

MURABAHAH AS ISLAMIC MICROFINANCE PRODUCT: A CASE STUDY OF MIB OF PAKISTAN

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Abstract

Islamic micro-finance has been the topic of debate for many years as the best alternative to conventional microfinance programs for poverty alleviation. Islam has two approaches towards poverty alleviation: Mission-based approach (such as *zakat* and *waqf*) and market based approach (such as *murabahah*, *mudharabah*, *musharakah*). In this paper, a case study is conducted on the *murabahah* as used by MIB as Islamic micro-finance tool. The purpose of this paper was to explore how the MIB made it possible to use *murabahah* as effective Islamic micro-finance tool? Further, it was investigated that what risks were faced by the bank while doing *murabahah*, and how they were mitigated, especially the customer default risk. It was found that the risk is mitigated very effectively. MIB gives finance to a person whose age is between 20-60 years having experience of at least 2 years of business who provides clear future business plan to MIB. Further, one guarantor is also required from him in addition to future dated cheque.

Keywords: Islamic Micro-finance, MIB, Poverty Alleviation

Microfinance is the provision of financial of services to poor and low income people who are unable to avail services of the mainstream finance system (Obaidullah, 2008).¹ Typically speaking, microfinance is giving small loans (without collateral) to poor² (Armendáriz and Labie, 2011), where charging interest is inherent even though in small amount. Islamic micro-finance is based on the Islamic ethos and principles. Islamic microfinance is an effective tool for alleviation of poverty from all over the world including Pakistan. Different tools such *zakat*, *waqf* and other profit earning modes such as

¹Mhuammad Obaidullah, *Introduction to Islamic Microfinance* (India: IBF Net Limited, 2008).

²Beatriz Armendáriz, and Marc Labie, *The Handbook of Microfinance* (Singapore: World Scientific Publishing, 2011).

mudharabah and *musharakah* can be used for Islamic micro-financing.³ One of these modes is murabahah that has been used for the first time in Pakistan for Islamic microfinance by MIB. Murabahah is a kind of sale in which the seller shall disclose the cost price and profit margin on it to the buyer. In this study we will try to find out that how the MIB made it possible to do Islamic microfinance by using murabahah and what problems did they face while starting it and how they overcome those problems?

Murabahah is one of the most commonly used mode of finance, forming approximately sixty six percent (66%) part of the total financing of Islamic banks all over the world (Usmani, 2008; I. A. Usmani, 2015).⁴ It is a contract considered to be a form of sale (INCEIF, 2012).⁵ Murabahah sale is a cost-plus profit sale in which the parties to contract negotiate the price over the cost of the commodity. In this transaction, the seller is bound to disclose all information to the buyer (Ayub, 2007).⁶

1.1 Rules for Murabahah Financing

1. The commodity in murabahah shall be existing at the time of the sale. Sale of non-existing thing is void;
2. The seller must be the owner of the commodity at the time of sale.
3. The seller must have in possession (physical or constructive) of the commodity at the time of sale;
4. There must be absolute sale of the commodity and the sale must not be attributed to a future date;
5. The commodity must have value in the eyes of Islamic law;
6. It must not be a commodity to be used for some un-Islamic purpose;
7. The commodity must be specified in terms of quality and quantity to the buyer;
8. Delivery of the goods to the buyer must be certain;
9. Price of the commodity must be certain;
10. The murabahah sale must be unconditional, unless the contingency condition is recognized as part of sale in custom of trade.⁷

³Syeda Shehrbano Kazim, and Syed Eisar Haider, *Islamic micro-finance models and their viability in Pakistan* (Pakistan: Pakistan Microfinance Network, 2012).

⁴ Muhammad Imran Ashraf Usmani, *Islamic Finance: Revised & Updated Edition of Meezan Bank's Guide to Islamic Banking* (Karachi: Quranic Studies Publishers, 2015).

⁵International Center for Education in Islamic Finance (INCEIF), *Shariah Rules in Financial Transactions 2012* (Kuala Lumpur: INCEIF, 2012).

⁶Muhammad Ayub, *Understanding Islamic Finance*, (England: John Wiley & Sons, Ltd., 2007).

⁷ Muhammad Imran Ashraf Usmani, *Islamic Finance: Revised & Updated Edition of Meezan Bank's Guide to Islamic Banking* (Karachi: Quranic Studies Publishers, 2015).

