Chapter 2

REVIEW OF RELATED LITERATURE
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Eminent scholars and academicians from different parts of the world have shown great interest in analyzing microfinance, interest free finance, impact of these institutions on society and its relationship with poverty alleviation in India as well as international level. They approached the problem from different angles at both micro and macro. In this chapter an attempt has been made to review the major studies on microfinance which are related to, in one way or the other, to the present study. It is done in five sections. Section I reviews the major studies on microfinance, Section II deals with studies related to microfinance in India, Section III deals with the studies related with poverty alleviation, Section IV enquires major studies on interest free microfinance. Section V discusses various studies relating Islamic economics and banking and the last section deals with other related studies.

2.1 Studies Related to Microfinance

a) Definition of Microfinance

ADB (2008)\(^1\) defined microfinance as the provision of a broad range of financial services such as deposits, loans, payments services, money transfers, and insurance to poor and low income households and their micro-enterprises. Enugu Forum (2007)\(^2\) defined microfinance as banking for the poor. Microfinance programmes provide loans, savings and other financial services to low-income and poor people to use in small businesses. According to Ledger wood (2000)\(^3\) microfinance has evolved as an economic development approach intended to benefit low-income women and men. The term refers to the provision of financial services to low income clients, including the self employed. These statements are elaborating that
microfinance is a financial services but designed specifically for poor to improve their lives in sustainable way.

b) History and development of microfinance

The concept of microfinance is not new. Savings and credit groups that have operated for centuries include the "susus" of Ghana, "chit funds" in India, "tandas" in Mexico, "arisan" in Indonesia, "cheetu" in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia, as well as numerous savings clubs and burial societies found all over the world. Enugu Forum (2007)\(^4\) observes that traditional forms of community financing as the early forms of microfinance is found all over the world in places such as Africa, Latin America and Asia. But in the modern times the microfinance movement began in the early 1970s in place like Bangladesh and Bolivia and has, over the last 30 years, captured the interest of multilateral donor agencies and private sector bankers.

James C. Brau, (2004)\(^5\) explains the origin and development of microfinance. Absent access to formal financial services, the poor have developed a wide variety of informal, community-based financial arrangements to meet their financial needs. In addition, over the last two decades, an increasing number of formal sector organizations have been created for the purpose of meeting those same needs. Microfinance is the term that has come to refer generally to such informal and formal arrangements offering financial services to the poor. It has only been within the last four decades, however, that serious global efforts have been made to formalize financial service provision to the poor.

To Rodney Wilson (2007)\(^6\) it predates modern banking as involved informal financing through moneylenders, pawn shops, loans from friends and relatives and supply of credit from merchants and landlords. There is an element of exploitation
with high rate of interest. The poor became easy victims of unscrupulous lenders, to whom they were often indebted from generation to generation in a vicious cycle of poverty. Such unfair conditions exist, even today. The poor cannot secure bank funding as they have no collateral to offer. Consequently they still continue to use informal sources of finance, despite the increasing presence and impact of modern banking in many developing countries.

CGAP\(^7\) in its study paper explains the recent history of microfinance institutions. One of the earlier and longer-lived microcredit organizations providing small loans to rural poor with no collateral was the Irish Loan Fund system, initiated in the early 1700s by the author and nationalist Jonathan Swift. Swift's idea began slowly but by the 1840s had become a widespread institution of about 300 funds all over Ireland. Their principal purpose was making small loans with interest for short periods. At their peak they were making loans to 20% of all Irish households annually. In the 1800s, various types of larger and more formal savings and credit institutions began to emerge in Europe, organized primarily among the rural and urban poor. These institutions were known as People's Banks, Credit Unions, and Savings and Credit Co-operatives.

Waheed Akhter \textit{et al.} (2009)\(^8\) in their study quoted the statistics from World Bank about the development of microfinance. The World Bank estimates that there are over 7000 microfinance institutions, serving some 16 million poor people in developing countries. The total cash turnover of MFIs world-wide is estimated at US$2.5 billion and the potential for new growth is outstanding. The Microcredit Summit estimates that US$21.6 billion is needed to provide microfinance to 100 million of the world's poorest families. Other estimates telling that worldwide, there are 13 million microcredit borrowers, with USD 7 billion in outstanding loans, and
generating repayment rates of 97 percent; growing at a rate of 30 percent annual growth. Despite all this less than 18% of the world’s poorest households have access to financial services.

c) Scope of microfinance

Agion and Morduch (2005), explains different possibilities of microfinance, including extending markets, reducing poverty and fostering social change. But there is widespread confusion that microfinance is just lending loan to poor but as we mentioned that microfinance is no more only loans but covering the issues of poverty alleviation, putting social impact on poor and educating poor to savings. Therefore, MFIs, today, not only NGOs but serving as a complete banking system. In his own words this discussion lead to us that microfinance is a form of financial services for poor to help them for their business activities by giving micro credit.

Gibbons and Kassim (1990) observing microfinance as a programme that extend small loans to very poor people for self employment projects that generate income in allowing them to take care of themselves and their families. The microfinance scheme has been proven to be successful in many countries in addressing the problems of poverty. The primary mission of microfinance is, therefore to help poor people in assisting themselves to become economically independent.

Develtere and Huybrechts (2005) observe the effect of microcredit programs on nonmembers in rural areas. In a way or another, nonmember groups in the villages can be benefited by the microcredit institutions. It is still worth looking at what we know about the indirect effects and impacts of the microcredit programs. According to them a more direct effect of microcredit will be felt in the credit market since the supply of total credit available will increase, leading to a decline in the interest rate. It will positively affect to the non members.
Judith Brandsma and Laurence Hart\textsuperscript{12} discussing the need for microfinance by distinguishing between two groups of poor people: those who can increase their income by themselves and those who cannot. Members of the first group can engage in economic activities are called the entrepreneurial poor or economically active poor. The households of the economically active poor may have some assets (such as land) and some members may be employed or run a micro business. Members of the second group are called the extremely poor. Microfinance targets the entrepreneurial poor.

Ledgerwood (2000)\textsuperscript{13}, discuss many activities and characteristics of microfinance institutions. Those are include, small and short term loans, social collateral rather than financial collateral, access to larger amount of loan if repayment performance is positive, search and access the real poor and their business demand, continuous monitoring of business, easy way to access finance, therefore not too much paper work, and easy and short procedures. These are also include offering saving services to borrowers even for smallest amount, offer training services to borrower’s business development, literacy training to borrowers so that they can come up with competence to daily business problems and its solutions, health care, social services and other skill training services to provide borrower a sustainable base for their business development. Financial intermediation is by far the most primary objective of MFIs because without loan/money social intermediations cannot work.

Fruman and Goldberg (1997)\textsuperscript{14} also listing the financial services provided by microfinance institutions such as credit and savings services to the entrepreneurial poor that are tailored to their needs and conditions. According to them good microfinance programs are characterized by small, usually short-term loans, and secure savings products, simplified borrower and investment appraisal, alternative approaches to collateral, quick disbursement of repeat loans after timely repayment
above-market interest rates to cover the high transactions costs, high repayment rates and convenient location and timing of services.

2.2 Indian microfinance sector

In its annual publication on Status of Micro Finance in India for 2009-2010, NABARD\textsuperscript{15} has indicated that the total exposure of banks and financial institutions to MFIs as on March 31, 2010, was Rs. 13,956 crore, representing a growth of more than 100 per cent during the year. It is discussing especially various SHG models practicing different groups of people in different parts of the country. Very important among it is SHGs formed among fishermen community in Kerala. The study finds that Joining SHGs has freed members from the shackles of moneylenders and intermediaries and contributed to income increases. Few success stories has also illustrated in the report. Important among it is Kumarakom Vikasana Samithy, which was decided to launch the Gramalakshmi programme in line with NABARD's SHG programme. As a result, the fishers can now sell their catch to anyone who offers them a good price. Significant changes in the fishermen's lifestyles have also been observed. Such like that experiments from other districts of Kerala and from other state of the country also explained in the report.

Shastri (2009)\textsuperscript{16} quoting an important study of 2005 – 2006, a survey of India’s leading 15 MFIs shows the industry’s strength in both size and growth. While MFIs globally and within the region average less than 20,000 clients per institution, well managed Indian micro finance institutions already rank top in outreach. Not to be left behind, Indian institutions top the charts of all 78 countries surveyed in 2005 for their phenomenal growth rates, the median leading MFI doubling coverage in a single year. A world wide survey of nearly 450 institutions in 2005 reported that five of the top 20 fastest growing MFIs were Indian.
Satya Sundaram (2007) has a comprehensive work on microfinance in India. Here he argues that microfinance is one of the innovative schemes to help the poor, but they met limited success. He suggests that the self-help groups are empowering the rural poor by providing them access to institutional credit and other relevant services. The SHGs lay stress on thrift, training and capacity building. Emphasis is placed on educating the members on social issues also.

Madhura Swaminathan (2007) in her article “The micro credit alternative”, explains the micro credit has been receiving a significant amount of attention all over the world especially in developing countries. She states that by providing micro credit to the poor people, the gap in the formal credit sector can be filled. Alysius P Fernandez (2007) also specifies the development of micro finance in India and its linkage with SHGs. M P Vasumalai and K. Narender (2007) give a brief picture of results of functioning ‘Kalanjiam Community banking programme based on Tamil Nadu. In their words Kalanjiam is a unique micro credit programme in south India and one of the largest micro finance programme in Asia and probably largest programme in the world. As on September 2006 the programme has an outreach of 347955 poor women spread over 139 locations covering 6605 villages. The writer try to prove that this programme reduce poverty in the country.

