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# Effectiveness of Islamic Microfinance Institutions through Customers Satisfaction in Pakistan

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## ABSTRACT

In developing economies, microfinance institutions have become an increasingly popular approach to reducing poverty, social empowerment (especially among women), and economic growth by providing new opportunities for the poor for entrepreneurship. This study investigates the effectiveness of Islamic microfinance programs on the comfort level of the Islamic Microfinance (IMF) system in Pakistan. The study examines the effectiveness of IMF institutions in the country's small and medium enterprises (SMEs). Quantitative research based on primary data is conducted to evaluate the effectiveness of various IMF institutions in Pakistan. The data is collected from the 88 SME owners located near Lahore (Punjab), Pakistan. The independent variables are the cost of the loan, income and living standard, loan repayment policy, Shariah compliance, and loan utilizing opportunities. The dependent variable is microcredit customer satisfaction examined through a 5-point Likert scale questionnaire. Regression analysis is applied and found that income, loan repayment policy, loan utilization opportunities, loan cost, and Shariah compliance have a statistically significant positive influence on the microcredit customer's satisfaction. The study implies that understanding customer satisfaction helps IMF institutions enhance their financial performance, improve client retention, and fulfill their social mission.

**Keywords:** Islamic Microfinance Institutions, Small and Medium Enterprises (SMEs), Satisfaction, Shariah Compliance, Pakistan.

## 1. INTRODUCTION

A customer is considered a vital factor for organizations to achieve success. If clienteles remain fulfilled, they are additional to remain trustworthy to their service

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providers (Henning & Klee, 1997). Accordingly, the ultimate goal of an organization is to gratify the needs of their customers and encounter their outlooks to sustain their business in the future. Turel and Serenko (2006) argued that organizations could not grow further if they did not have satisfied and loyal customers. For the organizations to sustain or achieve success within this speedily challenging business environment, customers deem to be the main allies who can survive in challenging times (Gustafsson, Johnson & Roos, 2005).

Microfinance refers to providing small economic facilities like microcredit, saving, and insurance to the poor who have limited access to traditional banking services (Lamrani Alaoui & Tkouat, 2019). It is a tool used to help poor people and eradicate poverty. Microfinance institutions provide an opportunity to help individuals by providing financial assistance, thereby promoting the country's economic development. The literature stresses that, in the last decade, microfinance institutions have focused more on their profit rather than the customer (Agyei-Boapeah et al., 2020). Various methods modeled customer satisfaction in microfinance (such as Lamrani Alaoui & Tkouat, 2019; Agyei-Boapeah et al., 2020; Pramono, Sihombing & Lemy, 2019). However, to the best of the researcher's knowledge, not a single study has been conducted to examine the effectiveness of Islamic microfinance (IMF) institutions through customer satisfaction in the context of Pakistan.

Pakistan is one of the most promising markets for IMF, with nearly 98 percent of the 180 million population being Muslim and a strong cultural focus on a just economic system (Haider, 2012). The 2000s saw the establishment of the first IMF institutions in the country in Akhuwat and Naymet Trust. Embedded within these organizations has been the development of unique public-private joint ventures in the provisioning of IMF to the needy segments that have thrust the industry into the spotlight of equitable financial inclusion. While the IMF's reach has increased considerably over the past few years, the provision of Shariah-compliant products is still in its early stage in Pakistan and globally (Khadija, Kamaluddin & Salin, 2015).

### **1.1. Problem Statement**

The primary source of the IMF fund is charity. Allah said in the Quran – "And worship

Allah and associate naught with Him, and show kindness to parents, and the kindred, and orphans, and to needy, and to the neighbor who is a kinsman and the neighbor who is a stranger, and the companion by your side, and the wayfarer, and those whom your right hands possess. Surely Allah loves not the arrogant and the boastful (Ch 4:36)." It means that providing much-needed finance to micro-entrepreneurs can gradually help them to become successful. According to an estimate, about 1.2 billion (35 percent) of the world's Muslims are poor. Hence IMF creates a massive market for micro-financing. Still, there are very few Islamic banks and IMF institutions that are focusing on microfinance. This study attempts to explore the determinants of microcredit program effectiveness through customer satisfaction within Pakistan. The study examines the IMF system and sees how the SMEs sector considers the effectiveness of the IMF system in Pakistan.