1.2 Murabahah in Islamic Banks

Murabahah, as is used in the current form by Islamic banks is different from its classical form. Here the banks take prior promise from the customer to buy the commodity to be provided by the bank later on (Ayub, 2007).⁸ In this type of transaction, the bank purchases the commodity on its own name upon the request of the customer, and then sells it to the customer (Usmani, 2015).⁹

1.3. Steps Involved in Murabahah Financing by Islamic Banks

Step 1: in step one, a master murabahah finance agreement is signed by the financier and financee. The financier agrees to sell the murabahah commodity to the financee, whereas, he promises to purchase it at a price in which the cost price and the profit margin is expressly disclosed;

Step 2: An agreement of agency is made in case the client is appointed to purchase the commodity on behalf of the financier;

Step 3: The client, as agent of the financier, purchases the commodity and takes its possession;

Step 4: After informing about the purchase of the commodity, the client informs the bank, and simultaneously makes an offer to purchase it from the client;

Step 5: The banks accepts the offer of the client and the risk as well as the ownership is transferred to him from the bank (Inceif, 2012).¹⁰

All the above steps are necessary for a valid murabahah in the modern system of Islamic banking. However, if the bank purchases the commodity directly from the supplier, then there is no need of creating agency. It means that step no. 3 is excluded and the customer only makes an offer to purchase the commodity in step number 4. Here the commodity is sold to the customer on installment, which he has to pay on regular intervals (Inceif, 2012).¹¹

As murabahah has been applied for the first time as Islamic microfinance tool by any Islamic bank (MIB) in Pakistan, therefore, it is important to explore as to how MIB applied it? Therefore, the following questions shall be tried to answer in this article.

⁸Muhammad Ayub, *Understanding Islamic Finance*, (England: John Wiley & Sons, Ltd., 2007).

⁹Muhammad Imran Ashraf Usmani, *Islamic Finance: Revised & Updated Edition of Meezan Bank's Guide to Islamic Banking* (Karachi: Quranic Studies Publishers, 2015).

¹⁰ International Center for Education in Islamic Finance (INCEIF), *Shariah Rules in Financial Transactions 2012* (Kuala Lumpur: INCEIF, 2012).

¹¹International Center for Education in Islamic Finance (INCEIF), *Shariah Rules in Financial Transactions 2012* (Kuala Lumpur: INCEIF, 2012).

1.4. Questions

1. How murabahah is applied by MIB for Islamic Microfinance in Pakistan?
2. What particular risks are associated with this transaction?
3. How these risks, especially the customer default, are being overcome by the MIB?

1.5. Objectives

1. To investigate the step by step process flow of murabahah being used by MIB for Islamic microfinance.
2. To find out the different kind of risks associated with this transaction.
3. To find out how these risks were overcome by the MIB? Here more focus will be on the customer's default risk mitigation.

1.6. Significance

First of all, this study is a knowledge contribution to the existing literature on the murabahah financing. This will explore the very first profit-earning mode (murabahah) used for the first time by any Islamic bank (MCB Islamic) in Pakistan. The study can be helpful for other banks as to how murabahah or any other Islamic mode can be used for Islamic micro-financing? Also, the study is beneficial to the micro-finance prospective customers as to how can they utilize the profit earning mode for fulfilling their needs for Islamic micro-financing. Based on this study, regulator can also recommend the same or other Islamic modes to be used for Islamic micro-financing.

2. Literature Review

One of the major reasons behind the low penetration of Islamic microfinance products in the banking industry is lack of research and product development in the field of Islamic microfinance.¹² Most of the available literature on Islamic microfinance is related to overall poverty alleviation through Islamic microfinance (Dusuki 2008; Hassan, 2014; Sohel, et al., 2016;

¹² Mohammad Ayaz, Hassan Shakeel Shah, Amat ul Mateen Noor, Sadaf Shaheen, & Jibrail Bin Yusuf. "Islamic Microfinancing by the Banking Sector of Pakistan." *Journal of Islamic Thought and Civilization (JITC)*, 9(2), 148-171. <https://doi.org/10.32350/jitc.92.08>

Rehman, et al., 2015.¹³ By using secondary data, Muhammad Sohel and others suggested a model to alleviate poverty from Palestine.¹⁴

There are also studies available on murabaha as a mode of mainstream finance. Like, Muhammad Taqi Usmani has suggested *murabaha* as Islamic mode of financing.¹⁵ This is used when customer does not sufficient amount to buy goods directly from the market. He approaches Islamic bank for financing. The Islamic bank can use *murabaha* as mode of financing for buying the goods of the customers. Similarly, Muhammad Ayub has also suggested *murabaha* as Islamic mode of financing for short term financing.¹⁶ Even Imran Ashraf Usmani has suggested murabahah for buying raw materials for factories but suggested not to use it in paying electricity bills or salaries of the factory.¹⁷ Murabaha as a mode of finance has also been suggested by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).¹⁸

Some studies are also available which are related to murabaha as a mode of for Islamic micro-finance, such as Kazim and Haider¹⁹ have discussed Islamic microfinance models out of which one mode is murabaha. Obaidullah has also discussed the two Islamic approaches towards poverty alleviation: mission-based and market-based, in his book “Introduction to Islamic Micro-Finance”.