The report namely “Micro finance Industry in India is a case study of Indian Centre for Management Research” presents a detailed overview of the microfinance industry in India. The advent of new millennium witnessed significant developments in the Indian microfinance industry, which attracted the attention of several private sector and foreign banks. The report analyzes the potential of Indian microfinance industry and examines the recent policies of Indian government to boost the growth of
the industry. Finally, the report examines the challenges facing the industry in the near future.

Debadutta K Panda, (2009)\textsuperscript{22} also focuses on Indian microfinance scenario. It gives an in-depth understanding on microfinance products, supported by relevant case studies and examples. The different components of microfinance in the Indian context are discussed with suitable examples such as demand and supply of microfinance, intermediation and regulations and so on. He analyzes the role of microfinance and microfinance institutions in natural disasters and also scans various microfinance lending models practiced throughout the world, and focuses on the models practiced in India. The book concludes with discussions on microfinance as a tool for poverty alleviation, social development, women empowerment, microenterprise development and socio-economic development of rural and urban poor, and is supported with many real cases drawn from the field.

Prabhu Gate (2007)\textsuperscript{23} gives a series of annual reports on the microfinance sector in India. It is a comprehensive one-stop document that provides a holistic view of the sector, providing a detailed analysis of its status and future. It highlights recent developments under each of the two main models of microfinance in India - the SHG and MFI models. The author in another article\textsuperscript{24} outlines a case study of the episode in 2006 in Krishna district of Andhra Pradesh when the state government temporarily closes down all the branches of microfinance there. The case study helps provide insights into the kind of consumer protection issues of relevance to Indian microfinance.

Sriram M S and Radha kumar (2007)\textsuperscript{25} analyzed the reason behind the regional skewness of microfinance institutions in India. The article concludes that there is no macroeconomic or demographic reason as to why microfinance emerges in
certain regions. Using the summary of the data, the writers assume that microfinance naturally emerges in places where the economic growth is slow, the connectivity is low, the poverty incidence is high, with dense population and a failure of formal financial institutions.

Radha G. Friedman (2005) conducted a study about the impact of Indian microfinance industry on poor especially women by taking two MFI s from south India; Jaya sangham Chennai and Prem Sangham Visakha Patanam. Both institutions are started its operations around 25 years back the functioning mainly concentrated among women. In 2005, Jaya Sangam owns its own cooperative bank and has more than 225,000 members in nine branches across the three southern states of Tamil Nadu, Andhra Pradesh, and Karnataka, and is considering expanding north into the state of Bihar. Prem Sangam provides programs and services to 185 villages spread out over a 100 KM radius. Both MFIs studied, revealed an unequivocal welfarist inclination in their mission, programs, and policies, which would suggest that they are far less easily influenced by policy from international development institutions.

2.3 Microfinance and poverty alleviation

a) Studies in favor of microfinance

Several studies are published about the microfinance and poverty alleviation in India as well as world level. One of the most widely cited poverty impact studies is Hulme and Mosley (1996). This employed a control group approach looking at the changes in income for households in villages with microfinance programs and changes for similar households in non-program areas. Programs in a number of countries are considered including the Grameen Bank in Bangladesh and the Bank Rakyat Indonesia (BRI). In general a positive impact is found on borrower incomes of
the poor (1988-92) with on average an increase over the control groups ranging from 10-12% in Indonesia, to around 30% in Bangladesh and India.

Another major early initiative that has provided some of the firmest empirical work was the surveys conducted in the 1990s by the Bangladesh Institute of Development Studies (BIDS) and the World Bank[^28]. The study summarizes a number of different studies conducted in Bangladesh using the 1991-92 survey and focusing on three major microfinance programs, including the Grameen Bank and the Bangladesh Rural Advancement Committee (BRAC). The study draws a number of conclusions, but the main one is that the program had a positive effect on household consumption, which was significantly greater for female borrowers. In terms of poverty impact it is estimated that 5% of participant households are pulled above the poverty line annually.

Khandker, Shahidur R. (1998)[^29] measures the varying effects of three microcredit programs from Bangladesh (Grameen, BRAC and RD-12) on participants, as well as the impact on the local economy. The study concludes that microfinance reduces poverty by increasing per capital consumption among program participants and their families. Poverty reduction estimates based on consumption impacts of credit show that about 5 percent of program participants can lift their families out of poverty each year by participating and borrowing from microfinance programs. Moreover, some of this reduction may result from income redistribution rather than income growth.

Zaman (2000)[^30] examines the extent to which micro-credit reduces poverty and vulnerability through a case study of BRAC, one of the largest providers of micro-credit to the poor in Bangladesh. The main argument in this paper is that micro-credit contributes to mitigating a number of factors that contribute to vulnerability.
whereas the impact on income-poverty is a function of borrowing beyond a certain loan threshold and to a certain extent contingent on how poor the household is to start with. Zaman discusses several ways by which membership in micro-credit programs reduces vulnerability - by smoothing consumption, building assets, providing emergency assistance during natural disasters, and contributing to female empowerment.

Numbers of research have been conducted with regard to the impact of microfinance in eliminating the poverty in Indonesia. Rudjito (2003) explained the successful of Bank Rakyat Indonesia using their microfinance programme such as BKD (Bank Kredit Desa/Village Credit Bank), P4K (Program Peningkatan Pendapatan Petani dan Nelayan Kecil/Fishery and Farmers Income Generating Project), and BRI Unit. Using cultural approach, BKD has built more than 4,500 microfinance institutions and served more than 700 thousands of people, only in Rural Area of Java and Madura Islands. The P4K has served the people by lending credit by more than 683 billion rupiahs to more 170 thousands group of people in the rural area, with non performing loan only 6.78 % on 2002. The BRI Unit which started since 1984 has achieved more than 25 millions of people in saving and serve more than 4 million of people in credit services.

SMERU (2005), a Research Institute Indonesia, specifically conducted research on microfinance in 2005, and found significant contribution of microfinance to the poverty alleviation. The research was named as Sulawesi Agriculture Area Development Project (SAADP) and funded by the World Bank. The project is an economic-commercial project whose aim is to reduce poverty in Central Sulawesi and Southeast Sulawesi. The result of the research reveals that SAADP had a positive impact on increases in all types of agricultural perspectives among farming
respondents. Most of SAADP respondents said that their nominal household income had risen as a result of their participation on project.

MkNelly et al. (1996)³³ evaluated the Freedom from Hunger credit with education program in Thailand operated through village banks. The results show positive benefits, however, although non-participants in non-program villages are used as controls, there are problems in accepting the results. No statistical tests are reported, so one cannot judge whether differences between participants and non-participants are significant.

Chen and Snodgrass (2001)³⁴ examine the operations of the Self Employed Women’s Association (SEWA) bank in India, which provides low-income female clients in the informal sector with both saving and loan services. The study tests for the impact of these services by comparing the bank’s clients against a randomly selected control group in a similar geographic area. Two surveys were conducted two years apart. Average incomes rose over time for all groups borrowers, savers and the control although the increase was less for the latter. In terms of poverty incidence there was little overall change, although there was substantial ‘churning’, in that amongst the clients of SEWA there was quite a lot of movement above or below the poverty line.

Chen et al. (1999)³⁵ in a study about SEWA bank in India; average daily expenditure on food is 21% higher than in non-client households. In contrast, saver only households enjoy only a small dietary margin over non-client households. Average daily expenditure on food is only 5% higher than in non-client households. The average number of income sources was 2.7 for client households compared with 2.5 for both saver-only and non-client households. It is interesting to note that the net impact of the wide-spread closure of large textile mills in Ahmadabad City appears to
be that the borrower households suffered greater setbacks (more jobs lost and less compensation paid) but were able to recover more quickly (more laid-off workers are currently economically active) than saver-only and non-client households.

There are some studies about poverty eradication measures taken by microfinance institutions at Latin America. Dunn and Arbuckle (2001a, 2001b)\textsuperscript{36} use an analysis of covariance to examine loans to micro-enterprises for 305 households in Lima, Peru by Mibanc, a microfinance institution. The study draws on data at two points in time 1997 and 1999 and looks at changes in the borrowers relative to a control group of households who had not received a micro-enterprise loan. On average the borrower group appears to be around or slightly above the national poverty line, with approximately 30% below the national poverty line. The poverty dimension of the study shows a positive poverty reduction effect.

Banegas et al (2002)\textsuperscript{37} look at the operations of two MFIs in Ecuador (Banco Solidario) and Bolivia (Caja los Andes) utilizing the CGAP poverty index to establish outreach and a logit regression model that links participation in a program with income changes and poverty scores. It is found that for both institutions taking a loan is associated with increases in income. However income change is measured not by the size of monetary values but by a simple scoring system (1 for income decrease, 2 for unchanged income and 3 for income increase).

From a nutritional perspective MkNelly and Dunford (1999)\textsuperscript{38} look at the impact of Credit with Education loans to women in rural Bolivia. A relatively rigorous approach is applied by collecting data two years apart from a participant group and a control group, who would be offered the credit at the end of the study period. Roughly two-thirds of participants reported an increase in income over the study period and their net incomes in 1997 appeared far higher than the control group.
In general, for Latin America the available studies suggest that MFIs, whilst they may be flourishing in commercial terms, and providing a valuable service to micro-enterprises often run by poor entrepreneurs, have relatively weak impact on those at the very bottom of the income distribution.

