services, digital marketing, event planning, and management. Entrepreneurs with limited resources can establish, run, and grow their businesses successfully with the support of Islamic microfinance.

Poverty can also be controlled through access to financial services for deserving individuals who possess skills but lack the resources to enhance their productivity. Islamic finance can play a crucial role in alleviating poverty by offering financial products that improve workforce productivity.



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Islamic financial institutions are available in the country. They operate under the regulatory framework of the State Bank of Pakistan. Some non-banking Islamic microfinance financial institutions operate under the regulatory framework of the Securities and Exchange Commission of Pakistan, while a few others are registered under the Societies Act. Their operations are found in various cities across the country.

Dedicated full-fledged Islamic banks and Islamic banking branches of all other banks, as well as specific-purpose Islamic microfinance banks, run under the regulatory framework of the State Bank of Pakistan. Several other non-banking Islamic microfinance institutions—including Akhuwat Microfinance, APNA Microfinance Bank Limited, Khushhali Bank Limited, Pak Oman Microfinance Bank Limited, Tameer Microfinance Bank Limited, The First Microfinance Bank Limited, Advance Microfinance Bank Limited, and FINCA Microfinance Bank Limited — also offer Islamic microfinance services.

Islamic finance represents a promising venue for fostering financial inclusion and creating equal opportunities across various demographic groups. By adhering to the principles of justice, transparency, and ethical investment, it has the potential to empower women, assist low-income individuals, and support underprivileged communities in their efforts toward economic well-being. With continuous efforts for public awareness about the concept of Islamic banking and Islamic financial products, and the development of innovative products suited to different marginalized segments of society, Islamic banking can significantly contribute to achieving a more inclusive financial landscape, covering the financial needs of various business ventures.

Islamic finance is based on Shariah laws, which emphasize justice, transparency, and ethical behavior. Its core principles include the prohibition of riba (interest), ensuring that lending and borrowing practices are fair and equitable. Islamic finance promotes risk-sharing among parties, fostering partnership and collaboration.



Funds in Islamic finance cannot be involved in or invested in businesses such as alcohol, gambling, and other prohibited activities. Such activities are considered harmful to society.

All Islamic finance transactions are backed by tangible assets, thereby promoting real economic activities and reducing speculation.

Islamic financial institutions are increasingly developing innovative financial products that cater to diverse demographic needs. These include Islamic microfinance, asset-based financing, and other Shariah-compliant investment vehicles that encourage participation from all segments of society.

Islamic finance provides access to financial services for low-income individuals, women, and marginalized communities who may be excluded from the conventional banking system. Microfinance initiatives following Islamic principles often offer interest-free loans or equity-based financing to enable entrepreneurship and self-employment.

Women can also benefit from various financial products tailored to their needs, such as microloans for female entrepreneurs, savings accounts, and investment opportunities. Programs specifically designed for women aim to address gender disparities in financial access.

Islamic modes of finance can be broadly divided into different categories based on their suitability to cater to customer-specific requirements. For the convenience of readers, these modes of finance can be classified as:

a) Equity participation basis

b) Term period basis (i.e., short- and long-term facilities)

c) Repayment terms basis (i.e., balloon payment in trade-based transactions and installment repayment in rental-based transactions).

Let's briefly explain such modes of transactions:

1) **Participatory Mode of Finance -** These products are designed on the principle of profit-sharing:

   a) **Musharakah Finance:** Both parties — the bank and the customer — jointly contribute the required capital to the business or assets and hold ownership according to their respective equity share. Profits are shared as per the agreed ratio, while losses are borne in proportion to each party's equity participation. This allows businesses to access financing without bearing the entire risk.

   b) **Mudarabah Finance:** The bank provides the full capital, while the customer contributes expertise and management. Profits are shared according to a pre-agreed ratio, and losses are borne entirely by the bank, provided there is no negligence or misconduct by the customer. This mode offers opportunities in Islamic finance for individuals with limited financial resources but relevant skills and expertise to operate a business diligently. It allows access to financing without the burden of interest payments and offers the satisfaction of Shariah-compliant profit-sharing arrangements that incentivize active involvement.