¹³Assyrif Wajdi Dusuki. “Banking for the Poor: The Role of Islamic Banking in Microfinance Initiatives.” *Humanomics* 24, no. 1 (2008): 49-66; Abdul Hassan. “The Challenge in Poverty Alleviation: Role of Islamic Micro- Finance and Social Capital.” *Humanomics* 30, no. 1 (2014); Muhammad Sohel Rana, Muhammad Aslam Mia, Izlin Ismail, and Nazari Ismail. “Evaluating Productivity of Microfinance Institutions in Palestine and Jordan.” Research Seminar on Palestinian Issues-2 (2017); Rasheedah Abdul Rahman, and Faisal Dean. “Challenges and Solutions in Islamic Microfinance.” *Humanomics* 29, no. 4 (2015).

¹⁴ Muhammad Sohel Rana, Muhammad Aslam Mia, Izlin Ismail, and Nazari Ismail. “Evaluating Productivity of Microfinance Institutions in Palestine and Jordan.” Research Seminar on Palestinian Issues-2 (2017).

¹⁵ Muhammad Taqi Usmani, *Introduction to Islamic Finance* (Karachi: Quranic Studies Publisher, 2008).

¹⁶Muhammad Ayub, *Understanding Islamic Finance*, (England: John Wiley & Sons, Ltd., 2007).

¹⁷ Muhammad Imran Ashraf Usmani, *Islamic Finance: Revised & Updated Edition of Meezan Bank’s Guide to Islamic Banking* (Karachi: Quranic Studies Publishers, 2015).

¹⁸Accounting and Auditing Organization For Islamic Financial Institutions (AAOIFI). *Shariah Standards* (Bahrain: AAOIFI, 2008).

¹⁹Syeda Shehrbano Kazim and Syed Eisar Haider, *Islamic micro-finance models and their viability in Pakistan* (Pakistan: Pakistan Microfinance Network, 2012).

One of the market-based modes he has discussed is murabahah.²⁰ All these studies have not covered the modalities of the murabaha to be used as a tool for Islamic micro-financing.

Hussam and Ebrahim conducted qualitative research and studied murabahah as a tool of transaction rather than as a financing tool.²¹ They discussed murabahah's elements its role in Islamic banking sector by highlighting the prospects and challenges. They concluded that murabahah is the best transaction tool in Islamic banking system. The trader is able to sell goods in the real sector of the economy on deferment.²²

Abu Umar Farooq Ahmad discussed the *shariah* parameters of *murabahah* in Islamic finance: a case study of Australia. The main objective of the study was analyzing the extent of divergence in murabahah financing a case study of Australian economy. He included Australian intuition-IFS which are offering differ from traditional *shariah* practice of *murabahah* product in three selected areas, home, motor vehicle and consumer financing. He concluded that *shariah* compliance of the Islamic financial services in murabahah finance be strictly maintained and make a rule for conventional finance for growth and development for Islamic financial services which leads to make *murabahah* financing *shariah* compliance.²³

Almsafir and Alsmadi conducted a study on murabahah versus interest rate, the equilibrium relationship with macroeconomic variables in Jordanian economy: An ARDL Approach. Time series data was used from 1984 to 2012. Macroeconomic variables used for research purpose were gross domestic product, unemployment, inflation rate and exchange rate. Main purpose of the study was to investigate the effect of murabahah and interest rate on global financial crises. Data was collected from Jordan statistic department, central bank of Jordan, Jordan Islamic banks and World Bank. Results of the study indicated that murabahah makes equilibrium faster than interest rate.²⁴

²⁰Mhuammad Obaidullah, *Introduction to Islamic Microfinance* (India: IBF Net Limited, 2008).

²¹Hussam Sultan, and Muhammed Shahid Ebrahim. "Murabaha." *SSRN Electronic Journal*. (2011).

²²Hussam Sultan, and Muhammed Shahid Ebrahim. "Murabaha." *SSRN Electronic Journal*. (2011).

