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Analyzing the Holistic Impact of Islamic Microfinance: A Dual Perspective on Social Welfare and Institutional Dynamics

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Abstract

This paper offers an in-depth investigation of the diverse effects of Islamic Microfinance Institutions (IMFIs) on social welfare and institutional dynamics. This study employs a dual perspective framework in form of a literature review to analyse the welfarist and institutionalist views, elucidating the significance of IMFIs in fostering societal welfare and along with sustainable longevity. The dual perspective provides a combined view of Islamic Microfinance in terms of its social welfare and its long-term sustainability which will help in the development of the overall Islamic micro-financial industry. From a welfarist standpoint, our examination uncovers the positive consequences linked to IMFIs, including the alleviation of poverty, the promotion of financial inclusivity, the empowerment of women, and the provision of assistance to small and medium-sized firms (SMEs). Nevertheless, this highlights the necessity for doing further comprehensive study in order to tackle the issue of urban poverty, meet the needs of vulnerable groups, and examine the psychological advantages of assistance provided by IMFI. The present study also investigates the possibility of IMFIs' involvement in augmenting social capital and community development, specifically through the use of contracts such as Qard al-hasan and Musharaka. Furthermore, it is well acknowledged that education and training aid play a crucial role in the reduction of poverty. In terms of the institutional aspects, many crucial elements are recognised as influential in determining the sustainability of IMFIs. These characteristics encompass government backing, the presence of diverse financial products, the composition of capital, adherence to Shariah rules, and the intricate equilibrium between social outreach and financial feasibility. The significance of government partnerships and subsidies in *enhancing accessibility to Islamic microfinance services is underscored. In addition, we propose the broader use of equity-based contracts, such as Musharaka and Qard al-hasan, as a means to decrease reliance on donors and improve long-term viability. In summary, the comprehensive comprehension of the societal and financial systems' function of Islamic microfinance is achieved through the convergence of the welfarist and institutionalist viewpoints. In order to optimise their efficacy in poverty alleviation and the promotion of financial inclusivity, IMFIs must adeptly manage the complex interrelationship between social and financial goals. The achievement of this equilibrium is contingent upon many critical initiatives, including collaboration between governments and IMFIs, the promotion of equity-based contracts, and the fostering of innovation in financial instruments.*

Introduction

In an era characterised by increasing economic inequalities and the enduring issue of poverty, Islamic microfinance has emerged as an alternative progressive and ethical financial tool (R. A. Ahmad & Ahmad, 2021). It aims to harmonise the goals of financial sustainability with the principles of social welfare. By an inspiration from the data analysis by (Widiarto & Emrouznejad, 2015) it could be derived that the examination of its impact on the social welfare and institutional dynamics provides a valuable dual perspective to the future of the industry in terms of the alignment of the objective and its sustainable growth. Islamic microfinance is often regarded as a more efficient alternative to traditional microfinance due to its incorporation of ethical principles and the availability of specialised financial tools (Kaleem & Ahmed, 2010). In a detailed comparison (Abdul Rahman, 2007) has summarised the characteristics of the conventional microfinance and Islamic microfinance which are as follows:

Differences and Characteristics of Conventional and Islamic MFIs

Characteristics	Conventional MFIs	Islamic MFIs
Liabilities (Sources of Funds)	External Funds, Savings of Clients	External Funds, Savings of Clients, Islamic Charitable Sources
Assets (Mode of Financing)	Interest-Based	Islamic Financial Instruments
Financing the Poorest	Poorest are left out	Poorest can included by integrating Zakah with microfinancing
Funds Transfer	Cash Given	Good Transferred
Deductions at inception of contract	Part of the funds deducted at inception	No deductions at inception
Target Group	Women	Family
Objective of targeting Women	Empowerment of Women	Ease of availability
Liability of the loan	Recipient	Recipient and spouse
Work incentive of employees	Monetary	Monetary and Religious
Dealing with the default	Group/Center pressure and threats	Group/center/spouse guarantee, and Islamic ethics

Social Development Program	Secular (or un-Islamic) behavioral, ethical, and social development.	Religious (includes behavior, ethics, and social)

Table 1. Differences and Characteristics of IMFIS and MFIS (Abdul Rahman, 2007)

In his research, (Rahim Abdul Rahman, 2010) has conducted an in-depth analysis of the potential of the Islamic microfinance. He argues that Islamic finance offers various ethical schemes and instruments that can be advanced and adapted for the purpose of microfinance. Comparatively, Qard al-hasan, Murabaha, and Ijarah schemes are relatively easy to manage and will ensure the capital needs (Qard al-hasan), equipments (murabaha) and leased equipments (ijarah) for potential micro-entrepreneurs and the poor. Participatory schemes such as mudarabah and musharakah, on the other hand, have great potentials for microfinance purposes as these schemes can satisfy the risk sharing needs of the microentrepreneurs. Several traditional microfinance organisations, although sharing the common objective of promoting social welfare, often deviate from their humanitarian mission as a result of imposing exorbitant interest rates (Mitra, 2009). (Hudon & Sandberg, 2013) confirm the high interest rate charges imposed by the conventional MFIs and justify the rationale behind the interest as relatively high operational costs than that of the Banks. In contrast, IMFIs offer financial solutions that adhere to Shariah principles, which play a crucial role in alleviating poverty and promoting welfare specially among marginalised populations. (Rahim Abdul Rahman, 2010) has described such principles and concepts extensively in his research. Over the course of time, a diverse range of Islamic microfinance institutions has emerged, encompassing rural Islamic microfinance banks, non-governmental organisations (NGOs), and other microfinance organisations.