McCulloch, Neil and Bob Baulch (2000) reported a research conducted by UK Institute of Development Studies about the poverty of rural Pakistan. The results of applying different measures of transitory and chronic poverty to the income data suggest that 68 percent of total poverty is transitory, arising from variations in households’ incomes. Reduction in chronic poverty will still require improvements in the human and physical capital of the poor. Most of the anti-poverty policies are to reduce transitory poverty and those are include two types of measures; firstly, enhancing the ability to smooth out income fluctuations and secondly possible interventions which include provision of micro-credit, seasonal public works, crop insurance and food price stabilization schemes.

Remenyi et al. (2000) concluding their study about microfinance that household income of families with access to credit is significantly higher than for comparable households without access to credit. In Indonesia a 12.9 per cent annual average rise in income from borrowers was observed while only 3 per cent rise was reported from non borrowers. Remenyi notes that, in Bangladesh, a 29.3 per cent annual average rise in income was recorded and 22 percent annual average rise in income from non-borrowers. Sri-Lanka indicated a 15.6 rise in income from borrowers and 9 per cent rise from non borrowers. In the case of India, 46 per cent annual average rise in income was reported among borrowers with 24 per cent increase reported from non-borrowers. The effects were higher for those just below the poverty line while income improvement was lowest among the very poor.
In a Zimbabwe study by Barnes, Carolyn and Erica Keogh (1999)\textsuperscript{31} observes major differences in income distribution. For example, nearly half of the new client and non-client households had a monthly income of less than Z$2,000, compared with about one-fifth of the repeat client households. In contrast, half of the repeat clients had an estimated monthly household income of Z$4,000 or more. Members of repeat borrower households have on average one year of education more than those of non-client households. The average number of income sources was 2.5 for clients households compared with 2.1 for non clients. Similar numbers in the Uganda study were 3.23 compared with 2.53.

Versluysen and Eugene (1999)\textsuperscript{42} in their study find that household income of families with access to credit was significantly higher than for comparable households without access to credit. Poor households that have had access to microfinance services show significant increases in asset accumulation, providing them with both a safety net against misadventure as well as resources for self-help investments. Increased household income improves nutrition, and improves the probability that poor children from poor families will go to school.

UNICEF (1997)\textsuperscript{43} experience with microcredit has shown that the poor can be disciplined borrowers and savers, able to repay loans on time and to save. In Nepal, UNICEF has linked the delivery of social services to credit and other support provided under the Small Farmer Development Programme (SFDP) since 1982-1983. In areas where credit has been combined with support for basic social services, infant mortality is lower, school attendance for girls is higher and children’s health, nutrition and education have shown greater improvement, than in areas where credit alone is given or where no credit is provided.
Nelson et al. (1996)\textsuperscript{44} in their study about village banking find that programme participation has positive economic impact borrowers had been able to improve their economic returns either by expanding their existing activities, diversifying their strategies or decreasing costs. In Thailand, the income generating strategies of 68 village bank members, who had participated for at least one year, were found to be more diversified and of a higher return than those of 60 randomly selected non-participants. In the previous year, 61% of the borrowers had earned income from animal rising and 31% from microenterprises as compared to 22% and 5% respectively for nonparticipants. Women participating in the programme had invested $65 of money they controlled in agriculture as compared to only $16 for non-participants.

Meyer (2002)\textsuperscript{45} reached a similar conclusion. Surveying available evidence for Asian countries, he concluded that while access to microcredit seems to have an overall positive effect on income and education, results differ substantially across countries and programs both in magnitude and statistical significance and robustness. Because income and expenditure are the basic measures of household welfare, rigorous microfinance impact evaluations almost always cover changes in these variables. While some studies show positive impacts, other studies could not establish significant impacts.

Chamhuri Siwar and Basri Abd (2001)\textsuperscript{46} wrote about the effects of microfinance on poverty alleviation in Malaysian context. It argues that as poverty alleviation measure Malaysia implemented micro finance programme since 1986. This work evaluates the performance of three MFIs namely Amanah Ikhtiar Malaysia (AIM), Yayasan Usaha Maju (YUM) and Koperasi Kredit Rakyat (KKR). The paper provides a micro-finance capacity assessment to identify issues and constraints.
especially with respect to outreach, viability or sustainability, resource mobilization, and policy environment.

Ruben D. Canlas Jr (2009)\(^47\) quotes rigorous impact studies of microcredit conducted in the past 10 years; show mixed results regarding impact on income and expenditure. Some studies show a significant, positive impact on beneficiaries while others show no significant impact. This evaluation study undertook a rigorous estimation of the impact of microcredit in the Philippines and compares the results with other similar studies. The literature on the five primary areas of concern regarding indicators of the impact of microfinance: (i) income, expenditure, and savings; (ii) other financial transactions; (iii) enterprises and employment; (iv) household assets; and (v) human capital investments.

In his book, *Banker to the Poor*, Yunus\(^48\) cites several stories on how Grameen broke formal barriers in politics to let in more women in political positions. He shows how Bangladesh has progressively included women in its parliament and comparisons are made with Philippines, a country that supposedly espouses gender equality has an equal percentage of women in high political seats compared with Bangladesh. He concluded that several decades ago, it would have been difficult to imagine women winning seats in Bangledeshi parliament.

Oomman (2008)\(^49\) made a study about the effects of *Kudumbasree* an official microfinance institution in Kerala. As we know *Kudumbasree* is the project implemented by govt. of Kerala since 1998. This study analyses the functioning and effects of this institution and concludes that it makes some positive impact on the members of the SHGs formed under it. This is the recent detailed study about microfinance programme and poverty alleviation in Kerala context. One other paper about *kudumbasree* is by Dr. VP Raghavan\(^50\). It examines the socio-economic impact
of the *Kudumbashree* projects on the rural and urban poor in salvaging from deprivation and creating gender equity.

b) **Studies against microfinance**

While a large literature exists that shows the success of MFIs, some recent studies show failure of these institutions in reaching some of their objectives. Fernando (2004)\textsuperscript{51} claimed that instead of eliminating poverty, microfinance is in fact perpetuating it. Cited from The Consultative Group to Assist the Poor (CGAP) in 2003, Fernando argues that the users of microfinance are generally those who are living within poverty lines, and those who are among the poorest in the society remain neglected and invisible by the microfinance. The requirement set by microfinance cannot be fulfilled by the poorest or extremely poor groups in the society.

Robinson and Marguerite (2001)\textsuperscript{52} states that there are two means for microcredit—the ‘poverty-lending approach’ which promotes donor-funded credit for the poor, especially the poorest of the poor; and the ‘financial systems approach’ which advocates commercial microfinance for the economically active poor and other, subsidized and charitable nonfinancial methods of reducing poverty and creating jobs for the extremely poor; choice of means can limit the goals that can be reached. Robinson criticizing poverty-lending approach and supporting financial systems approach according to him it is the only method for sustainable microfinance operation. The economically active poor tend to know their business and to understand their financial needs better than the institutional staff who train them.

Develtere and Huybrechts, 2005\textsuperscript{53} questioning the argument of many researchers that the contribution of microfinance to poverty alleviation and whether they can reach and positively affect the “bottom poor.” Using a unique panel dataset with monthly consumption and income data for 229 households before they received
loans in two Bangladeshi villages, it is found that while microcredit is successful at reaching the poor, it is less successful at reaching the vulnerable. The study results also suggest that microcredit is unsuccessful at reaching the group most prone to destitution, the vulnerable poor.

Amin, et al. (2003)\textsuperscript{54} in a study based on some programs in South Africa, it was found that in practice, microfinance may still not reach the very poorest, since some borrowers still experience credit rationing in microcredit programmes, including inequality in terms of benefits and loan sizes as well as limited access to services. The empirical study of Chowdhury (2006)\textsuperscript{55}, et al, indicates that the main objective of the micro-credit movement in Bangladesh (and elsewhere) is to reduce poverty. Despite this there is still considerable debate in the development economics community concerning the effect of micro-credit on poverty. However, the effectiveness of micro-credit as a real poverty alleviation tool does not depend on its short-run impacts. Giving people money may raise them out of poverty for a short period of time but when the money is spent they fall back into poverty. For microcredit to permanently reduce poverty it must have a long-run impact. Its aim is to lead to a sustainable increase in a household’s ability to create wealth.

Microfinance, as for examples in case of Grameen Bank or Bangladesh Rural Advancement Committee (BRAC), is subsidized. Analysis shows that Grameen Bank is heavily subsidized by donors and the government, thus, with its performance conditional upon grants and subsidized funds, Grameen Bank possibly cannot survive without subsidy.”\textsuperscript{56} Many NGOs in the microcredit industry survive primarily on such subsidies, and in reality many NGOs come to the industry specifically seeking such subsidies as avenues for financial benefits of the organizers of those NGOs. The NGO sector is still, with exceptions, not financially sustainable and continues to rely on
subsidies of various sorts. In these circumstances, there is a need for studies that shed
light on the poverty consequences of different modalities. If NGOs are to continue to
draw on subsidized finance there is a need to demonstrate that they can reach the poor
and do so in a cost-effective manner, as compared with other forms of poverty
targeting interventions.\textsuperscript{57}

Wright and Graham A. N. (2000)\textsuperscript{58} quoted an Asian Development Bank
(1997) report notes that in Bangladesh, between one quarter and on third of the loans
were used fully or partly for purposes that were not directly related to production. In
rural areas, these uses included subsistence household expenditures on food and
clothing; housing improvements; loan repayments; tube wells for drinking water;
purchases of homestead land; and the release of mortgaged land. In urban areas, these
uses included payment for medical expenses, household expenses, and the purchase of
furniture.