²³Abu Umar Farooq Ahmad. "Shari'ah parameters of murabaha in Islamic finance: the Australian experience." (2012): retrieved from: <https://www.researchgate.net/publication/286920779>

²⁴Mahmoud Khalid Almsafir and Ayman Abdalmajeed Alsamdi. "Murabahah versus interest rate, the equilibrium relationship with macroeconomic variables in

Hassan and others studied the Designing Islamic microfinance product for Islamic banks in Malaysia. The main objective of the paper was to propose *shariah* compliant product in Malaysia. Murabahah is one of the challenging products of Islamic microfinance among various products discussed in paper. Islamic microfinance institutions need to redesign many products according to the client need and preferences. The researchers highlighted the strengths of murabahah being used by Islamic microfinance institutions these days.²⁵

It is clear from the above literature that in spite of the widespread (90 %) use of Murabaha as a tool of finance²⁶, murabaha has not been utilized by any bank as a microfinance tool except the MCB Islamic Bank. Recognizing the great potential of the product to cater the need of the lower income poor people, the MIB has applied it recently. As to the best of the researchers' knowledge, no study has been conducted so far in this aspect, so, this is the gap the in existing literature. Therefore, this study is conducted to fill the obvious gap.

3. Methodology

This is an exploratory qualitative case study. 360 degree information were tried to be collected by using all means of resources with more focus on the interviews of MIB's Islamic microfinance experts. Most of the information were collected by in-depth interviews with experts involved in Islamic micro-financing of MIB. Some documents like policy and process flow of murabahah were accessed through official website of MIB to further verify the information collected through interviews. Interviews of the respondents were coded and then further interpreted and analyzed to draw information-based logical conclusion. The interview questions are attached as **attachment 1** to this paper.

4. Murabahah as Islamic Micro-Finance by MIB

MCB is Islamic Bank is the first bank, who has channeled a profit-earning mode i.e. murabahah as a tool for Islamic micro-financing in the recent months. The name of MCB Islamic Bank's Microfinance Product is **Sharai Karobar (SK)**, which is an unsecured product to cater the needs of those individuals who don't have access to the commercial / Islamic banking sector and want access to Riba free financing to increase the scale of their business

Jordanian economy: an ARDL approach.” *Procedia – Social and Behavioral Science*, 129 (2014): 349-357.

²⁵ Salwana Hassan, Rashidah Abdul Rahman, Nordin Abu Bakar, Rohani Mohd and Aliyu Dahiru Muhammad. “Designing Islamic Microfinance Products for Islamic Banks in Malaysia.” *Middle-East Journal of Scientific Research* 17, no. 3 (2013).

²⁶ Muhammad Imran Ashraf Usmani, *Islamic Finance: Revised & Updated Edition of Meezan Bank's Guide to Islamic Banking* (Karachi: Quranic Studies Publishers, 2015).

under Islamic mode of financing. The product in its spirit and application is an unsecured installment-based financing developed under Murabahah mode.

The Process flow of the murabahah transaction is given below:

1. Bank and Customer Execute Murabahah Financing Agreement (**Figure 1**)
2. Bank appoints Customer as Agent to purchase Goods (**Figure 2**)
3. Bank Gives Money to Supplier Through Agent for Purchase of Goods (**Figure 3**)
4. Agent Takes Possession of Goods on Bank's Behalf (**Figure 4**)
5. Client Makes Offer to Purchase Goods from Bank Through Declaration (**Figure 5**)
6. Bank Accepts the Offer-Sale is Concluded (**Figure 6**)
7. Client Pays Agreed Price to Bank According to an Agreed Schedule (**Figure 7**)