### **1.2. Research Questions**

1. TO examine the association between the microcredit customer's income and their satisfaction level?
2. TO observe the link between the microcredit customer's standard of living and their satisfaction level?
3. TO examine the association between the cost of loans and microcredit customers' satisfaction levels?
4. TO observe the link between the loan repayment policy and microcredit customers' satisfaction levels?
5. TO examine the association between the Shariah compliance and the microcredit customer's satisfaction level?
6. TO observe the link between the loan-using opportunities and the microcredit customer's satisfaction level?

## **2. LITERATURE REVIEW**

Earlier studies established that conventional microfinance has been unsuccessful to accomplish its goal efficaciously (Ahmed, 2002) and cannot meet the requirements of the deprived (Khan, 2008; Barr, 2004). IMF institutions work based on principles of Islam and are involved in the halal project. Still, such types of these projects must be charitable or help the country's economic development (Kollontai, 2008). The IMF can meet the financial needs of poor people and associate Islamic principles with the power of microfinance to meet the demands of poor people (Wilson, 2007). The IMF is the

alternative to conventional microfinance that aims to provide the products following Islamic law teachings (Rahman, 2007). The IMF is sometimes known as "Shariah-compliant finance." It differs from conventional finance because it adheres to certain principles agreed upon by the Muslim community (Sadr, 2014). Also, Islamic finance requires that the risk of the transaction should be shared by all parties (Khoirul, 2010).

Initially, many studies analyzed the growth of microfinance by developing repayment of loans and proxy measures of outreach. The basis of this postulation stood that if the number of borrowers upsurges and the borrowers repay the loans, it is an indication that the microfinance sector is performing well (Khandker, 1999). Many used this approach, but there are some limitations, that is, the breadth of outreach is the only component to analyzing the sector's scope, financial health, and worth (Schreiner, 2002). Wambugu and

Through his paper, Khan (2008) examined the theories, policies, and practices utilized in the IMF system. He proposed a pragmatic course of actions and strategies through which IMF programs can be devised. It also highlighted various financial services and techniques which adhere to Shariah rules including the profit-loss-sharing mechanism. Obaidullah and Khan (2008), through their study, point out that a hybrid approach is required to eradicate poverty by utilizing IMF as different poverty levels and cultures exist in other Islamic Development Bank-member countries.

Saqib et al. (2015) concluded that the IMF is the only hope for the poor to resolve economic and social problems. He conducted the case study of Akhuwat and found out that 380,000 families are taking the facility of Qard e Hasan, the product of IMF.

The research by McIntosh, Villaran, and Wydick (2011) discussed microfinance's impact on the improvement in the lifestyle of borrowers. They argued that access to microfinance could help to improve people's living standards. Moreover, Akhter, Akhtar, and Jaffri (2009) have also recognized Islamic microfinance as a significant element in strategies for poverty alleviation. This study commences with a situation training of Akhuwat which is an IMF group in Pakistan. The in-deep analysis of Akhuwat has revealed that it provides facilities for altogether public living lower the poverty line. The

case study has also indicated that interest-free loans can be a powerful tool for eradicating poverty. The study has also recommended that the integration of the IMF with NGOs, NPOs, Zakat, Awqaf, and Takaful should take place to provide complete financial services to the poorer people. It will ultimately facilitate uplifting the people's living standards, hence contributing to its economic development and prosperity.

Saleemullah (2010) described IMF as an essential instrument to assist poor and under-resourced segments of the society by providing financial assets to start their business ventures and hence creating opportunities for self-employment and development. The research concluded that the IMF is not being utilized to achieve its ultimate goal of eradicating poverty; instead, borrowers take loans to expand their business operations and achieve their targets, increasing the cost of borrowing (Saleemullah, 2010).

The idea of the IMF initiative concerning Ibn Khaldun's concept of social solidarity was presented by Wajdi Dusuki (2008). It highlights the loyalty and group efforts in comparison with the self-interest of individuals. According to him, the IMF is based on cooperation. Hence, the group lending technique can be promoted in different sections of society. The benefit can be given to the poor who are deprived of other banking services (Wajdi Dusuki, 2008).