Marcus et al. (1999)\textsuperscript{59} concerns that the recent international enthusiasm for
microfinance is obscuring other, possibly more effective, means of poverty reduction,
and that some of the best practices which these initiatives promote may be
undermining the wider potential of microfinance. The effects of failed investments
have received little attention. Hulme and Mosley’s seven country study, however,
suggests that a significant proportion of enterprises financed by MFIs do fail for
example 10-15\% of those supported by BancoSol in Bolivia and 25\% of the early
activities financed by the Malawi Mudzi Fund. It is often observed that returns to
labour in income-generating projects are very low and that similar remuneration for
the same hours worked in wage employment would be considered extremely
exploitative. Whilst participants may view this as preferable to working for an
employer, this is not always the case, many micro entrepreneurs start businesses because they cannot get employment.

Hume (2000)\textsuperscript{60} argues that MFIs are not a cure for poverty. However, MFIs could create and provide a broad range of micro financial services that would support poor people in their efforts to improve their own prospects and the prospects of their families. He believes that effective microfinance makes these agencies designed to help the poor more likely to achieve the goals that poor people seek to achieve.

Kingsbury (2007)\textsuperscript{61} argued that microcredit programs did little to alleviate overall poverty, even in countries like Bangladesh. About 45 percent of the country’s population lives below the poverty line, down just 2 points in the past decades. Bornstein (1999) attacked the impact of important microfinance institutions, particularly Grameen Bank and Bangladesh Rural Advancement Committee and have been criticized for many reasons. In his view, MFIs put rigorous social control measures and many disciplinary imperatives.

Dyal Chand (2005)\textsuperscript{62} asked the question whether microcredit is a cure for entrenched poverty or not. She herself answered based on the information available to her; there aren’t the statistics to prove that yet. She is, indeed, a vociferous critique of the Grameen Bank and micro-lending projects and her experience and work on microfinance programs created a negative image of this new paradigm of development in the intellectual community.

Buss, Terry (1999)\textsuperscript{63} reviews the current issues in the microcredit field and summarizes criticisms of microcredit. According to him governments are supporting microcredit because they fear implementing large-scale land reform. Microcredit may force poor people or groups of borrowers into debt they cannot repay, or into businesses where they can barely subsist. Heavily-subsidized microcredit distorts
capital markets, crowding out private credit or channeling resources away from more productive investments and politicizing the process. Even if microcredit programs succeed, they make little difference in economies, even in small developing economies. The poorest of the poor are rarely helped and often hurt. Those who receive subsidized credit in many cases likely do not need it. Most do not have positive impacts and many are highly inefficient (no source listed). Extending microcredit may be a bad investment for these reasons.

Pitt, et al. 64 jointly concluded after a study conducted at Bangladesh that the women’s credit has a large and statistically significant impact on two of three measures of the health of both boy and girl children. Credit provided to men has no statistically significant impact. A 10% increase in credit provided to females’ increases the arm circumference of their daughters by 6.3%, twice the increase that would be expected from a similar proportionate increase in credit provided to men. Female credit also has a significant, positive but somewhat smaller effect on the arm circumference of sons. Female credit is estimated to have large, positive and statistically significant effects on the height-forage of both boys and girls.” No statistically significant effects were found for Body Mass Index (BMI)

Rahman, Aminur (1999) 65 concludes his paper in recent years the most important criterion for success of microcredit programs is determined by their ability to achieve financial sustainability which is a desirable concern. But, at the same time, the service-providing institutions must also consider whether the attainment of such sustainability involves too large a cost in terms of borrowers, socio-economic impoverishment. If the aspirations for financial sustainability and the objective of serving poor women are contradictory, it is likely the latter will be sacrificed, especially when the donor and international development community’s attitude and

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support reward the former. The microcredit and microenterprise development projects are going to the “the” significant component of the 21st century’s development initiatives in both poor and industrialized countries.

Nonetheless, Rahman points out a number of issues with relationships in the single village he studied which had Grameen Bank operations. For example: “Out of 120 women borrowers, 18% claim a decrease and 70% emphasize an increase in violence and aggressive behavior in the household because of their involvement with the Bank. In all five loan centers in the study village, he discovered that one or two influential members had real control over the decision making process of the center. Perpetuation of such power relations in the loan centers is contradictory to Grameen Bank ideology. Rahman attributes these problems to a “gulf between the ideology and vision” but does not offer specific remedies for Bank practices in the village.

Gibbons, David S. (1999) also specifically address the work of Rahman: “There is of course a flip side to this miracle story. He suggests, from his village-level observations in Bangladesh, that the Grameen Bank prefers women more for strategic reasons in relation to investment and recovery of loans than for the benefit of the women themselves has described it most fully, because they are more compliant and easier to discipline than the men. Moreover as the honor of their wives (and themselves) is at stake in repayment the husbands also pressure their wives to repay as required. Thus poor women are pressured from both sides, and some describe this as intolerable. These observations are useful because these things do happen from time to time, in GB and probably most of its replications. Money lending, and fundamentally that is the core of the GB methodology for poverty-reduction, is not a pleasant business.
Khandker, Shahidur R. (1998)\textsuperscript{67} pointed out the negative effects of borrowing. BRAC and RD-12 reduced employment in villages reflecting the decline in farm employment it reduced the farm income. According to Kandker, the usefulness of microcredit as a tool for reducing poverty depends on local circumstances. Poverty is often the result of low economic growth or high population growth or very unequal distribution of wealth/resources. The immediate determinants of poverty are unemployment or under-employment. When poverty results from unemployment, creating jobs is appropriate. When poverty results from low productivity or low income, increasing productivity through training, capital investment etc is key.

ILO\textsuperscript{68} in a study about microfinance listed the negative impacts of microloans such as increased workloads, higher social pressure to ensure loan repayment, women often employ daughters and daughters-in-law as unpaid employees thereby increasing their workload and participation in credit schemes can lead to indebtedness that is unmanageable, simply because there are no sufficiently profitable income-earning activities in which to invest. In this situation, women may end up being even more dependant that they were before.

Neils Hermes and Robert Lensink (2007)\textsuperscript{69} critically evaluate the microfinance. Microfinance does not reach the poorest of the poor, or that the poorest are deliberately excluded from microfinance programmes. First, the extreme poor often decide not to participate in microfinance programmes since they lack confidence or they value the loans to be too risky. They will therefore benefit only to a very limited extent from microfinance schemes. Second, the core poor are often not accepted in group lending programmes by other group members because they are seen as a bad credit risk. Third, staff members of microfinance institutions may prefer to exclude the core poor since lending to them is seen as extremely risk. Finally, the way
microfinance programmes are organized and set up may lead to the exclusion of the core poor. They concluded that it is unclear whether microfinance contributes to a reduction in poverty or is the most efficient method to reduce poverty without additional measures in areas such as education, health and infrastructure.

Robineson (2001)\textsuperscript{70} rightly remarks that it needs to realize that poverty alleviation is a multifaceted problem which cannot be realised through the introduction of finance alone, it requires several solutions. Even then, there are still many that perceive microfinance as one of the keys to resolving their poverty issues. If microfinance is implemented correctly it improves economic prospects, paving the way for better equality of income opportunity.

2.4 Microfinance and interest rates

Many studies are published about exploitative nature of interest charged by microfinance institutions. Surya (2005)\textsuperscript{71} highlights two issues; high interest rate and high transaction costs per loan. Here she justifies the high rate of interest charged by microfinance institutions by quoting high interest rate charged by local money lenders. She explain that money lenders in Philippines charging up to 20 percent of interest per day. Many people who embrace microfinance are still shocked by the double-digit interest rates that MFIs charge their poor clients. When the Mexican MFI Compartamos sold shares to the public, there was an outcry about its interest rates, which were above 100 percent a year for a while. In fact, the median interest rate for the 700 MFIs in the Mix Market database for 2006 was 30 percent.

According to Anyanwu (2004)\textsuperscript{72} the interest rates in the microfinance institutions are much higher than the prevailing rates in the banks. This ranges between 32-48%. During this period the banks are charging between 19.5% and 21.6%. Two reflections could be made. First, given the fact that people borrowing at this
rate indicate that they are industrious and productive. It is only that they are not given access to financial institutions, because they do not have collateral to meet the requirements of formal financial institutions and then they remain poor and liabilities to the economy instead of being assets. Second, the objective of microfinance to combat poverty might be defeated since the clients have to repay back double of what they have received at all cost.

Shariq Nisar (2003)\textsuperscript{73} is explaining the origin of interest based financial system in the world. The present interest-based banking system, originated from the practices of goldsmiths who established the first modern bank in Europe. These goldsmiths initially offered their services to those who wished to deposit gold coins for safekeeping. Upon taking a deposit the goldsmith would issue a receipt to the depositor. The receipt would be issued in 'bearer' form, meaning that any individual bearing it could claim back the face value in gold from the goldsmith on demand. As time progressed, the public found that the goldsmiths' receipts would be accepted in payment for goods and services. These receipts had become the earliest form of 'bank money'. As time passed goldsmiths realized that there was little need to lend the vault gold itself as their own receipts were by now regarded as money among the general public. A further step was taken when goldsmiths started issuing receipts to be lent out as a proxy for gold coins. This was of great advantage to them as receipts could be manufactured at almost no cost, whilst gold could not be. By lending the receipts instead, the goldsmiths charged interest on the amount lent. Upon repayment, the receipts could be destroyed as easily as they had been manufactured, but the interest charged would remain as revenue.