Figure 1: Bank and Customer Execute Murabahah Financing Agreement



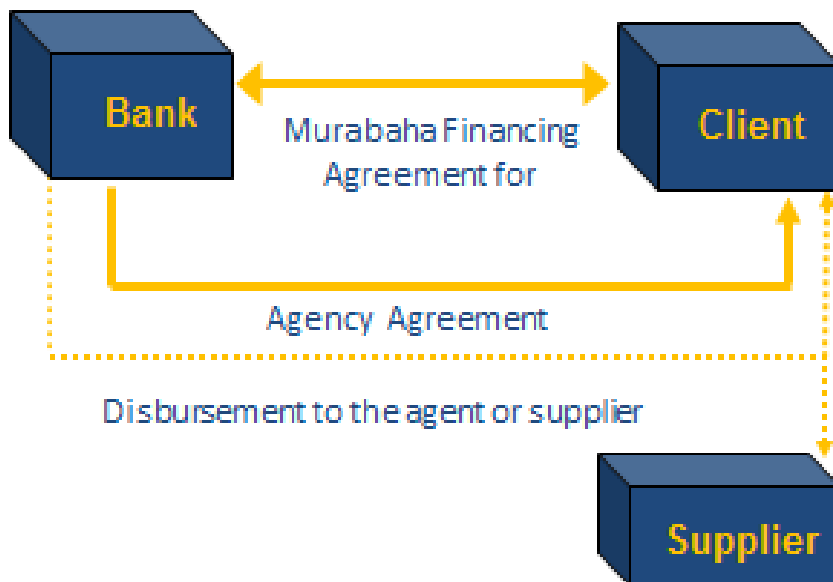
Source: Author's self-construct

Figure 2: Bank appoints Customer as Agent to purchase Goods



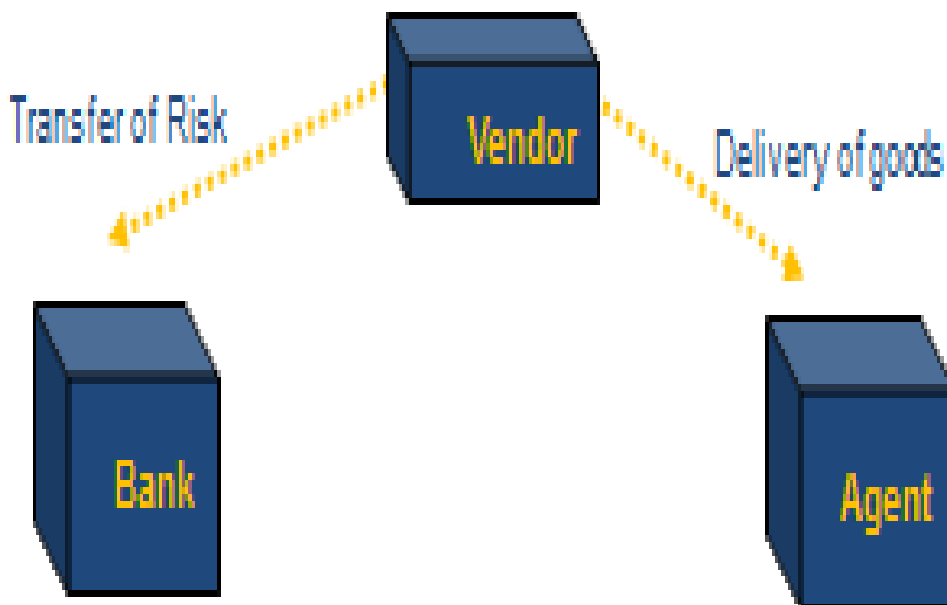
Source: Author's self-construct

Figure 3: Bank Gives Money to Supplier through Agent for Purchase of Goods



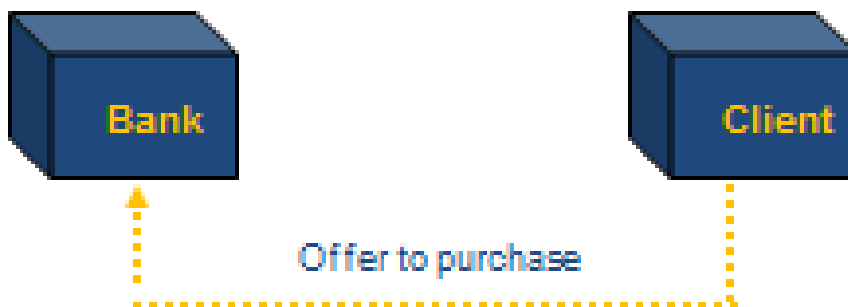
Source: Author’s self-construct

Figure 4: Agent Takes Possession of Goods on Bank’s Behalf



Source: Author’s self-construct

Figure 5: Client Makes Offer to Purchase Goods from Bank through Declaration



Source: Author's self-construct

Figure 6: Bank Accepts the Offer-Sale is Concluded



Source: Author's self-construct

Figure 7: Client Pays Agreed Price to Bank According to an Agreed Schedule



Source: Author's self-construct

4.1 MIB Target Market

The target of MCB is Small-scale Entrepreneurs. The bank helps them to meet their working capital or Business expansion needs. Both men and women have equal opportunity to avail the Islamic microfinance facility. The financing range is between rupees ten thousands (Rs.10K) to rupees 500K to individuals, who have at least two years of business experience.²⁷

4.2 Islamic Micro-finance Sectors

Any individual with 2 years of business experience, involving in the sector of trade, production, services, livestock raising and agriculture, can avail the Islamic micro-financing facility, agriculture financing.²⁸

4.3 Terms of Murabahah

The profit rate being offered by the MCB Islamic Bank is ranging between 23%-25%. The maximum financing amount being offered is PKR 500,000/-. The financing tenor for both fresh & repeat clients is 3 - 24 Months. The age of the customer should be between 20 to 60 years having at least 2 years of experience. The customer has to provide one guarantor to avail the facility. Once all the required documents are complete, the turnaround time (TAT) is six to eight days. The Microfinance product can be offered to the customer in 15 Km's radius from branch's location. Once financing is booked, the customer will have to repay the finance & profit amount in Equal Monthly Installments (EMI). The financing will be approved based on eCIB exposure.²⁹