Throughout the progression of the Islamic financial sector, several institutions have prioritised the objective of poverty alleviation. According to (Frasca, 2008) and (Macias Alonso, 2015) among these organisations, the Mit Ghamr bank, formed in Egypt in 1963, stands out as one of the pioneering Islamic financial institutions. Subsequently, the Islamic commercial finance industry saw significant growth, with the primary objective of poverty eradication not being the foremost purpose of any Islamic commercial organization. In a field research performed on 46 Islamic banks (Salma Sairally, 2013) found that the practices of the Islamic financial institutions reflected a more limited approach to the corporate social responsibility (CSR). Most of the Islamic financial institutions were observed to be focused on meeting their legal, economic and Shari'ah responsibilities, and were concerned with the goals of profit maximisation and for their transactions to meet Shari'ah compliance. CSR was practised as a peripheral activity by the Islamic financial institutes as opposed to being an integral, well thought-out and deliberate policy decision of management. Similarly, (Abdul-Baki & Uthman, 2017) found that the Islamic banks tend to pursue their profit maximization goals which results in a failure to adhere the social goals of the Islamic finance.

However, this paradigm shifted with the emergence of Islamic microfinance institutions. The field of microfinance had significant growth subsequent to the formation of the Grameen Bank in Bangladesh, under the leadership of Mohammed Yunus (Mia & Ramage, 2018). On the contrary to collateral-based lending model, (Yunus, 1999) states that the Grameen bank does not follow the conventional wisdom. Researchers (Wahid & Hsu, 2000) have explained the money lending process of the Grameen bank in a detailed article. They have expressed that "the lending decisions in a microfinance institution such as the Grameen bank are taken on the basis of group credit worthiness. The borrower must form a group of five co-borrowers based on their preferences. Before the formation of a group, the members go through a training session to learn the bank's rules and regulations. This training session also teaches the participants fundamentals such as how to sign their names and how to make key decisions. A chairperson and a secretary are elected by the group members. Within the group the first two neediest members get the loan first and they must repay on schedule before the next two receive the loan. Often the group chairperson is the last one who receives the loan. The size of the loans provided under the Grameen bank lending model ranges from $100 to $300." The Grameen Bank does not adhere to the Shariah principles as it operates on a lending model that involves the charging of interest. The rise of Islamic microfinance organisations was afterwards influenced by analysing the potential of Islamic tenets in providing microfinance and by the introduction of innovative microfinance solutions based on Shariah principles along with a primary objective of social welfare (Rahim Abdul Rahman, 2010). Islamic microfinance has witnessed a subsequent progression and dissemination of microfinance sectors, particularly in developing nations. As of 2019, Islamic microfinance institutions have established their presence in over 15 countries spanning across Asia, including Afghanistan, Indonesia, Bangladesh, Pakistan, and Malaysia. Additionally, these institutions have also expanded their operations in the Middle East and North Africa region, encompassing Bahrain, Egypt, Iraq, Jordan, Lebanon, Palestine, Sudan, and Yemen (Tamanni & Haji Besar, 2019).

Furthermore, Islamic microfinance institutions have extended their reach to Central Asian countries such as Kazakhstan and Kyrgyzstan, as well as certain Eastern European nations like Bosnia Herzegovina and Kosovo (Tamanni & Haji Besar, 2019).

According to a literature review by (Mohamed & Fauziyyah, 2020) the academia has widely acknowledged the effectiveness of Islamic microfinance organisations in addressing poverty and promoting social welfare. This literature review also substantiates the influence of Islamic microfinance institutions on economic development, the reduction of poverty, the expansion of small and medium enterprises, the empowerment of women, the enhancement of living standards, and even the rates of employment. Hence, the effectiveness and the potential of IMFIs in eradicating poverty is already recognized and acknowledged. Despite the fact that researchers are largely in agreement regarding the positive effects of IMFIs, there are a number of challenges inherent to the IMFI sector that highlight the need for a nuanced understanding of the complex dynamics at play. For instance (Azmi & Thaker, 2020) in their literature review have identified several sustainability concerns such as sustainability, governance, and regulatory frameworks for IMFIs continue to be the primary concerns of researchers and institutions for their future growth from an institutional standpoint. This research provides a multidimensional view of IMFIs from an institutionalist and as well as a welfarist perspective.

Existing research has comprehensively investigated both the social welfare effects or the institutional dynamics of Islamic microfinance in isolation; this study bridges the gap by providing a comprehensive and integrated analysis. This research provides an extensive and nuanced understanding of the topic by simultaneously assessing the effectiveness of Islamic microfinance in reducing poverty, promoting economic growth, and enhancing social welfare, along with an in-depth review of the underlying institutional structures, governance mechanisms, regulatory environments, sustainability, and financial stability. As a result, it not only enriches the academic discourse but also provides valuable insights for policymakers, practitioners, and stakeholders in the Islamic microfinance sector, allowing them to make more informed decisions and develop strategies that promote both social welfare and institutional resilience. This dual perspective approach thus considerably contributes to the existing literature concerning Islamic microfinance and its multifaceted impact on society and financial systems. Firstly, the objective of this paper is to investigate the impact of Islamic microfinance on poverty reduction and economic development, using a welfarist perspective as the analytical framework.

Secondly, this paper explores the analysis of how the institutional structure of Islamic microfinance institutions influences their long-term viability, governance practises, and financial resilience. Moreover, this paper aims to clarify the degree of alignment or divergence between welfarist and institutionalist perspectives when assessing the effectiveness of Islamic microfinance in promoting social welfare and economic progress. Lastly, this paper aims to investigate how the Islamic microfinance sector may effectively and durably maintain its impact on social welfare, in order to get a comprehensive understanding of the subject matter.

Literature Review

Islamic microfinance is a well researched topic among the academia. Researchers have examined its complex effects on numerous facets of society and communities through theoretical and primary research.