Kabir Hassan\textsuperscript{74} is listing the major problems of microfinance. One important among them is micro-credit has a basic assumption that the poor can be good
entrepreneurs given access to credit. There is no base for this assumption. Apart from these there are some other impediments that endanger the desired effects of microfinance on poverty alleviation. Those are asymmetric Information Problems, lack of economic viability of micro enterprises, high interest rates, focus on short term loans, high dropout rate, low rate of return on investment, debt trap of clients and credit rationing.

Kanagasabapathy (2010) also raising the high rate of interest charged by MFIs which are considered to be usurious, though perhaps not as usurious as the rates charged by the traditional money lenders. Several committees in the past desisted from imposing any ceiling on the interest rate. The Andhra Pradesh ordinance has not introduced any ceiling, except for saying that the interest should not exceed the principal. The Finance Ministry has said that the new Bill will not impose any ceiling on interest rates. Given that the current average interest rate is in the 30 plus range, even a ceiling of 24 per cent would seem to have a large repercussion on the sector, as per a recent study posted by a global agency monitoring MFIs.

2.5 Interest free microfinance

Microfinance has emerged as an important instrument to help a large number of unbankable members of society, as a tool to help reduce poverty and encourage economic growth in neglected parts of the world. However, despite being able to demonstrate successes, many experts have argued that conventional microfinance is not fully reaching the poorest of the poor and loans are going to activities unrelated to entrepreneurs. As Waheed Akhter et al. (2009) pointed out there is no single or uniform approach to microfinance. CGAP emphasizes, diverse approaches and channels are needed to get diverse financial services into the hands of a diverse range of people who are currently excluded. Making this vision a reality entails breaking
down the walls real and imaginary that currently separate microfinance from the much broader world of financial systems.

Dhumale and Sapcanin (taken from Segrado 2005) introducing interest free Islamic microfinance as a new and emerging approach. In Islam, charging interest (Ribâ) on liquid cash is prohibited because by Islamic teachings, money is not an asset for earning profit. Islam emphasizes on social, ethical, moral factors for distribution of wealth and guide towards social and economic justice. Islam rather than interest encourage profit because earning profit evolves productive activity and involve in profit and risk sharing between lender and borrower. Basic motive behind this approach is more than profitability, repository of wealth but collective wisdom of development of business, sharing profit and loss and collective struggle for business development. So the final gain from this is social benefit rather than profit gain and maximization which are helpful to microfinance and micro entrepreneurship.

Habib Ahmad explains the important role of financing microenterprises in alleviating poverty; several Islamic MFIs have been initiated in some countries. Islamic MFIs retain the innovative operational format of conventional MFIs and orient the program towards Islamic principles and values. Islamic MFIs, however, can have potentially more varied liabilities and assets. For example, on the asset side various modes of financing used and on the liability side sources of income can also include zakat, waqf, etc. Furthermore, the Islamic content of the Social Development Program can build the social capital that is needed for successful functioning of MFIs.

ABAC Malaysia (2008) explains the functioning of an alternative model of microfinance. In some Muslim communities, conventional interest based microfinance has always been rejected, principally of its non-compliance with the Islamic principles, particularly on the issue of paying of interest or ribâ, which is forbidden under the
Shariah. This has to some extent caused failure of government initiatives to overcome poverty and promote economic development through micro financing. Islamic finance could help correct the shortcomings of conventional microfinance as it focuses on achieving social justice and disallows exploitation and also battles poverty. This is further strengthened by the fact that the philosophical basis of Islamic financial system lies in ‘adl’ (social justice) and ‘ihsan’ (benevolence). In this respect, Islamic finance incorporates the social and equity elements along with the normal financing practices. This will ultimately be beneficial to the segment of the population that has been excluded from financial services and help to alleviate poverty.

As a mother country for microfinance initiatives many Bangladesh based studies are available about the effect of it on poverty alleviation. Mohammed Obaidullah (2008) compiled 17 studies about effect of microfinance on poverty alleviation. Most of the studies find that the positive effects of functioning of microfinance on poverty. But in his book he make a comparative study about the interest based institutions and interest free institutions, both are prominent in Bangladesh. He also makes case studies from Indonesia and Turkey, two secular countries and does a comparison with those countries. After a deep analysis he concludes that interest free micro credit is more productive and so effective for poverty alleviation. For that he studies about Rural Development Scheme of Bangladesh Islamic Bank, Credit guarantee scheme of Turky and micro finance sheme of Bank Rakyath Indonesia. It also suggests concentrating finance to livelihood-growth enterprises on interest free basis is more helpful to reduce poverty because it is more productive.

Hamid MA in his study observes the contribution of Islami Bank Bangladesh Limited (IBBL), the country’s pioneer Islamic Bank, in the development of small
entrepreneurs in Bangladesh, through its Rural Development Scheme (RDS) and Small Business Investment Scheme (SBIS). There are also microfinance schemes of several other government and non-government financial institutions for development of small scale enterprises, which is regarded as a major instrument of poverty alleviation. The study makes a comparative assessment of the performance of the IBBL programmes, which are shariah-based, and microfinance schemes of other institutions, which are interest-based. It also provides an idea about how small entrepreneurs can be developed through an Islamic way. Drawing on the experience gained through field surveys, some mechanisms for invigorating the Islamic bank’s role in this area are suggested.

The application of Islamic finance to microfinance was first discussed in depth by Rahul and Sapcanin (1998)\textsuperscript{82}. They demonstrate that Islamic banking, with its emphasis on risk sharing and, for certain products and collateral-free loans, is compatible with the needs of some micro-entrepreneurs. Viable projects that are rejected by conventional lending institutions because of insufficient collateral might prove to be acceptable to Islamic banks on a profit-sharing basis.

Dusuki (2006)\textsuperscript{83} has presented the idea of Islamic microfinance initiative in the perspective of Ibn Khaldun’s concept of ‘Asabiyah or social Solidarity that emphasizes group efforts and loyalty over self-interests of individuals. He argues that Islamic microfinance can be promoted through group lending to the poor who are normally denied access to mainstream banking services.

According to Dr. Abbas Mirakhor, Executive Director of the IMF as referred by Chaudhri (2006)\textsuperscript{84} important function of Islamic finance that is seldom noted, is the ability to provide the vehicle for financial and economic empowerment to convert dead capital into income generating assets to financially and economically empower
the poor. Microfinance is already more structurally aligned to applying Islamic equity financing structures. As mentioned previously, microfinance programs are based on group sharing of risk and personal guarantee while maintenance of trust and honesty is tied to the availability of future funds.

Ahmad (2007)\textsuperscript{85} opines that contemporary Islamic finance has been largely disengaged from microfinance. On the one hand, most microfinance institutions (MFIs) are not Islamic as their financing is interest based. On the other hand, Islamic financial system has been dominated mainly by Islamic banks. He further argues that MFI has to create various reserves to cover various risks arising due to the nature of its assets and liabilities. To protect from withdrawal risks, the MFI can use \textit{takaful} and profit-equalization reserves to give depositors competitive returns. The paper shows that the proportion of \textit{waqf} funds that can be allocated into micro financing will depend on the \textit{takaful} and economic capital reserves.

Frasca (2008)\textsuperscript{86} while focusing on the competitiveness of Islamic Microfinance, argues that Islamic finance could be potential ‘heaven’ for the investors who have become victim of current global credit crisis to relieve them from the speculative excess of the conventional system. Karim (2008)\textsuperscript{87} conducted a survey, which includes 125 institutions in 19 Muslim countries. It shows that Islamic microfinance providers still reach only 300,000 clients, one-third of them in Bangladesh alone. They argue that to reach more people and build sustainable institutions, it is essential to focus on designing affordable products, training and retaining skilled loan officers and administrators, improving operational efficiency, and managing overall business risk.

Harper (2002)\textsuperscript{88} claims that in terms of MFPs the poor are dealing with substandard banking, and ultimately microfinance should only be seen as temporary
solutions to poverty matters. According to Harper, and Hulme’s cases are not often highlighted by practitioners that credit can direct the borrower into debt far greater than they can bear sometimes which subsequently leads to suicide. Hulme and Mosley also found that many poorer microfinance clients have endured “bankruptcy, forced seizure of assets, and unofficial pledging of assets to other members of a borrowing group. There have even been reports of suicide following peer-group pressure to repay failed loans”. It needs to be understood that microfinance is far from a flawless tool, it requires thorough examination to ensure it assists the borrowers best interest and if there are serious concerns a better alternative should be provided. This study will examine whether Islamic microfinance can be a better option to the poor.

Ahmed (2002; 2004a) provided the theoretical basis, operational framework and empirical support for the establishment of Islamic MFIs. After critically evaluating the conventional MFIs, an Islamic alternative is presented. The theoretical as well as the empirical parts of the paper showed that there was a great potentiality of Islamic MFIs that could cater for the needs of the poor. Ahmed acknowledged the social dimension of banking programs and focused on the way of manifesting the social role of Islamic banks to provide finance to the poor to increase their income and wealth. This paper investigated if a marriage between Islamic banks and micro-financing was possible or not. The paper argued that there had been a strong case for such a union as Islamic banks could deliver finance to the poor more efficiently and effectively.

Frasca (2008) undertakes two seminal case studies in the use of Islamic finance instruments in MFIs: a) the Sanduq project in Jabal Al-Hoss, Syria; and b) the Hodeidah Microfinance Programme (HMFP) in Hodeidah, Yemen. He concludes that Islamic MFIs can be both competitive with conventional MFIs in the region and meet
the reported demand for religiously tailored financial services for lower income groups. If we are to assume that microfinance in general can improve standard of living and alleviate poverty, Islamic MFIs appear to be doing as well as their conventional microfinance counterparts.