2) **Short-Term and Long-Term Period Modes of Finance** - These products are designed to fulfill working capital requirements or to acquire capital assets, as outlined below:

   a) **Murabaha Finance:** A short-term transaction suitable for meeting raw material requirements. The bank purchases goods from suppliers as the sole owner and sells them to the customer at a disclosed cost-plus profit, on a deferred repayment basis.

   b) **Musawamah Finance:** It is a short-term transaction similar to Murabaha, but the bank does not disclose the cost or profit margin when selling the goods to the customer.

   c) **Istisna Finance:** A short-term transaction suited to customers manufacturing goods. The bank makes advance payments (either partially or in installments) for the goods, and the customer agrees to sell the manufactured goods to the bank on a future date. The bank becomes the sole owner of the goods and may sign an agency agreement authorizing the customer to sell the goods on behalf of the bank and remit the sale proceeds back to the bank.

d) **Salam Finance:** A short-term transaction ideal for customers involved in agricultural produce. The bank makes full advance payment for seasonal goods to be delivered at a later date. The bank becomes the sole owner and may sign an agency agreement with the customer to sell the goods on behalf of the bank and return the sale proceeds as per agreed terms.

e) **Al Bai / Al Tijarah:** A short-term transaction to meet receivable financing needs. The bank pays the customer upfront to purchase goods already available, receiving immediate delivery. The bank becomes the sole owner and authorizes the customer through an agency agreement to sell the goods and return the sale proceeds later as agreed.

f) **Ijarah Finance:** A long-term transaction for acquiring assets such as machinery, equipment, tools, appliances, or vehicles. The bank purchases the asset and offers it to the customer on a rental basis (fixed or variable). As the sole owner, the bank bears all risks and rewards. The customer may request to purchase the asset from the bank at an agreed price during or at the end of the lease term.

g) **Diminishing Musharakah Finance:** A long-term transaction used for acquiring capital assets. The bank and the customer jointly purchase the asset and become co-owners. The customer uses the bank's share on a rental basis, while gradually buying out the bank's ownership through unit purchases. Eventually, the customer becomes the sole owner of the asset at the end of the agreed term.

3) **Repayment Terms Basis -** These products are structured based on the customer's cash flow and repayment capacity, enabling them to meet their obligations smoothly on the respective due dates. While the products have already been discussed above, they are categorized below for convenience:

a) **Balloon Repayments:** Lump-sum repayments due at maturity. This structure is applicable under Murabaha, Musawamah, Istisna, Salam, Al Bai, and Al Tijarah transactions.

b) **Installment Repayments:** Repayments are made through rentals and/or installments on an agreed frequency (e.g., monthly or quarterly) under Ijarah and Diminishing Musharakah transactions.

c) **Participatory Mode of Finance (Musharakah, Mudarabah):** Repayment of profit and equity



contributions is made based on mutual agreement, depending on the business performance and terms agreed upon.

Islamic banks are fully equipped to handle import and export transactions and charge a fixed or variable fee for providing these services.

Under the supervision of Shariah scholars, Islamic banking institutions can also offer tailor-made financial solutions. These are developed in collaboration with their Shariah Product Development and Shariah Compliance departments and may be based on concepts such as Wakalah (agency), Kafalah (guarantee), or other permissible Shariah-compliant structures.

Welfare organizations such as Al Khidmat Foundation, Saylani Welfare Trust, and Alamgir Welfare Trust are also actively serving deserving individuals through various initiatives. These include Asaan Rozgar programs, educational institutions, and medical facilities — all aimed at enabling individuals to enhance their skills and become self-reliant.

Conclusion

Islamic financial institutions in Pakistan are well-positioned to provide Shariah-compliant financial services that promote economic empowerment and contribute to poverty alleviation. Although the Islamic microfinance sector currently holds a relatively small share of the overall microfinance industry in Pakistan, it is steadily growing. However, funding arrangements remain a major challenge. Institutions must explore innovative ways to mobilize deposits and lower the cost of funds.

About the Author: *The author is a retired Islamic banker who served as Vice President in the Islamic Banking Operations of a leading commercial bank, bringing over three decades of experience to the field. He holds a Master's degree from the University of Karachi, a Postgraduate Diploma from the Centre for Islamic Economics, JAIBP certification from the Institute of Bankers Pakistan, and has completed professional training at NIBAF, State Bank of Pakistan.*