This literature review offers a thorough examination of the institutionalist and welfare perspectives on IMFIs provided by the researchers. This study examines the vast corpus of research that gives light on the efficiency and limitations of IMFIs, including topics like poverty reduction, financial inclusion, women's empowerment, and their involvement in small and medium-sized firms (SMEs). It also looks at the important elements affecting the sustainability and growth of IMFIs. By a combined analysis of these perspectives, significant contributions and limitations of IMFIs have been identified that are crucial in addressing societal issues and the policy considerations that could shape their future. This review serves as a comprehensive resource for anyone seeking to understand the nuanced role of IMFIs in the evolving landscape of global finance and social development.

1.0 Welfarist Perspective

1.1 Effectivity of IMFIs in Poverty Alleviation

Multiple studies have indicated the efficacy of IMFIs in mitigating poverty and providing social welfare services to its clientele. (Naveed Aslam, 2014) performed an empirical study that examined the role of Islamic microfinance in poverty alleviation in Pakistan. The research studied the impacts of Islamic microfinance, measured the degree of satisfaction among individuals, and explored the future prospects of Islamic microfinance institutions in Pakistan. The analysis has determined that Islamic microfinance plays a significant role in enhancing the standard of living, per capita income, educational attainment, ethical values, profitability, sustainability, infrastructure development, employment rates, and addressing issues of inflation and wealth inequality within society. The individual posited the significance and impact of religiosity on the expansion of the IMFIs. (Zahid Mahmood et al., 2017) conducted a study examining the impact of borrowing from Islamic microfinance institutions, specifically Akhuwat, Farz, and Naymet, on various socio-economic indicators in Pakistan. Through regression analysis, the researchers found that borrowing from these institutions had a significant positive effect on monthly income, expenditures on food, education, and health, as well as the accumulation of household assets. However, it was also observed that an increase in the borrowed loan amount had a negative impact on the income of the poor. In their critical examination of the Akhuwat Foundation, (Akhter, 2009) reached the conclusion that the organisation extends its services to those residing below the poverty line, including those categorised as the "extreme poor." The authors also assert that interest-free loans can serve as a potent instrument in combating poverty. Furthermore, they suggest that the incorporation of philanthropic contracts, such as Qard al-hasan, might enhance the effectiveness of the contracts in poverty alleviation.

In the context of Indonesia, a case study is undertaken to examine the operations and practises of BMT MMU Sidogiri. According to a study conducted by (Adnan & Ajija, 2015), it has been demonstrated that Baitul Maal wat Tamwil (BMT) finance exhibits efficacy in mitigating poverty. The majority of participants saw a rise in their income subsequent to getting BMT funding. The use of BMT products, particularly Bay' Bithaman Ajil (BBA) and Mudarabah, has demonstrated efficacy in facilitating the economic empowerment of impoverished individuals through their engagement in diverse productive enterprises, hence resulting in a notable reduction in both the scope and intensity of poverty. In a research conducted by (Rokhman, 2013), an empirical investigation was carried out including a sample of 150 borrowers sourced from 20 IMFIs. The results of the empirical tests demonstrate that microfinance plays a substantial role in enhancing income levels, promoting children's education, and fostering business advancement. Nevertheless, the research could not identify any substantial impact of microfinance on the availability of healthcare services. In their study, (Quraisy et al., 2017) has also provided empirical evidence supporting the positive impact of BMTs in Indonesia on the well-being and quality of life of the participants.

According to (Elwardi, 2015), the implementation of Islamic microfinance in Bangladesh has demonstrated a favourable influence on the alleviation of poverty in rural regions. This effect is particularly notable when borrowers possess adequate material resources and social connections. (Bhuiyan, 2013), a highly referenced academic researcher in the field of Islamic microfinance, did a comparison analysis between the Grameen bank and IMFIs in Bangladesh. The study determined that the provision of credit has had a significant role in enhancing the sustainable livelihoods of borrowers from both microfinance institutions. Additionally, the study's results indicate that participants from Islamic banks who received microcredit shown a higher propensity to use credit for income-generating endeavours, hence lowering vulnerability and enhancing their overall livelihood status in comparison to participants from the Grameen Bank microcredit programme. According to (Khandker, 2005), a prominent economist affiliated with the Poverty Reduction and Economic Management Division and the Development Research Group at the World Bank, his research findings indicate that Microfinance Institutions (MFIs) play a significant role in fostering rural village development and promoting women's empowerment.

Based on the findings by (Hamdan et al., 2012), Amanah Ikhtiar Malaysia (AIM) has emerged as the most effective IMFI in Malaysia in terms of its impact on poverty reduction. (Othman, 2016) has also presented comparable findings, accompanied by an examination of the prospects for sustainable growth within the organization. During previous periods, several IMFIs have been formed across the African continent. According to the findings of (Gumel et al., 2014), their research on the influence of IMFIs in Nigeria revealed a noteworthy and comprehensive impact on poverty alleviation. This impact was shown through the good outcomes observed in terms of household income, children's education, and purchase of assets. The influence of IMFIs in Mogadishu was investigated by (Xalane & Mohd Salleh, 2019). The study revealed that the existing implementation of Islamic microfinance in Mogadishu demonstrates its efficacy in servicing impoverished individuals. Specifically, these microfinance initiatives have shown beneficial in facilitating access to loans, improving living standards, and demonstrating the utility of the system. However, it is evident that there exists a limited degree of awareness among the local population regarding the accessibility and availability of Islamic microfinance options.

In addition to the broader implications of IMFIs on the reduction of poverty, scholars in their scholarly discussions have recognised the particular components offered by IMFIs that contribute to the well-being of society and individuals experiencing poverty. The literature review elucidates to some of the most discussed topics among the academia.

1.2 Financial Inclusion

IMFIs possess the capacity to assume a pivotal role in promoting and enhancing financial inclusion, particularly within regions that are both developing and neglected. Financial inclusion encompasses the endeavour to guarantee that both individuals and companies are provided with accessible and cost-effective financial services that are suitable for their needs, including savings, credit, and payment systems. According to (Rhule, 2016), it is argued that governments and religious scholars should actively promote the area of IMFI in order to fully realise the advantageous outcomes of financial inclusion inside the Islamic microfinance system.