4.4 Documents Required

The customer has to provide the following documents:

- Copy of National Identity Card (CNIC) or Smart National Identity Card (SNIC) or National Identity Card for Overseas Pakistanis (NICOP) or (Pakistan Origin Card (POC) for both the Applicant and Guarantor.
- 2 passport sized recent colored photographs for Applicant and Guarantor
- Utility bills of Applicant
- Proof of business and other documents for income calculation

4.5 Competitive Advantages

MCB is the first Islamic and first commercial bank to start Micro-financing in Pakistan on the basis of riba-free transaction that is as per the Shariah Standards. It provides Life Takaful coverage in case of the customer's death. The product has a convenient disbursal and repayment plan, which involves a hassle-free process. The process of verification is transparent and the

²⁷ <https://www.mcbislamicbank.com/>

²⁸ <https://www.mcbislamicbank.com/>

²⁹ <https://www.mcbislamicbank.com/>

terms & conditions are discrete. The product also offers competitive rates i.e. 23 % to 25 %.

4.6 Risks Faced by MIB and their Mitigation

All the basic risk involved in any transaction are also involved in this type of murabahah. These include benchmark risk, liquidity risk, operational risk, legal withdrawal risk, fiduciary risk, displaced commercial risk and of course the credit risk. Interestingly, the mitigation tools are also the same as is used in the mainstream finance by other Islamic banks.

4.7 Customer Default Risk Mitigation

The main risk that is also the focus of our study is the customer's default risk. This is because the murabahah facility is a clean financing, which unsecured, where no security or collateral is taken from the customers. Many ways are utilized to ensure that the customer would not default (**See Table 1**).

From **Table 1** it is clear that CIB report, if any, of the customer is taken from the Customer Information Beauru (CIB) to know previous credit history of the customer. Household living place and business site is visited so that as much as possible information is collected about the customer. A good relation is developed with the customer by providing a friendly environment to him to know more about him. A survey of the market is also done to collect further information about the customer.

Only those customers are provided financing, who have at least two years of working experience in order to reduce the risk that the amount shall go into the hands of unskilled person who can misuse it. Further, a proper business plan is taken from him to ensure that the skilled customer has a clear business plane for the finance amount.

To secure itself from losses, the customer is asked to provide future dated cheque in the name of the bank. To further secure itself, the bank also requires one guarantor from the customer, whose financial position shall be better than the customer. The financing is provided only for the working capital or business expansion and not for starting a new business.

The customer, who is capable of working is given financing, who should not be too young or too old. That's why the age limit is fixed to be from 20 to 60 years. The microfinance, is provided to a customer who lives/works within the fifteen (15) Kilometer radius from the branch. So that it will be easy for the bank to develop relation and properly monitor the customer's activities.

Table 1

NO	Question	Respon dent 1	Respond ent 2	Respondent 3	Respon dent 4
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	<p>How MIB Made it possible to use <i>Murabahah</i> as tool for Islamic microfinance?</p>	<p>This was really a tough job. With Allah's blessing we made it possible. Our team was very dedicated.</p>	<p>Exactly the same rules applied to mainstream <i>murabahah</i>, are also applied in <i>muarabahah</i> for Islamic microfinance except there is no collateral taken.</p>	<p>All the steps of modern <i>murabahah</i> are followed in this type of financing. First the thing required by a customer is bought by MIB and then sold to the customer on installments.</p>	<p>The bank buys the required commodity by itself for which the customer is appointed as agent. The agent buys thing on behalf of MIB. Then buys this thing from MIB on installments which he has to pay periodically.</p>
	<p>What risks are being faced by your organization in the process of <i>murabahah</i> financing</p>	<p>We face the same risks which MIB and other Islamic banks face in <i>murabahah</i></p>	<p>Financial risk, market risk, liquidity risk, operational risk, credit risk, HR</p>	<p>We face two types of risk. One which are similar to other <i>murabahah</i> financing such as financial risk, market and liquidity risk, <i>shariah</i></p>	<p>The risks which are faced by our organization i.e. MIB are as follows: credit</p>