The working paper for IRTI (2007) discussing the practicability of Islamic microfinance in detail. The authors specifying that microfinance and Islamic finance have much in common. Islam emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole. Principles encouraging risk sharing, individual rights and duties, property rights, and the sanctity of contracts are all part of the Islamic code underlying the financial system. In this light, many elements of microfinance are consistent with the broader goals of Islamic finance. Both advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. Both focus on developmental and social goals. Advocate financial inclusion, entrepreneurship and risk-sharing through partnership finance. Both involve participation by the poor.

There are however, some points of difference, discomfort and discontentment. Conventional microfinance is not for the poorest of the poor. There is a sizeable substratum within the rural poor whose lives are unlikely to be touched, let alone improved by financial services. They are not "bankable" in their own or their neighbor's eyes, even when the bank is exclusively for poor people. Yet they desperately need some sort of assistance. An Islamic microfinance system, on the other hand, identifies being the poorest of the poor as the primary criterion of eligibility for receiving zakah. It is geared towards eliminating abject poverty through its institutions based on zakah and sadaqah.

Omar Imady and Hans Dieter Seibel (2003) in their study report about Islamic
microfinance discussing the functioning of sanaduq microfinance in Syria. Jabal al-Hoss is one of the poorest areas in Syria where UNDP has supported the establishment of self-reliant local financial institutions, sanaduq means savings box: a novel concept in centralized banking system. The sanduqs are self-managed and autonomous in their decision-making, which has included the adoption of financial practices consistent with local values. The start-up is self-financed through member share capital, from which small loans are given for up to three months. Whenever initial financial intermediation is satisfactory, UNDP provides an additional capital injection, thereby increasing outreach, loan sizes and loan periods. Now this organization is a well functioning Islamic microfinance institution. The authors explaining the details of this institution.

Kiran Aseer Siddiqi (2008)\textsuperscript{93} make a study in order to gain an in-depth understanding of the potential of Islamic microfinance in Pakistan, qualitative research in the form of an explorative study was used. Islamic alternatives could replace interest with equity based products and encourage household lending to promote family unity. A case study approach was adopted which shows that Akhuwat microfinance have many avenues of funding which remains untapped and they have also not applied the array of Islamic financial instruments.

Mohammed Rafeeq (2005)\textsuperscript{94} gives a detailed picture about evolution of interest free financial institutions in India. In his study he classifies IFIs in India in to financial association of persons, co operative credit societies, and Islamic financial investment companies. Financial association of persons does not belong to the organized sector of Islamic finance in India. These are the effort of private efforts of ordinary Muslims living or working together in market, Madrasas, colleges, mosques and anjumans. They are generally organized small funds by subscribing weekly or monthly basis and
utilizing it to finance a member by taking lot or using any other method. More than hundred these institutions are identified by the author which financing up to one lakh with a capital of up to 100 lakhs. Another model is Muslim fund which was originated during the Indian independence movement due to financial problems of that period. Among the whole models Islamic investment and financial companies are generally the only profit earning IFI s in India which is functioning on profit and loss sharing basis.

Habib Ahmed (2002)\textsuperscript{95} boldly concludes that there are many studies already taken place about the growth and development of microfinance institutions as well as their interest free counterpart. Most of the studies show that interest free microfinance is the effective method of poverty alleviation and reaching poorest of the poor than interest based microfinance institutions.

Hussain, (2008)\textsuperscript{96} give the statistics and a brief picture of the working of interest free microcredit institutions working under his organization, interest free establishment coordination committee, Calicut. More than 360 microcredit institutions registered under various acts with a capital of more than 7 crores are working under this committee. The article also explains various modes of financing used by these institutions. He states that no study is taking place till now about the net effect of these institutions on society.

Arun K Vaish (2010)\textsuperscript{97} quote the writings of eminent scholars and justifies Islamic model of microfinance is better than conventional interest based model. According to Wilson (2007)\textsuperscript{98}, an advantage of the wakalah model is that it combines some of the features of a credit union with professional financial management, but ensures the interests of the participants by the management as there is a potential for a conflict of interest, with participants losing out if management remuneration is
excessive and not transparent. Hence, with the wakalah model, the management is remunerated by a fixed fee, and they do not share in the wakalah fund, the sole beneficiaries from which are the participants. The paper reviews the concepts of microfinance, and argues that the main objectives of microfinance schemes to alleviate poverty and to enable the poor to empower themselves are in line with the Islamic economic principles of justice.

2.6 Studies related to Islamic economics and finance

The literature of Islamic economics is rich in certain desirable socio-economic goals, such as social justice, equity, the alleviation of poverty and human well-being. Chapra (1987)\textsuperscript{98} observes the concept of social responsibility and working for the common good was central to most of the early writings on this subject and is one of the main features of Islamic economics and finance which, at least in theory, distinguishes it from its conventional counterpart. Eradication of poverty, socio-economic justice and equitable distribution of income are among the primary goals of Islam and should be unyielding features of an Islamic economic system.

In another work Chapra (2009)\textsuperscript{99} explain the philosophical basis of the whole Islamic financial system. He observes the two features of Islamic financial system; \textit{al-adl} (social justice) and \textit{al-ihsan} (benevolence) which should be reflected in their operations, and the people running these institutions are supposed to be philanthropic and altruistic. According to him unlike the person motivated by self-interest alone (homo economicus), the practicing Muslim has different motives (homo Islamicus) and is expected, in theory at least, to be more socially aware than his or her counterpart as s/he supposedly prefers altruism and humanism to self-centeredness and egoism.
Different scholars submitted their view on recent financial crisis and submitting Islamic economics and finance as a solution. Chapra (2009)\textsuperscript{100} try to determine the primary cause or causes of the financial crises that have plagued almost every country around the world over the last three decades. It argues that one of the major causes of these crises is the absence of risk-sharing, which dilutes market discipline in the financial system and leads to excessive lending, high leverage, speculation, and unsustainable rise in asset prices. Risk-sharing along with the availability of credit for primarily the purchase of real goods and services that Islamic finance aims at introducing, can help inject greater discipline into the system and, thereby, substantially reduce financial instability.

Siddiqui (1998)\textsuperscript{101} wrote about the origin of Islamic banking in the modern world. The first modern experiment with Islamic banking was undertaken in Egypt undercover, without projecting an Islamic image, for fear of being seen as a manifestation of Islamic fundamentalism, which was anathema to the political regime. The pioneering effort led by Dr. Ahmad El Najjar, took the form of a savings bank based on profit sharing in the Egyptian town Mit Ghamr in 1963. This experiment lasted until 1967 by which time there were nine such banks in the country. These banks which neither charged nor paid interest, invested mostly by engaging in trade and industry, directly or in partnership with others, and shared the profit with their depositors.

Khurshid Ahmad (1983)\textsuperscript{102} by his book contributed a lot of works on theoretical base of Islamic economics and finance. The articles contributed by various scholars in this book assert that the scope of Islamic economics is wider in its approaches and radically different from that of conventional economics. It give that the message of Islamic economics that life is an organic whole and that man has a
moral personality and that social science cannot be value neutral. According to the author economists is also not value neutral. This concept is the base of Islamic economics and finance.

Kahf (2002)\textsuperscript{103} submitting Islamic alternative way of income distribution and argue that Islamic method for allocation of output will prevail justice in the economy. Before presenting income distribution in Islam he discusses Marx’s theory and neo classical theory of income determination. After criticizing the conventional theories he presenting features of Islamic method of income determination.

Kahf and Tariqullah\textsuperscript{104} explain the principles of Islamic finance from the historical perspective. The paper consists of three sections. First part concentrates on early works of Muslim scholars. In this part rationale of financial tools at the period of prophet Mohammed and its followers are discussed. In the second part reviews the recent works of scholars on Islamic economics and finance. Last section deals justification of return on financing in the Islamic economic thinking. Concluding with differentiate all types of income like rent, wages, profit from interest on Islamic perspective.

Probably the first book on Islamic economics in Malayalam language was from Ahmad (1964)\textsuperscript{105} about wealth distribution system of Islam. The book offers solutions to various economic problems faced by the present day world by elucidating a system which justice and equity as the prime motto behind any economic activity. He discusses the measures for distribution of wealth in an equitable manner, Islamic doctrine of ownership of means of production and wealth and economic transactions without interest are the methods to realize equitable social system in the economy. The author also narrates the all rules and procedures of an Islamic economic system to prevail the welfare society.
Ismail Sirageldin (2000) examines Islamic economic policies to reduce poverty in the country. He focuses on four basic tenants of the Islamic ethical system and treats the Islamic ethos as an ideal, through which socioeconomic policies dealing with poverty elimination are assessed. Islam views society as a unified equity in which individual freedom and human dignity is supreme although subject to the axiom of responsibility. Based on the conceptual and empirical evidence, the paper concludes that Islamic ethics support a poverty-alleviation strategy based on the principle of promoting economic growth with productive equity.

Angelo M. Venardos (2011) explain various issues in introduction of Islamic banking and finance in different countries. In the beginning of the book he wrote that Islamic Banking and Finance (IB&F) is recognised by both Muslims and non-Muslims as an ethical alternative, protecting against the worst excesses of leverage whilst reinstating values, such as trust, which have been lost in conventional finance. Figures cited show that Islamic finance is growing in popularity as a result of the current crisis and there is scope for it to move into the financial mainstream with the sector estimated to reach US$4,000 billion in the next 5 years. He suggests that to recover from global economic crisis and to attain stable economy Islamic ethical financing as an alternative system is practicable.