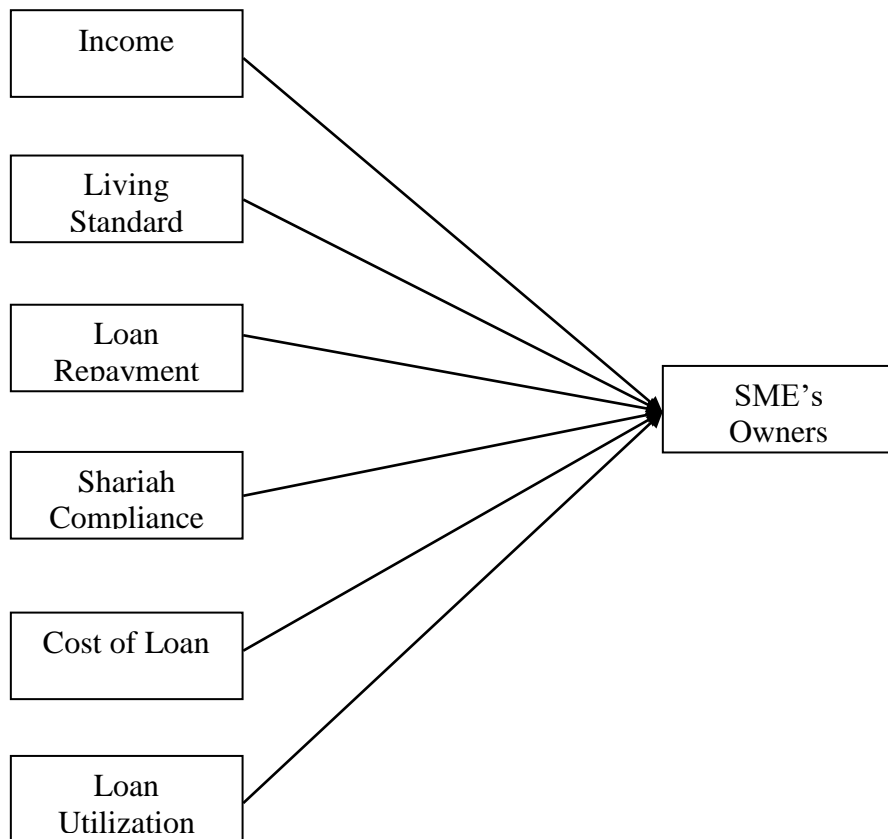
Although several researches investigated the corporate enlargement facilities to the small and medium enterprises (SMEs) satisfaction, there is a need to understand and develop a model to examine the effect of corporate development services on the SMEs' satisfaction in the literature (Mahmood, 2011; Ellahi, Bukhari & Naeem, 2010). In general, the satisfaction with the business development services from the SME's owners' perspective offered by the Islamic banking and finance system and, in particular, from the IMF institutions still requires more and more research to be conducted. Since the main objective of IMF institutions is to provide financial services to the needy or small and medium enterprises on easy payback installments and also as SMEs are the prominent source for the economic development which is responsible for poverty reduction and paving the way for new jobs as it constitutes the majority of the employment and contributes in GDP. It indicates the vital role of SMEs within the economy of Pakistan

(Durrani et al., 2011).

### 2.1. Hypothesis development

- H<sub>1</sub>:** *Microcredit customers' income has a significant association with their satisfaction level.*
- H<sub>2</sub>:** *Microcredit customers' standard of living has a positive relationship with their satisfaction level.*
- H<sub>3</sub>:** *Cost of loans has a positive and significant impact on the microcredit customers' satisfaction levels.*
- H<sub>4</sub>:** *loan repayment policy has a significant impact on the microcredit customers' satisfaction levels.*
- H<sub>5</sub>:** *Shariah compliance has an affirmative and significant association with the microcredit customer's satisfaction level.*
- H<sub>6</sub>:** *loan-using opportunities significant impact on the microcredit customer's satisfaction level.*

### 2.2. Conceptual Framework



### 3. RESEARCH METHODOLOGY

This study employed a quantitative research strategy. The population for the research is the SME owners who had taken the microcredit facility from the IMF institutions of Pakistan. According to Pakistan Microfinance Network, a total of 19 IMF institutions are providing microfinance facilities within Pakistan. The data is collected from the 88 SME owners located near Lahore (Punjab), Pakistan. The independent variables are the cost of the loan, income and living standard, loan repayment policy, Shariah compliance, and loan utilizing opportunities. The dependent variable is microcredit customer satisfaction examined through a 5-point Likert scale questionnaire. Regression analysis is applied and found that income, loan repayment policy, loan utilization opportunities, loan cost, and Shariah compliance.