The Pakistan Microfinance Network have stated that the outreach indicators for Pakistan in the year 2021 revealed a closing value of the gross loan portfolio amounting to 373 billion PKR. The extensive range of IMFI institutions in Pakistan is likewise deserving of attention. The following exhibit presents a visual representation of the ten largest IMFIs in Pakistan and their respective loan portfolios for the year 2021 (Aqil et al., 2021).

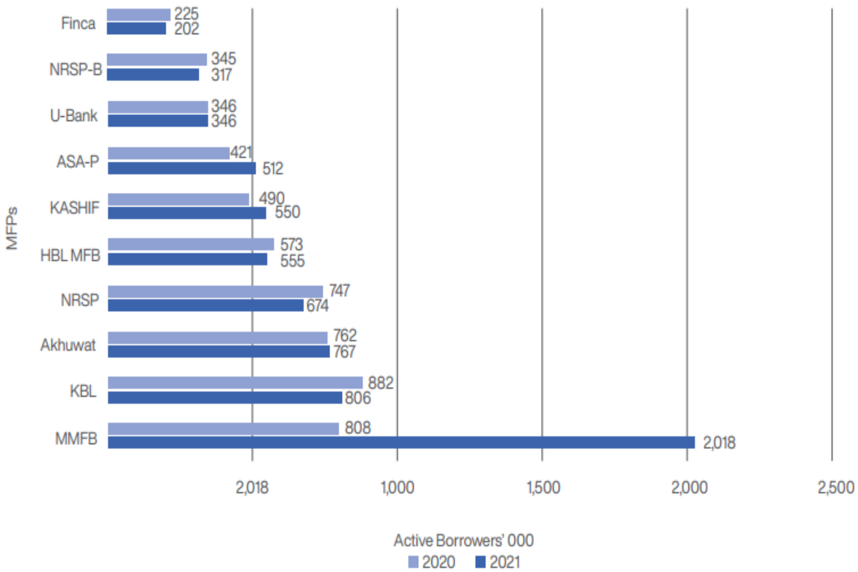

Figure 2. The Ten Largest IMFIS in Pakistan and Their Respective Loan Portfolios for The Year 2021

According to (Muhammad et al., 2023), the financial inclusion rate of both men and women in Bangladesh is a significant concern. According to available data, around 46% of males and 74% of females are considered to be excluded from accessing financial services. The author expounds upon and proposes several potential ramifications for the future advancement of the industry. (Nabi et al., 2017) performed a thorough literature study to analyse the IMFI models and find effective strategies for promoting financial inclusion among the Muslim community in Bangladesh.

In the specific context of Indonesia, (Wulandari, 2019) finds there is a need for BMT institutions to strengthen their role in order to successfully incorporate the financially underserved people at the base of the socioeconomic pyramid into the range of financial services offered by these organisations. The research reveals that the implementation of BMT (Baitul Maal wat Tamwil) in Indonesia necessitates the establishment of distinct structures and responsibilities tailored to each stage in order to achieve optimal effectiveness. There is a distinct necessity to differentiate the function of Baitul Maal from Baitul Tamwil in order to augment its efficacy in providing Qard al-hasan finance to those situated at the lower echelons of the socioeconomic hierarchy. In their study, (Abdullahi et al., 2021) employed a quantitative research methodology to investigate the factors influencing the desire to embrace Islamic financing in Nigeria. The findings had a beneficial outcome. The author suggests that players within the Nigerian financial system should initiate educational programmes aimed at enhancing public perception of the role of Islamic microfinance banks in facilitating financial inclusion and reducing poverty. (Onakoya & Onakoya, 2014) have likewise arrived at comparable findings.

1.3 Women Empowerment

IMFIs and the Islamic microfinance sector play a crucial role in promoting women's empowerment inside Muslim-majority nations and communities. Islamic microfinance plays a significant role in promoting the economic, social, and cultural empowerment of women via the provision of financial services, entrepreneurial possibilities, and financial education. The process of empowerment yields advantages not just for women on an individual level, but also generates favourable consequences that extend to their families and communities. (Islam, 2020) did a main research study that involved a sample of 389 female respondents who were recipients of services provided by the IMFIs in Bangladesh. The researcher discovered that Islamic micro financial services have had a noteworthy and favourable influence on various aspects of households' financial well-being. These services have resulted in increased income, savings, and expenditure for households, leading to an improved standard of living and the development of human capital. Furthermore, they have contributed to the enhancement of three dimensions of empowerment: economic empowerment, socio-cultural empowerment, and familial empowerment. In contrast, (Rahayu, 2020) posits in her empirical study conducted in Indonesia that the inclination of the BMT system towards women is mostly driven by commercial and pragmatic factors. By strategically focusing on women as creditworthy customers, these institutions can enhance their ability to meet operating costs and create the necessary revenues to continue their microfinance programmes in the long run, as well as expand their outreach to a larger population of underprivileged consumers. (Shafique & Siddique, 2020) have established a positive association between Islamic microfinance services and women empowerment in Pakistan.