Mohammed Ayub (2007) illustrates the theoretical and practical aspects of Islamic banking and finance in his book understanding Islamic finance. The author first examines the theoretical background of Islamic economics and finance the problem faced by the conventional theory and practice. Then come to the distinguishing features of Islamic financial system. Then go through the philosophy and features of Islamic financial system and finally explain Islamic law of contracts and practical methods adopted by the Islamic financial institutions.
Ali F Darrat and Shahid Ebrahim (1996) attempts to design interest-free financing instruments that can be used to finance short-term government projects. It has been shown that in the case of risk neutral investors, the proposed interest-free security is at least equally efficient compared to the interest-based security. However, for the more realistic case of risk averse investors, the numerical simulation suggests that, within reasonable limits of the coefficient of risk aversion, the interest-free scheme appears more efficient than the interest-based alternative. This is because in a good state of the economy, the government generates a surplus income which is possibly gifted to the investor. The government can make this form of financing more appealing to the general public by not taxing the extra payment in the good state of the economy. In contrast, most western governments fully tax the interest returns from financial securities.

Badel Muckerji (1984) illustrates the growth of a firm in a zero interest rate economy. Here the author try to study the partial equilibrium problem of the growth and investment of a firm which has to operate in an economy in which, following the precept of Islam, interest-bearing loans no longer exist - neither to give, nor to receive. As in any partial equilibrium model, we implicitly assume that there is one bank (or firm) paying one dividend. It would be the task of the monetary theorist to study and explain the nature and spread of dividend rates that the banking system as a whole would sustain. The critical point is the replacement of a known, non stochastic interest rate by an uncertain rate of dividend payment; of a sure source of funds (credit) by an unsure one (equity investment). This is the problem discussed at length in this book.

Martin Cihak and Heiko Hesse (2008) in their paper at IMF examine relative financial strength of Islamic banks by assessing empirically based evidence
covering individual Islamic and commercial banks in 18 banking systems with a substantial presence of Islamic banking. They find that (i) small Islamic banks tend to be financially stronger than small commercial banks; (ii) large commercial banks tend to be financially stronger than large Islamic banks; and (iii) small Islamic banks tend to be financially stronger than large Islamic banks, which may reflect challenges of credit risk management in large Islamic banks. They also find that the market share of Islamic banks does not have a significant impact on the financial strength of other banks.

Ausaf Ahmad (2000)\textsuperscript{112} explain the role of central bank in regulating Islamic banking system. Central banks are controlling the commercial banks in an interest based set up by using monitory instruments determined by interest. Therefore in an Islamic banking system it needs alternative policies and instruments to control the function of commercial banks. The regulation and control of Islamic bank raises a number of issues. The financial operation of Islamic banks have to be reviewed carefully in order to ascertain which of these operations create credit and need to be controlled and regulated. Islamic banks are performing number of functions. Only those operations which have influenced the money supply of the economy need to be controlled. Obviously that technique which involves interest in any respect shall be out of question. Finally the author suggests few monitory instruments to control money supply in the economy.

K Ramachandran Nair (2000)\textsuperscript{113} observes that the central concern of Islamic economics is man, mankind, human behavior, human well being, and sustainable development, equitable distribution of wealth and guarantee of social justice. As such its core position is said to have taken shape in the 1940s. More than sixty countries implemented the Islamic financial system. Some countries have outlawed every form
of interest as it is a symbol of greed and exploitation of man by man. Attempts are also underway to disseminate religious norms of price setting, bargaining and wage determination. He continues that in recent times western banks through their marketing hype have been trying to offer innovative Islamic financial products. He concludes that the reason for financial crisis in the capitalist world can be traced to the monitory system that is based on interest and fraud.

The role of Islamic financial institutions in India is explained by Ibrahim (2006). He observes that Islamic financial institutions are somewhat similar to conventional financial institutions as financial intermediaries. Only difference is in the methods of mobilization and investment of savings. After the briefing of the functioning of interest free institutions the author examines the relevance and prospects of such banks in Indian context. He illustrates the theory and practice of interest free banking and introduces a true picture of operational success of such system.

Shariq Nizar (2004) gives a guideline to interest free investment opportunities in India. He argues that in the present scenario of financial situation, with extreme poverty and financial exclusion interest free finance has enough scope in the country. India the world’s largest democracy, offers some very clear advantages. India is one of the fastest-growing large economies in the world. With a population of over 1.3 billion, with huge human and natural resources, and with costs that are at the very low end of the global average, India represents economic opportunities on a massive scale. Its legal framework which protects foreign investments is one of the best in the region. The economy offers an abundance of technical and managerial talent, with international experience. And most importantly, India has a demographic advantage that will see its working age population continue to grow in the next couple
of decades. Islamic finance, on the other hand is another great success story of modern times.

Habib Ahmed\textsuperscript{116} wrote about the origin of Islamic finance and microfinance in the following words. The last quarter of the 20th century witnessed numerous financial innovations that catered to various needs of different segments of the society. While most of these innovations were concentrated in the countries with developed financial markets, couple of new ideas emerged from Muslim countries. The concepts of Islamic banking and microfinance surfaced almost concurrently, yet independently, in the mid-1970s. From its humble start, Islamic financial institutions have grown in size and scope rapidly. Given the large size of the potential market, non-Islamic financial institutions are also offering financial services that conform to Islamic principles. Currently, it is presumed to be one the fastest growing sectors in the banking industry worldwide.

Obaidullah (2008)\textsuperscript{117} is describing a new model of interest free microfinance in Sri Lanka. There was an economic trends in Sri Lanka have discouraged paddy cultivation, paving the way for rice imports which is the main staple food of Sri Lankans. The paper outlines a model developed and piloted by Muslim Aid Sri Lanka based on a combination of two Shariah-based modes – salam sale and mudharabah partnership - to empower poor paddy farmers from Sri Lanka. The model was developed in order to reduce the dependence and consequent exploitation of the poor farmers by financier-middlemen through high-interest loans and artificially depressed market prices during harvesting season due to over-supply of agricultural produce.

Najmul huda (2010)\textsuperscript{118} observes that faith based microfinance has superiority in some religious societies. The various models of MFIs display variations along several dimensions: nature of clientele, focus area, interest rate, savings linkages,
collateral, coverage and organizational/legal structure. An important model of microfinance, well documented by Malcolm Harper and other eminent scholars, derives its underlying principles from the major faiths. These institutions operating on the principles of any particular faith are called Faith Based Organizations (FBO) and this model of microfinance is called faith-based model of microfinance. A faith-based microfinance and poverty alleviation initiative is generally started by a religious institution, or by an individual for strong religious motives; works with and through local ‘branches’ of the religion – churches, mosques, temples – and raises substantial proportion of its funds from people of the same faith.

Mohammed Khalid et. al (2008)\textsuperscript{119} study is comparing the efficiency of Islamic banks and conventional interest based banks. This work measures and compares the cost, revenue and profit efficiency of 43 Islamic and 37 conventional banks over the period 1990-2005 in 21 countries using Data Envelopment Analysis. It assesses the average and overtime efficiency of those banks based on their size, age, and region using static and dynamic panels. The findings suggest that there are no significant differences between the overall efficiency results of conventional versus Islamic banks. Overall, the results in this paper are favourable with the Islamic banking system.

Indah Piliyanti & Septin Puji Astuti (2010)\textsuperscript{120} explains the functioning of Islamic microfinance institutions in Indonesia. \textit{Baitul Maal wa Tamwil} (BMT), the Islamic micro finance institution in Indonesia, performs two main activities, business (\textit{tamwil}) activities in addition to social (\textit{maal}) activities. \textit{Qardh al-hasan} is one of BMT’s social financing products. Moreover, it is a benevolent loan, hence, it is a non-profit financing product of financial institution which is “provide a hook”, not “supply
the fish”. The main aim of benevolent products (*qardh al-hasan*) is for helping the business development of the poor (*dhufa*).

Devi Miranti Karthika (2010)\(^1\)\(^2\)\(^3\) observes the development of interest free islamic insurance known as *thakaful* in Indonesia. According to her development of Islamic finance industry in Indonesia has reached double-digit growth within the latest six years. However, the market penetration as well as asset of these industry is pitily small. This condition also happen with the country’s *takaful* industry. The author also of added brief history of *takaful* industry. *Takaful* originated within the ancient Arab tribes as a pooled liability that obliged those who committed offences against members of a different tribe to pay compensation to the victims or their heirs. This principle extended too many walks of life, including sea trade, in which participants contributed to a fund to cover anyone in a group who suffered mishaps on sea voyages (PricewaterhouseCoopers, 2008).

Shariq nisar (2010)\(^4\)\(^5\) is presenting interest free bonds known as *sukuk* as an important instrument to raise funds in international capital markets. Multinational corporations, sovereign bodies, state corporations and financial institutions use international *sukuk* issuance as an alternative to syndicated financing. *Sukuk* is generally understood as a *shariah* compliant ‘Bond’. In its simplest form *sukuk* represents ownership of an asset or its usufruct. The claim embodied in *sukuk* is not simply a claim to cash flow but an ownership claim. This also differentiates *sukuk* from conventional bonds. *Sukuk* is a process in which ownership of the underlying assets is transferred to a large number of investors through certificates representing proportionate value of the relevant assets.

Arshad ajmal (2010)\(^6\)\(^7\) explores the cooperative model for interest free microfinance in India. The author presents that interest free microfinance as an
endeavor (envisioned by its proponents) part of an alternative of present economy after criticizing the present microfinance institutions. It tries to evaluate whether the economy of unorganized sector is in itself can be a viable proposition in terms of efficiency and acceptability. This evaluation is not based on class consciousness but encompassing the all who believe in justice and equity in economy.