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	<p>on micro level?</p>	<p><i>ah</i> such as market risk, liquidity risk, displaced commercial risk, operational risk, <i>shariah</i> non-compliance risk.</p>	<p>Risk (incompetent employees), <i>shariah</i> non-compliance risk and so many others.</p>	<p>compliance risk. We also face some risks which are particularly related to <i>murabahah</i> micro-finance. Compliance risk, HR risk, Over indebtedness of customer risk, Limitation of Products/Stress Risk. Compliance risk is the particular risk of not being in compliance with regulations for microfinance sector. HR risk is associated with not having qualified and specialized human resource for IMF. Over indebtedness risk reflects the burdening of customer with debt and not considering his</p>	<p>risk, market risk, liquidity risk, <i>shariah</i> non-compliance risk, default risk, operation risk, displaced commercial risk.</p>
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				position to repay back. Limitations of Product/Stress Exposure risk means that all assumptions may not be tested based on assumptions.	
	How these risks are mitigated?	As the risks are the same with other types of financing, therefore, we use the same tools being used in other financings for mitigation of these risks.	Collateral is not taken from the customer in credit risk mitigation. Apart from this all the conventional tools are used for mitigation of other risks. But for <i>shariah</i> compliance risk, strict screening criteria is followed. Similarly, the <i>Shariah</i>	For financial risk , Robust structuring has been made in: <ul style="list-style-type: none"> - Financing Risk Design - Financing Risk Approval Process - MFBs shall obtain a credit report from the Credit Information Bureau of State Bank of Pakistan. Further details of the steps taken are given in the 'Risk Strategy' section. With more stringent controls and measures introduced in terms of	Our risk department has devised certain tools for mitigation of all the particular risks. We use the same tools.

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			<p>board check all the transactions. <i>Shariah</i> compliance department make review of all transactions. Internal <i>shariah</i> audit gives independent view about <i>shariah</i> compliance of the transactions.</p>	<p>people, process and technology, financing risk will be considerably mitigated. Furthermore Charity clause is also there to mitigate this type of risk. For operational risk There is a separate Risk function established for effective management of operational risks in the bank. This functional set up assists management to understand and effectively manage operational risk. The function assesses monitors and reports operational risks as a whole and ensures that the management</p>	
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				<p>of operational risk in the bank is carried out as per strategy and policy.</p> <p>For Compliance risk:</p> <p>1. SBP Places high priority to microfinance as well as Islamic banking as reflected in their action of support</p> <p>2. Cash flow analysis is mandatory for all Microfinance financing except where Corporate Guarantee is being taken. In this regard, Business shall be responsible to obtain Group Head Consumer and Microfinance approval of companies whose corporate guarantees shall be acceptable.</p>	
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				<p>3. Branch / Approving authority</p> <p>For HR risk 1. The Financing/credit risk staff will be Specialized in individual financing of lower tickets financing.</p> <p>2. The staff capacity will be strengthened through ongoing trainings, continuous interaction with Head office teams /Risk Team and feedback through continuous monitoring.</p>	
	<p>As no collateral is taken from the customer, don't you think credit risk is the main risk faced by your</p>	<p>Customer default risk is very important</p>	<p>Credit risk or customer default risk is very high in this transaction.</p>	<p>This risk is the main risk we face in <i>murabahah</i> for microfinance. This is because we do not take any collateral.</p>	<p>All the risks are very important. But this risk the major one.</p>

	organization?				
	How your organization manages credit/customer default risk?	By the following ways: CIB report of the customer is taken from SBP. Household business site is visited. Minimum experience of the customer is fixed as 2 years. He should be of age 20-60 years (not too young not too old). One guarantor is	We collect information about the customer from many ways. We make friendly relations with customers. Visit him frequently. Currently on for running business we do <i>murabahah</i> . To make sure that customer is known, microfinance is made only to people living	CIB report of the customer is taken from the Customer Information Beuro (CIB). Household living place and business site is visited so that as much as possible information is collected about the customer. A good relation is developed with the customer. We also do market survey. Only those customers are provided financing, who have at least two years of working experience in order to reduce the risk that the amount shall go into the hands of	As MIB does not take any collateral from the customer so our main focus is on guarantor and cheque. Further, it is made sure that the customer will be able to pay the amount. For this MIB takes future business plan from him. The customer business site is

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		<p>demande d from him. Future dated cheque is also taken from him.</p>	<p>within 15 KM radius.</p>	<p>unskilled person who can misuse it. Further, a proper business plan is taken from him to ensure that the skilled customer has a clear business plane for the finance amount. To secure itself from losses, the customer is asked to provide future dated cheque in the name of the bank. To further secure itself, the bank also requires one guarantor from the customer. The financing is provided only for the working capital or business expansion. The customer, who is capable of working is given financing, who should not be</p>	<p>visited frequentl y so that he is reminde d that he has to pay MIB's money back.</p>
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				too young or too old. That's why the age limit is fixed to be from 20 to 60 years.	
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NO	Question	Respondent 5	Respondent 6	Respondent 7	Respondent 8
	How MIB Made it possible to use <i>Murabahah</i> as tool for Islamic microfinance?	MIB is committed to use all profit earning modes for Islamic micro-financing . We started with <i>murabahah</i> for which we made a lot of efforts. We found that currently <i>murabahah</i> can be the best tool to be used. We finance	It is exactly the same steps are being followed in this type of <i>murabaha</i> as well except we do not take any security from the customer. The customer first buys something on our behalf and then we sell it to customer on installment basis.	First the customer applies to MIB for purchase of something and promise to purchase it from MIB. The MIB appoint him as his agent. He buys thing on behalf of MIB. Then makes an offer to MIB. MIB accepts his offer. The cost price and profit margin is disclosed to the customer.	