1.4 Impact on SMEs and unemployment rates

Based on a study conducted by (Najeeb Jamal & Sheikh, 2013) in Pakistan, they discovered that the Islamic Microfinance model encompasses various dimensions and a regulatory framework. This model aims to address the social, financial, humanitarian, and religious objectives of micro entrepreneurs and SMEs, which are often overlooked by conventional microfinance institutions. In a scholarly article, (Antonio, 2011) asserts that SMEs in Indonesia have a range of challenges when dealing with conventional financial institutions. However, the author suggests that these obstacles can be alleviated by the adoption of an Islamic financial alternative. In a study conducted by (Herlinawati et al., 2017), a sample of 30 individuals was analysed to determine the impact of Islamic microfinance institutions on the growth of SMEs in Indonesia. The findings revealed that about 67.5 percent of the development of SMEs in Indonesia can be attributed to the role played by Islamic microfinance institutions, particularly in terms of financing. The remaining 32.5 percent was impacted by other variables that were not specifically explored in the study. (Rokhman & Abduh, 2019) conducted a study to evaluate the levels of satisfaction and loyalty among clients of IMFIs in the region of Central Java, Indonesia. The study sample consisted of 246 respondents. It has been observed that the existing Islamic microfinance initiatives have not yet succeeded in enhancing the financial well-being and quality of life of their clientele. Additionally, clients continue to have difficulties in differentiating between conventional and Islamic microfinance offerings. Contrarily, (Nugroho & Utami, 2021) conducted a study on customers of the Micro–Banking Division of Bank Syariah Mandiri, wherein it was discovered that a majority of respondents expressed satisfaction with the credit and its associated attributes, including loan size, cost, collateral requirements, processing time, and application form. The provision of credit facilitated the enhancement of their business operations, leading to an increase in sales and overall revenue. Nevertheless, the significance of the religious aspect of the Islamic Microfinance organisation was deemed rather insignificant in the process of choosing a microfinance organization. In Yemen, research was undertaken by (Fararah & Al-Swidi, 2013) on a sample of 320 respondents within the IMFI industry. The researcher discovered a significant impact of business development services offered by IMFIs on the satisfaction and perceived advantages experienced by SME owners while engaging with the Islamic microfinance system. (Adeyemi, 2015) and (Jafori & Afzal, 2016) arrived at comparable findings in their respective studies, which involved conducting research interviews to examine the possible influence of IMFIs on social welfare in relation to the undisclosed poverty within the nation.

2. Discussion on the Welfarist Approach

The literature review highlights certain favourable outcomes associated with IMFIs in relation to poverty alleviation, financial inclusion, women's empowerment, and support for SMEs. However, there exist certain gaps pertaining to the long-term sustainability of these impacts, the extent of awareness and outreach of IMFIs, and the necessity to strike a balance between commercial viability and adherence to religious principles. The outcomes pertaining to the welfare effects of Islamic microfinance exhibit heterogeneity across different geographical areas. This implies that the attainment of success is not consistent and can be influenced by geographical areas, methodologies, and several other variables.

The existing body of research pertaining to Islamic microfinance has not adequately addressed the several aspects that should be considered within the welfarist approach. The unacknowledged poverty within industrialised nations is a challenge that IMFIs appear to struggle to address. Although several studies have investigated the impact of Islamic microfinance on reducing rural poverty, further investigation is required to assess its efficacy in tackling urban poverty and narrowing the gap between rural and urban areas. Examining the potential impact of Islamic microfinance on urban populations' access to economic opportunities and welfare enhancement is a significant area of scholarly inquiry. This will further contribute to the determination of the true extent of financial inclusion among IMFIs on a global scale. In a similar vein, while several studies have addressed the issue of poverty reduction, there exists a requirement for more comprehensive research that delves into the particular effects of Islamic microfinance on vulnerable and marginalised groups, including refugees, internally displaced people, and minority communities. Inclusive development necessitates a comprehensive comprehension of the distinct problems and welfare requirements faced by individuals.

The examination of scholarly literature pertaining to the psychological advantages associated with IMFIs financial support may contribute to a better understanding of the impact of IMFIs on the holistic welfare of impoverished communities. Additionally, evaluating the ease of implementation of IMFIs might be beneficial in terms of their financial systems and the level of pleasure they offer to impoverished individuals.

Islamic microfinance banks frequently operate inside tightly-knit communities. Examining the impact of involvement in these establishments on social capital, community cohesiveness, and wider community development endeavours can offer valuable insights into their contribution to promoting social well-being. Based on existing scholarly research on IMFIs, it is evident that Qard al-hasan, a benevolent loan contract, holds significant value in terms of poverty alleviation and community cohesion and development. Several frameworks have not yet examined or applied different principles of Qard al-hasan. The notion of Kafil, which refers to a sponsor or guarantor, has the potential to bolster the social dimension of those experiencing poverty. By creating a fostered helper who possesses a higher standard of living, income, and general well-being, this idea can contribute to the improvement of the impoverished individual's social circumstances. The construction of a repository facilitated by a Kafil has the potential to enhance the integration of impoverished individuals within their society, therefore contributing to the overall reduction of poverty. At now, it appears that the Murabaha contract holds a prominent position within the market of IMFIs. Musharaka and Mudaraba had the ability to offer more welfare, particularly to emerging SMEs, in comparison to contracts based on debt. The integration of seasoned Muslim business professionals with emerging entrepreneurs with limited financial means, in exchange for a minority ownership stake, has the potential to increase the performance of their respective enterprises through the provision of valuable guidance and insights from the more experienced individuals. Such schemes have the potential to be advantageous in the context of poverty alleviation. These initiatives can also have a significant impact on the promotion of financial literacy among aspiring entrepreneurs from economically disadvantaged neighbourhoods. The provision of educational assistance has the potential to provide a novel avenue for poverty reduction, as it can yield more effect than the monetary aid often offered by IMFIs.