**Table 1. Selected Islamic Microfinance Institutions**

1.	Institution
2.	Akhwat
3.	Farz
4.	Esaar Foundation
5.	Muslim Aid
6.	Islamic Relief
7.	Wasil Foundation
8.	National Rural Development Program (NRDP)
9.	The NGO World Foundation
10.	Naymet Trust
11.	Kashf Foundation

$$LS = \alpha + \beta_1(In) + \beta_2(SL) + \beta_3(LRP) + \beta_4(LUO) + \beta_5(LC) + \beta_6(SC) + \varepsilon$$

Where,

*LS* = Level of Satisfaction

*In* = Income

*SL* = Standard of Living

*LRP* = Loan Repayment Policy

*LUO* = Loan Utilization Opportunities

*LC* = Cost of Loan

*SC* = Shariah Compliance

$\beta_i$  = Coefficients

$\varepsilon$  = Error Term

## 4. RESULTS AND ANALYSIS

<b>Table 2: Summary Statistics</b>					
	<b>N</b>	<b>Mean</b>	<b>Std. Deviation</b>	<b>Skewness</b>	<b>Kurtosis</b>
Income	88	3.2542	.75021	.752	3.244
Living Standard	88	3.1557	.75260	-1.086	2.122
Loan Cost	88	3.1761	.57380	-1.268	3.408
Loan Repayment Policy	88	3.2988	.65517	.026	2.253
Loan Utilization Opportunities	88	2.9350	.87239	.328	3.120
Shariah Compliance	88	3.2570	.55234	.377	2.180
Level of Satisfaction	88	3.4631	.48325	.421	2.894

<b>Table 3: Reliability Analysis of Constructs</b>		
<b>Variables</b>	<b>No. of Items</b>	<b>Cronbach Alpha Value</b>
Satisfaction Level	04	.608
Income	03	.712
Standard of Living	05	.731
Shariah Compliance	03	.748
Loan Repayment Policy	03	.751
Cost of Loan	04	.688
Loan Utilization Opportunities	03	.731
Overall	25	.812

### 4.1. Regression Model

The  $R^2$ , the coefficient of determination, shows variability in the outcome variable explained by the variability in explanatory variables. This value tells us how satisfaction levels regarding the effectiveness of microcredit programs being offered by the IMF institutes can be presented by Income, Standard of Living, Loan Repayment Policy, Loan Utilization Opportunities, Loan Cost, and Shariah Compliance. The  $R^2$  value of 0.132 implies that the variations in the independent variables explain 13.2% of the variations in the satisfaction level. Table 4 shows the results of ANOVA, the value of F is 8.15, which is greater than 3.5, and the p-value is 0.00 which is less than 0.05 at the 95% level of confidence, which shows that our model is statistically fit. The regression equation will be as given:

**Table 4: Regression Coefficients**

Model	Standardized Coefficients	t	Sig.
(Constant)	2.774	6.003	.000
Income	.209	2.348	.021
Living Standard	.149	1.481	.142
Loan Cost	-.038	-3.363	.011
Loan Repayment Policy	-.040	-2.409	.013
Loan Utilization Opportunities	.167	2.208	.030
Shariah Compliance	.174	4.646	.006
R Square = 0.132			
Adjusted R Square = 0.068			
F statistics = 8.15			
F statistics (Sig.) = 0.000			