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		only those customers who do not have money for working capital for running business who has at least 2 years of experience.	All steps of <i>murabahah</i> are followed in this type of micro-financing?	Equal installments of payments are made, which the customer has to pay regularly.	
	What risks are being faced by your organization in the process of <i>murabahah</i> financing on micro level?	Similar to all the other modes of financing, in <i>murabahah</i> also the MIB faces the same risk. They are not different. The only difference is that credit risk is mitigated in different way,	There are two types of risks: common risk and specified risks. Common risks are similar in all financing such as liquidity risk, market risk, operational risk, credit risk etc. Some specific risk are also there	In <i>murabahah</i> first MIB faces financial risk, then credit risk, market risk, operational risk, liquidity risk, displaced commercial risk, customer default risk and <i>shariah</i> noncompliance risk.	

		which shall be discussed in the coming question.	in <i>murabaha</i> micro financing. Such as HR risk, compliance risk, limitations of products risk, stress risk etc.		
	How these risks were mitigated?	If we talk about shariah non-compliance risk for this we apply strict criteria. Our SCD makes review of all transactions and gives report to RSBM who check that all transactions are shariah compliant. For financial	As the risks are common , therefore, the strategies are also common to other financing. As far as the specific risks are concerned, for example, financial risk For financial risk , there is proper risk mitigation structure and proper financing	Same strategies used in other financings.	

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		<p>risk, we specialized experts who keep insight in the market. In this way market risk is covered. Similarly, for operational risk, we devised proper strategy. For credit risk, we take future dated cheque from the customer.</p>	<p>approval strategy. Similarly, eCIB report is taken from SBP. Similarly strong controls are used. Charity clause is put in contract to further mitigate the risk. For operational risk There is a separate Risk function established for effective management of operational risks in the bank. This functional set up assists management to understand and</p>		
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			<p>effectivel y manage operation al risk.</p> <p>For Complia nce risk: Cash flow analysis is mandator y for all Microfina nce financing except where Corporate Guarantee is being taken. In this regard, Business shall be responsibl e to obtain Group Head Consumer and Microfina nce approval of companie s whose corporate guarantee s shall be acceptabl e.</p>		
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	<p>As no collateral is taken from the customer, don't you think credit risk is the main risk faced by your organization?</p>	<p>Off course this the main risk.</p>	<p>In my view this risk is equal in value to all other risks.</p>	<p>You are right. This risk is very important.</p>	
	<p>How your organization manages credit/customer default risk?</p>	<p>Our organization (MIB) manages this risk in an efficient way. To mitigate this risk, yes MIB takes future dated cheqe. Yes it also demands for guarantor whose financial position should be better than the customer.</p>	<p>All the available information possible to be collected about the customer, are collected in many ways. MIB visits the financee. His business is evaluated. CIB report is collected about his previous record. MIB also takes</p>	<ol style="list-style-type: none"> 1. Yes MIB takes future dated cheqe. 2. Yes guarant or is demanded from the customer. 3. Yes we demand for 2 years of experience. 	

		<p>MIB provides financing only to experienced person. Therefore, a minimum of 2 years of experience is required from the customer.</p>	<p>future dated cheque from him in addition to demand for the guarantor. The customer capability is assessed whether he will be able to increase his business profitability. For this purpose only experienced persons are financed having at least two years of experience.</p>		
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Source: Based on the experts' interviews, authors' self-construct

5. Conclusion

Islamic microfinance can play a better role in the poverty alleviation by applying the profit earning modes. Previously, most of the financial institutions applied the interest-free loan by ignoring the profit-earning modes. The profit earning mode like murabahah will not only benefit the poor customers but also the banks. Currently, the murabahah applied by MIB as Islamic microfinance

mode is a good initiative. The customers are getting benefits from it. Customers with working experience and clear future plan can get the finance facility. In addition to the other common risks, the most significant risk for banks in the case of murabahah is default in payment by the customer. For which the MIB develops better relations. The customers do not have to pay any security. They only have to provide a future dated cheque and a guarantor whose financial position should be better than the customer. The practice of murabahah is a step towards the use of profit earning modes for Islamic micro-finance bank in Pakistan. Other banks of Pakistan are also suggested to start Islamic microfinance by using profit earning modes like *murabahah* and *mudharabaha*.

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