3. Institutionalist Perspective

In comparative research conducted by (Marwa Fersi & Mouna Boujelbéne, 2016), the sustainability of 333 MFIs and 49 IMFIs was studied. The findings revealed that the proportion of borrowers impacted by IMFIs was significantly lower in comparison to their conventional counterparts. Furthermore, the economic magnitude and established status of MFIs contribute to the enhancement of their social performance. In terms of financial aspects, MFIs mainly depend on loan financing and the effectiveness of their staff to achieve financial performance. Nevertheless, the IMFIs primarily depend on the allocation of financial capital and the efficiency of its workforce. IMFIs exhibit more potential for ensuring their sustainability by relying more on social performance as compared to the conventional. MFIs exhibit superior financial performance compared to Islamic MFIs in their pursuit of long-term viability. The organization's ability to sustain its customer base is contingent upon its organisational and financial success. According to (Obaidullah & Khan, 2008), microfinance providers have significant obstacles at the micro level, which arise from their varied organisational structures, concerns over adherence to Shariah principles, limited product variety, and inadequate connections with banks and capital markets. Several strategic initiatives are proposed as potential solutions. These include promoting a collective approach to resolving Shariah issues, expanding the range of products through research and financial engineering, and increasing the involvement of banks in microfinance by offering credit guarantees and safety nets. The conventional MFIs have demonstrated superior performance in terms of sustainability and institutionalisation compared to IMFIs. The academic discourse around the future and sustainability of IMFIs has identified many key aspects that have been essential to the ongoing discussions pertaining to the potential expansion of IMFIs. Several major factors have been studied below.

3.1 The Government and the Sustainability of the IMFIs

According to (Azmi & Thaker, 2020), the government plays a crucial role in ensuring the sustainability and effectiveness of Islamic microfinance organisations. One potential avenue for government aid to financial institutions is the provision of enhanced infrastructure and related amenities, with the aim of facilitating access to financial assistance for economically disadvantaged individuals residing in rural regions. Furthermore, it is suggested that governmental assistance and subsidies be provided to nascent Islamic microfinance institutions in order to facilitate their establishment and subsequent self-sufficiency within the market. In addition to this, it is recommended that the IMFIs should enhance their efforts in raising awareness and promoting the sector. Moreover, they should prioritise educating a larger population about the business, aiming to expand the reach of those who may avail themselves of the goods and services offered.

According to (Abbas & Shirazi, 2015) study conducted in Pakistan, a significant proportion of micro-entrepreneurs and petty traders surveyed expressed the belief that the government of Pakistan does not provide sufficient support for the development of Islamic microfinance initiatives aimed at benefiting individuals from low-income backgrounds. According to the findings of (Ayaz et al., 2019), the involvement of the Pakistan government in the IMFI sector is relatively limited. One of the primary issues contributing to the limited presence of banks in the Islamic microfinance market is the perceived lack of government backing. The study conducted by (Aspiranti et al., 2021) asserts that the internal management concerns, particularly those pertaining to government contacts, play a pivotal role in facilitating the efficient operations of Islamic non-banking MFIs and their capacity to provide money to other Islamic financial firms.

3.2 Preferred Modes of Financing

In their study, (Smolo & Ismail, 2011) have compiled a comprehensive inventory of the financial instruments employed by IMFIs on a global scale in order to facilitate the provision of their services. The products available in this context can be categorised as follows: (i) Mudha¯raba, which involves profit and loss sharing (PLS); (ii) Musha¯raka, which refers to a partnership arrangement; (iii) Ija¯rah, which pertains to leasing; (iv) Ija¯rah wa iqtina¯, which involves a lease-to-purchase arrangement; (v) Qard al-hasan, which refers to a benevolent loan; (vi) Mura¯bahah, which entails cost-plus financing; (vii) Bay′ al-sala¯m, which involves a pre-paid purchase; (viii) Bay′ al-istisna¯′, which pertains to progressive financing; and (ix) Musha¯raka mutana¯qisah, which refers to a diminishing partnership. The financial instruments may be categorised into two distinct groups: profit-based products and charity-based products. The items that generate profit may be classified into two distinct categories: debt-based products and equity-based products. Ijarah, Murabaha, Bay al-istisna, and Bay al-salam may be classified as debt-based financial goods, whilst Musharaka and Mudharaba can be categorised as equity-based financial products. One may argue that Qard al-hasan is also regarded as a form of debt-based financial instrument. Nevertheless, a number of scholars have classified Qard al-hasan with other forms of charitable contracts, such as Zakah and Waqf, due to its altruistic characteristics.

Based on the findings of (Hassan et al., 2013), the Murabaha contract emerges as the most favoured contract within IMFIs. This preference is attributed to the absence of a requirement for the client's credit record, the presence of clearly specified contracts, and the reduced administrative expenses associated with this particular contract. (S. Ahmad et al., 2020) conducted a study which revealed that among various Islamic financial products, murabaha, a kind of debt-based financing, is the most prevalent. Their findings indicate that 64.7 percent of the Islamic microfinance institutions included in their sample provide this product. Equity-based products, such as Musharaka, are offered by a limited number of MFIs due to the significant level of risk involved. The conventional MFIs demonstrated superior performance in comparison to the IMFIs primarily because the latter lacked a comprehensive and resilient financial instrument framework. According to (Abdul Rahman & Dean, 2013), their study findings indicate that Islamic microfinance has predominantly focused on the murabaha financing mode. Despite being considered a "ideal" form of finance, profit or loss sharing arrangements are rarely utilised. The current quantity of Zakah, Awqaf, and Qard al-hasan institutions falls well short of their potential, while other services like as savings deposits and insurance remain unavailable. The provision of a more extensive array of shariah-compliant products and services would enhance accessibility for a diverse clientele. In addition to the prevalent utilisation of Murabaha, another significant concern is to the adherence to Shariah principles in Murabaha contracts, commonly known as the Murabaha Syndrome within academic discourse (Miah & Suzuki, 2020).