Farook Ahmad (2009)\textsuperscript{124} in a study gives a picture about Islamic microfinance services in Australia. In Australia, Islamic microfinance enterprises that mostly rely on their shareholders’ savings proved to be very successful in providing microfinance to their clientele. The study offers an introduction to the emergence and development of Islamic microfinance in Australia. It also studies the current realities of the Islamic financial system of Australia from the perspective of the theories of modern financial intermediation and Islamic microfinance contracting. It explains the key role of Islamic Microfinance Services Providers (IMSPs) in Australia in fulfilling the microfinance needs of Muslim community.

The Harvard Law School of Harvard University (2008)\textsuperscript{125} conducted an international workshop on Islamic microfinance and its report is published. This workshop focused on different models of Islamic microfinance to be fit for different countries and how the poverty and vulnerability is to be alleviated by using Islamic finance in the grass root level. The sessions bring forth ideas that foster a more organic connection between Islamic finance and microfinance initiatives to alleviate poverty and stimulate economic growth.

Sunil Gidwani and Amit Kumar Bansal (2010)\textsuperscript{126} observe that by realizing the growing need of Islamic investments in the country, the government has taken a number of steps in this direction. The Indian government, in keeping with its policy of inclusive growth, took the initiative in 2005 and asked the RBI to explore ways to
introduce Islamic banking in India. A report published in the April-June 2005 issue of *RBI Legal News and Views* outlines the fact that interest-free banking is an attractive proposition gaining currency all over the world and so it was time India introduced it.

M Y Khan (2006)\textsuperscript{127} examines the regulatory barriers of Islamic financial institutions in India and suggesting few steps of ease the functioning of Islamic financial institutions in the country. This paper explains banking regulations in India briefly and then takes up the case of nonbanking financial companies working in India. It undertakes a comparative analysis of Islamic banking and interest-based banking, discusses issues and constraints of Islamic banks, specifically in the Indian context. The paper goes on to make relevant recommendations and suggestions for the growth and stability of this nascent industry.

Omar Khan (2010)\textsuperscript{128} wrote about the potential of Islamic finance for alleviating poverty in the country. According to him Indira Gandhi’s slogan, “garibi hatao” (eliminate poverty) is as poignant and relevant today as it was in the early 70’s. Its popularity serves as evidence of the belief among all Indians that those born into lower stations in life, through no fault of their own, deserve a chance to better their own condition—and that it is the responsibility of the government to help them have that chance. Yet even today, horrible disparities exist between different segments of Indian society. We should do all that we can to provide disadvantaged Minorities with the tools they need to improve their condition. Islamic banking is one way to better provide the disadvantaged Muslim minority (among others) with the tools it needs to improve its situation.

Keyur Shah (2010)\textsuperscript{129} observes the potential of Islamic finance in India. In his words there are approximately 175 million Muslims which accounts for around 13.4
percent of the country’s total population. 60 percent of the community’s population is below 25 years of age and over 35 percent of the community’s total population lives in urban areas, thus making Muslims one of India’s youngest and most urbanized communities. However, some studies and reports have shown that Muslim participation in the Indian financial system is minimal. Also, according to a report by the Reserve Bank of India (‘RBI’), India’s Central Bank, the Credit to deposit ratio of Muslims in the country is 47 percent against the national average of 74 percent. It can be observed from the above statistics, India offers a huge potential for Shariah finance.

Yakoob (2009)\textsuperscript{130} examines the impact of interest free institutions working in Kerala. After a detailed case study of 50 units working in the state he concludes that interest free institutions are of great help to the rural people in meeting their short term financial needs and saving them from exploitation by money lenders. If IFIs are organized in a better way similar to co-operative societies it can achieve better and easy credit dispensation among the rural folk on interest free basis and thereby bring about their socio-economic upliftment.

Interest free banking institutions in Kerala an economic analysis by Rahman (1998)\textsuperscript{131} is a first empirical work in Kerala about the interest free institutions. He identifies the working of various interest free financial institutions in the state and highlighted the aspects like the evils persistent in the interest ridden financial transactions, evolution and growth of interest free financial institutions, various features of interest free banking differences between the interest free banking and conventional banking and problem faced by the sector in the country. He suggests lot of areas in this field for further research and analysis.
2.7 Other related studies

Kabeer Hassan (2010)\textsuperscript{132} suggests the combination of Islamic microfinance with two traditional Islamic tools of poverty alleviation such as Zakat and Awqaf in an institutional set-up. He suggests that the inherent nature of the proposed model may ensure equitable distribution and welfare among the poor. As the model is based on profit sharing and concessional contract modes, distribution of earnings should be allocated among different stakeholders such as depositors, shareholders, investors in the NGO. The proposed model will be financially viable and sustainable in the long run, resulting from lower default rates reduced the proper use of Zakah funds, which do not require any return. If implemented, this model will contribute to poverty alleviation.

Afzal Peersade (2010)\textsuperscript{133} observes Islamic directions for financial inclusion through its activities of zakah and infaq two types of flow of money from haves to have notes. Author points out that in history up to Islam there was no systematic support from the part of the state or community to financially include the relatively worse people. Historically, the financial inclusion in Islam may be linked to the economic exigencies of early followers of Islam in particular and the moral and ethical obligations of the Islamic state in general. According to him zakah and sadaqah are the very important instrument for financial inclusion.

Aly Khurshid (2004)\textsuperscript{134} elucidates the Islamic insurance system and its development. After explaining the need for insurance and its background in Islam the book examines the non Islamic practice of conventional insurance system. Then present the operational format of interest free Islamic insurance system practicing in different countries. Finally illustrate case studies of insurance system in Malaysia and
Saudi Arabia. He concludes that Islamic insurance operations are an alternative ethical option to the insurance sector.

Yulizar D. Sanrego Nz (2010)\textsuperscript{135} explains how Islamic way of financial empowerment will lead to poverty alleviation. In particular the writer try to show at least seven out of eight points of millennium development goals would certainly be achieved. Throughout five stages, three model institutions would be discussed in this paper; Charitable giving (Baytul Maal), Interest free micro loans and micro saving (Baytut Tamwil) and saving and interest free investment loans (Baytut Ta’min) so that can contribute significantly for the economic empowerment of poor and low-income family.

Samad (2010)\textsuperscript{136} explained the possibility of Islamic finance in India. In the years to come India needs approximately US$ 700 billion to fund its growth story and is seriously considering all possible avenues for the funds. The Middle East is the only place in the world to have surplus money to the tune of US$ 800 billion according one estimates. And if this money were to be channeled into Indian projects then that would be big boon for the development of the country. According to RBI research Muslim control about US$ 1.5 trillion assets with a growth rate of 15% in India that goes totally in untapped suspended bank accounts due to lack of Islamic Finance avenues for Muslims to invest.

Abul Hassan (2010)\textsuperscript{137} discuss the interest of Indian banks in investing microfinance institutions. According to him, microfinance is beyond the purview of development institutions. Compared to returns on government bonds of 6 to 7 per cent, the Microfinance Institution (MFI) lending provides returns of 10 to 14 per cent. The commercial banks in India, therefore, have expanded investments in these areas. Secondly, microfinance lending - as it is currently practiced - is simply not very risky.
The banks in India then get the best of both worlds - higher rates of return with very low risk. The result is massive expansion in micro-lending.

Despite the massive growth in micro-credit, the Sachar Committee Report (2005)\(^{138}\), expressed serious concern over the higher percentage of financial exclusion of Indian poor Muslims. For instance, spatial distribution of banking services indicates that rural credit, deposits, and offices at the Muslims’ concentrated areas of more than 70 districts in India, decreased the share of overall services in the recent years. In view of the above, the conventional financial services absolutely failed to attract the economically poor Muslims. The argument of this study is that Islamic financial service will allow the poorer Indian Muslims households in financial inclusion.

Habib Ahmad (2004)\(^ {139}\) discusses the role of zakah on poverty alleviation. Though there have been some progress in reducing poverty in a few countries, there is now emerging consensus that many development programs aimed at poverty reduction in the past have not achieved their intended results in many parts of the world. There is, therefore, a need to seek credible programs and strategies that can effectively mitigate poverty. In this regard, one of the important pillars of combating poverty in Muslim societies is the institution of zakah. Zakah along with other charitable institutions emerged as a result of specific emphasis of Islam on meeting the needs of less privileged members of the society.

Ramzan (2009)\(^ {140}\) conducted an interesting study about indigenous financial transaction in Kerala especially Malabar. He finds that there are different modes of indigenous financial transaction existed in the society since long years back. That type of transactions was the life blood of villages. Kurikkalyanam or panam payattu is one of the important indigenous modes deeply rooted among village peoples. Now we see
only the relics of this system, which once was all-pervading. Nevertheless, it has not disappeared completely in the debris of the past. It still acts as a source of consolation in this interest–ridden financial set up. All modern financial institutions are extending their help generously. But when one receives this help, he becomes under the complete control of these institutions and the repayment of the loan will be a lifelong process. And in case he fails to repay, his assets will be confiscated and he finds refuge in committing suicide. In this God’s own country suicides of those who are in debt trap do not get even the proper news value. Therefore, an alternative is necessary to save the society from the clutches of interest.

These literatures reveal that microfinance and Islamic finance are two important and expanding area of study. Many studies have already been conducted in microfinance and its influence on welfare of the society in India as well as abroad. There are lot of studies are published in Islamic economics and finance also. But no study has been taken place till now about the impact of interest free micro credit institutions in Indian society as well as Kerala. So the present study is an humble attempt to fill this research gap.

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