The above regression equation shows that if  $\beta_1 = 0.209$  and a 1-unit increase in the value of Income (In), then the effectiveness (or satisfaction level) of Islamic microfinance institutions' microcredit programs will be increased by 0.209 units. Similarly, living standard (LS), loan utilization opportunities (LUO), and Shariah compliance (SC) have  $\beta_2 = 0.149$ ,  $\beta_5 = 0.167$ ,  $\beta_6 = 0.174$  respectively if a 1-unit increase in the value of the living standard (LS), loan utilization opportunities (LUO), and Shariah compliance (SC) then effectiveness (or satisfaction level) of Islamic microfinance institutions microcredit programs will be increased by 0.149, 0.167 and 0.174 respectively. On the contrary, loan cost (LC) and loan repayment policy (LRP) has  $\beta_3 = -0.038$  and  $\beta_4 = -0.040$  respectively if a 1-unit increase in the value of loan cost (LC) and loan repayment policy (LRP) then the effectiveness (or satisfaction level) of Islamic microfinance institutions microcredit programs will be decreased by -0.038 and -0.040 respectively.

Furthermore, this shows that five independent variables, namely Income, Loan Repayment Policy, Loan Utilization Opportunities, Loan Cost, and Shariah Compliance, have a p-value less than 0.05. So these five variables have a significant relationship with the dependent variable effectiveness of Islamic microfinance institutions' microcredit programs in Pakistan. So our five alternate hypotheses  $H_1$ ,  $H_8$ ,  $H_4$ ,  $H_5$ , and  $H_6$ , are accepted by rejecting their respective null hypothesis ( $H_0$ ). The remaining independent variables,

the standard of living, have a p-value of more than 0.05, meaning that it has no significant relationship with the dependent variable effectiveness of IMF institution's microcredit programs. Hence the Null hypothesis ( $H_0$ ) of the independent variable – the standard of living is accepted by rejecting their alternate hypothesis ( $H_2$ ).

Prior research works found the same results in developing country. This study also found similar findings regarding the income variable found to be positively correlated and statistically significant. However, the standard of living is found to be insignificant in this study which is contrary to the earlier work of Doeringer (1980) and Ahsan Ullah and Routray (2007), who observed that the living standard of the rural poor would only be uplifted when the income received from the economic activities of micro-entrepreneurship could be augmented. Kingsbury (2007) also observed that the cost of credit and loan repayment policy are other significant factors and are interrelated to evaluating the effectiveness of microcredit organizations. This study also shows similar and consistent results.

## 5. CONCLUSION

The Islamic banking and finance system's main principle is to support the needy and poor through a microfinance system. Customers are considered to be a vital factor for organizations to achieve success. If customers are satisfied, there is more likely to be a chance that they are loyal to their service providers. The ultimate goal of an institution is to satisfy the needs of its customers and meet their expectations to sustain its business. The study concluded that Income, Loan Repayment Policy, Loan Utilization Opportunities, Loan Cost, and Shariah Compliance have a p-value less than 0.05, thus having a significant relationship with the dependent variable, the effectiveness of IMF institution's microcredit programs in Pakistan. The IMF is a relatively new experience in Pakistan that the industry stakeholders have overlooked until recently.

Notwithstanding the enormous probability of the IMF, it has also become an approximately serious challenge on operational grounds. Simultaneously, it has some opportunities to be availed for more growth and outreach in IMF programs. The IMF industry has opportunities for growth and development with enhanced outreach in the

existing and potential operating areas, but these opportunities are subject to institutional adaptability. The possibilities for IMF institutions are to liaise with the International IMF network for an effective interface and Coordination with other IMF institutions and expansion of market where the conventional microfinance institutions face limitations, especially in Muslim majority countries. To make the safety nets of microfinance institutions to be helpful for the rural poor, the variables identified in the earlier discussion should be reconsidered by the existing microfinance institutes. Otherwise, the poverty level would persist rather than come down, and alternative measures should be in consideration to reduce poverty from its root level in society.

In terms of alternative measurement, the prospects of Islamic microfinance institutions are proposed to be potential in the present socio-cultural, religious, and people's psychological background of many Muslim countries, including Pakistan. Lastly, the extent of this study is limited to the sample of selected Islamic microfinance offering institutions geographically located in Lahore based on convenience sampling. Future studies may be expanded to a large number of samples with a broader geographical scope. Some other dimensions of Shariah Based compliance may be included, keeping in view the social welfare setup of Pakistan.

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