3.3 Capital Structure of the IMFIs

As noted by (Azmi & Thaker, 2020), there exists a robust demand for Islamic microfinance goods and services; nonetheless, the expansion of the Shariah-compliant microfinance industry continues to exhibit sluggish progress. The primary factor contributing to this phenomenon is the reliance on specialised entities such as non-governmental organisations (NGOs) and donors to offer the facilities and services of Islamic microfinance, as opposed to Islamic banks. In similar research, (Tamanni & Haji Besar, 2019) discovered that the future of IMFIs is confronted with two significant challenges: the acquisition of sustainable funding due to the diminishing availability of donor money and government subsidies, and the need to strike a delicate balance between poverty outreach and financial sustainability. (Abdul Rahman & Dean, 2013) assert that the economic viability of most donations MFIs and IMFIs are compromised by the insufficient mobilisation of funds and the burden of excessive administrative expenses. Certain detractors argue that the Grameen Bank's financial operations would incur losses in the absence of funding. The resolution of the sustainability dilemma cannot be effectively achieved just through voluntary contributions. According to the findings of (Tamanni, 2017), the IMFIs do not prioritise sustainability objectives at now. This is because their financing mechanism is capable of supporting their primary focus on poverty reduction. Nevertheless, due to the ongoing push for commercialization and increasing competition, particularly with the growing selectivity of foreign funders, it is imperative for IMFIs to reduce their dependence on subsidies or grants.

4. Discussion on the Institutionalist perspective

As previously mentioned, the viability of Islamic microfinance institutions is contingent upon several factors, encompassing governmental backing, a diverse range of financial products, the structure of capital, adherence to Shariah principles, a harmonious integration of social outreach and financial sustainability, and a diminished reliance on external donors. By considering these variables and achieving a harmonious equilibrium between their societal objectives and economic viability, IMFIs can persist in their pivotal role of reducing poverty and promoting financial inclusivity in areas mostly inhabited by Muslims. The provision of government aid, subsidies, and the construction of infrastructure can play a crucial role in enhancing the accessibility of Islamic microfinance services, particularly in rural regions. It is imperative to engage in partnerships with governmental entities in order to enhance infrastructure and foster the dissemination of knowledge regarding Islamic microfinance. Governments have the capacity to provide assistance to emerging IMFIs.

The selection of financial instruments, namely the widespread adoption of Murabaha, has a significant impact on sustainability. The prevalence of debt-based products, such as Murabaha, is notable, although the availability of equity-based products, like Musharaka, is limited primarily owing to perceived dangers. Governments and financial institutions appear to prioritise the establishment of debt-based contracts over equity and charity-based contracts, therefore institutionalising the former. As elucidated within the framework of the welfarist approach, it is imperative for governments to further institutionalise Musharakah and Qard al-hasan, as these financial mechanisms possess considerable potential. The problem of IMFIs relying on donors can be addressed by governments' sustained funding and the implementation of more efficient Shariah-based schemes, as opposed to Shariah-compliant ones. The problem of reconciling social outreach initiatives, such as poverty reduction, with financial sustainability represents a vital concern for IMFIs. Excessive dependence on poverty reduction efforts has the potential to undermine the long-term financial viability of a given system or organisation. Hence, it is imperative for IMFIs to formulate methods that effectively reconcile their objective of alleviating poverty with the need of maintaining financial viability. The organisation has the potential to prioritise the promotion of financial inclusion across a wider range of clients, while concurrently diminishing reliance on subsidies over time.

Based on the extant literature pertaining to Murabaha and the capital structures of contemporary IMFIs, it is evident that both the conventional and Islamic banking frameworks exhibit inefficiencies in effectively reconciling their social and financial objectives. IMFIs should refrain from adopting conventional and commercial Islamic banking structures due to the profit-oriented nature of these institutions, which ultimately results in a deviation from the objective of both IMFIs and MFIs. Alternatively, the implementation of a financial framework centred around Qard al-hasan or Musharaka holds potential for enhancing the welfare and sustainability of IMFIs, contingent upon government support.

5. Addressing the IMFIs' Welfare and Sustainability dilemma

The welfarist perspective places a primary focus on the overall well-being and welfare of both people and communities. The literature analysis highlights the significant impact of IMFIs in several areas such as poverty reduction, financial access, empowerment of women, and assistance for SMEs. Welfarists hold the belief in the inherent worth of these results, placing emphasis on the improvement of individuals' standard of living as the central objective of IMFIs. The welfare impacts are often seen as crucial indications of success, serving as tangible evidence of the positive transformation that these institutions may foster within marginalised groups. The institutional approach viewpoint examines the formal and informal mechanisms in which IMFIs function, including their governance, legal frameworks, financial structures, and compliance with Shariah rules. The literature study underscores the need of adhering to Islamic values, promoting a diverse range of financial products, maintaining an appropriate capital structure, and receiving government backing as essential elements for ensuring institutional survival. The institutionalist perspective argues that the efficacy and durability of IMFIs are closely linked to the robustness and flexibility of these organisations.

In order to address the existing predicament encountered by IMFIs, governments might employ many approaches, including the establishment of public-private partnerships with IMFIs and the implementation of co-financing programmes alongside IMFIs. Public-private partnerships have the potential to produce a revenue stream for the government, while co-financing programmes can assist IMFIs in securing funds. Moreover, from a welfare standpoint, such collaborations have the potential to facilitate the expansion of IMFIs to the unexplored regions. SME-specific initiatives have the potential to contribute to a reduction in unemployment rates and foster the growth of diverse business sectors within the country. From a welfare standpoint, it is possible to accomplish comprehensive development for the emerging entrepreneur over an extended period of time. Musharaka and Qard al-hasan are highly significant resources for the effective implementation of such initiatives. Training camps and educational assistance have the potential to significantly contribute to the alleviation of poverty. Governments and IMFIs have the potential to collaborate in order to harness the untapped potential of the people through the establishment of government-funded companies. Instead of providing financial assistance, the government and IMFIs should consider employing the impoverished people in cofunded companies. This approach would enable them to earn a daily wage, while also being cost-effective owing to the establishment of a consistent revenue stream. The issue of women empowerment may also be effectively tackled via the utilisation of this particular strategy. Governments can also employ the nudge hypothesis as a means of effectively securing increased money from donors. While dependence only on donors is not a reliable and enduring source of funding, marketing initiatives supported by the government have the potential to produce a significant pool of charitable donations, and therefore enhancing the funding of IMFIs.

6. Conclusion

In summary, this paper conducted a comprehensive examination of the Islamic microfinance sector by employing a thematic analysis approach to study the existing literature on Islamic microfinance.
From a welfarist standpoint, our examination underscores the favourable consequences linked to IMFIs, encompassing the alleviation of poverty, the promotion of financial inclusivity, the empowerment of women, and the provision of assistance to small and medium-sized enterprises. Nevertheless, it is crucial to emphasise the necessity for further extensive investigation in order to tackle the issue of urban poverty, susceptible demographics, and the psychological advantages associated with help from IMFIs. Moreover, it is imperative to conduct additional exploration into the social capital and community development potential that may be derived from engaging with IMFIs, specifically through contracts such as Qard al-hasan and Musharaka. Education and training support can significantly contribute to the reduction of poverty.

The sustainability of IMFIs is contingent upon several institutional elements, encompassing government backing, a diverse range of financial products, the composition of capital, adherence to Shariah rules, and the equilibrium between social outreach and financial feasibility. Governments have the potential to improve the accessibility of Islamic microfinance services by establishing partnerships and providing subsidies. These measures can facilitate the growth and expansion of IMFIs, allowing them to cater to a broader range of clients. Furthermore, it is imperative to promote the utilisation of equity-based contracts such as Musharaka and Qard al-hasan in order to mitigate reliance on donors and foster long-term viability.

The convergence of the welfarist and institutionalist viewpoints provides a holistic comprehension of the societal and financial ramifications of Islamic microfinance. In order to uphold their efficacy in poverty reduction and facilitation of financial inclusion, IMFIs must effectively manage the intricate equilibrium between social and financial goals. The achievement of this balance necessitates the establishment of collaborations between governments and IMFIs, the promotion of equity-based contracts, and the study of novel financial instruments.

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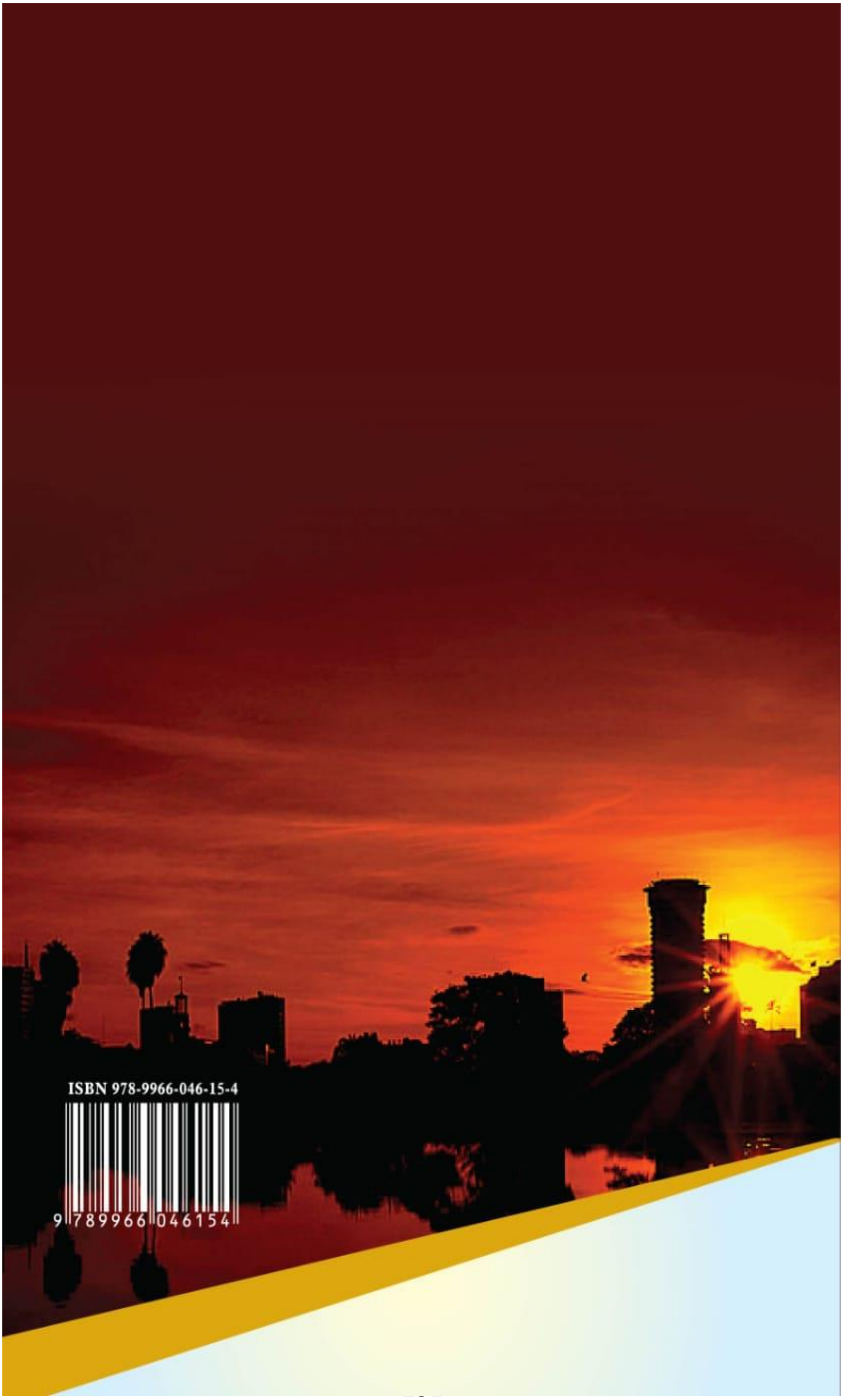

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