Blekinge Institute of Technology, Ronneby

Islamic Microfinance

"Monitoring of Profit and Loss Sharing Loans"

Case Study of Bank Islami, Pakistan.

Supervisor:

Henrik Sallberg.

Authors:

Muhammad Mohsin Saeed (840424-5832).

Tanzeel Ur Rehman (820320-P515).

Muhammad Qasim (830131-5498).

Master Thesis in Business Administration, 15 ECTS.

Abstract

Title: Monitoring in Profit and Loss Sharing Model of Islamic Microfinance

Subject: Master Thesis in Business Administration (15 ECTS)

Authors: Muhammad Mohsin Saeed.

Tanzeel Ur Rehman.

Muhammad Qasim.

Supervisor: Henrik Sallberg

Key Words: Islamic finance, Mudarabah, Monitoring, Profit and Loss sharing system of Islamic microfinance.

Islamic finance is entering into a new pattern. It is deemed that Islamic finance should take initiative to meet the increasing needs of microfinance with aim of alleviating poverty and to help the poor people in their distress.

Concept of Islamic Microfinance is being used to fulfill the demands of microfinance in the developing countries. Different models of Islamic finance are proposed to be used in microfinance activities to help the poor people for betterment of their personal life and to initiate the small business for the overall growth of the economy. But profit and loss sharing (Mudarabah) model is being criticized due to high risk involvement. Due to high risk factor, proper monitoring is deemed necessary for the smooth running of the contract. Our current research tends to investigate the underlying risk attached with Profit and Loss sharing project. As per theory of Profit and loss sharing financing all the risk is to be borne by the investor of the capital i.e. microfinance institution. But monitoring itself is not risk free and can result in expenses that would surpass the original price of the sanctioned loan.

Case study of Bank Islami reveals significant results in finding answers to our research question. We have tried best to find out a better solution to address the issue of monitoring in Islamic microfinance. In the long run and at very end, we are hopeful that our research findings would play an important role to overcome the issue of monitoring in profit and loss sharing loans in microfinance.

Acknowledgement

Successful completion of our study was a time bound task. This is a result of team effort and moreover due to the continuous guidance, help and support from our colleagues, seniors and supervisor. Above all, blessings of ***ALLAH ALMIGHTY*** *are always with us as a source of courage, enthusiasm and motivation.*

We are very thankful to ***Dr. Anders Nilsson*** *for his wise suggestions and effective guidance in selection of topic for this study. And Special Thanks to our supervisor* ***Henrik Sallberg*** *for his continuous help and support through the whole period of our research.*

We would also like to pay my sincere compliments in favor of our interviewee respondents and to Customer Services Executive of Bank Islami Peco Road, Lahore bracnch, ***Mr. Adnan Khalil*** *for providing us fruitful information. We are grateful to* ***Mr. Bilal Munawar*** *(Head of Bank Islami, Lahore Division) for his special interest in our topic. In addition we could never forget the efforts and precious time of* ***CH WAQAS of*** *Bank Islami, Walton Road Branch, Lahore.*

Nevertheless, we are indebted to our friends for cheering us up whenever we are tired and for their continuous cooperation throughout the whole study period.

Muhammad Mohsin Saeed

Muhammad Qasim

Tanzeel Ur Rehman

Dec 11, 2009

Blekinge Tekniska Hogskolan

Table of Contents

List of Tables

List of Figures

Chapter 1: Introduction

This chapter provides us the overview of our research topic. It is divided into 4 parts including background of microfinance, problem discussion and end up with the purpose of our study.

1.1. Background

Before the spread of microfinance and development of microfinance institutions, commercial banks were deemed to be a formal source of loan. But the problem faced by poor people in getting loan from commercial banks was that they were not able to fulfill collateral or security requirement. Sometimes lack of creditworthiness was regarded as the main problem for sanctioning loans to the poor. Hence poor people in the underdeveloped countries were dependent on the mercy of the fuderal landlords and private money lenders. Those landlords often charge much higher interest rates thank banks do and loans were granted on complicated terms and conditions. The aforesaid reasons opened a new paradigm for microfinance initiatives as a desirable alternative source for the poor people to borrow money on favorable terms such as without need of collateral. (Barr, 2005) Further micro finance is being needed due to its increasing demand and ample importance worldwide (Sengupta and Aubuchon 2008).

1.1.2. Defining Microfinance

According to Michael S. Barr, "Microfinance is a form of financial development that is primarily focused on alleviating poverty through providing financial services to the poor". Most people think of microfinance, if at all, as being about microcredit, lending small amounts of money to the poor. Microfinance is that, but it is also broader concept including insurance, transactional services, and importantly, savings". The primary objective of microfinance is poverty alleviation that in the long run leads to financial development. *Microcredit* is a tool of microfinance to provide small sum of loan to poor people and small households. Such initiatives have been started since 1970 by Grameen bank founded under the supervision of Mohammad Younas and has been continuously supported by government officials of the developed countries like President Clinton.

Micro financing implies providing small credit facility to the poor in order to encourage them to start a business activity and to play their role in the development of their country. In the long run, provision of microfinance grants a viable source of financing to the poor to increase their social well being through increase in income level (Dixen, Ritchie and Siwale, 2006).

1.2. Problem Discussion

Developing countries are facing a number of economic and social issues related to increasing poverty, low growth rate and globalization. There is a huge increase in the facilitating finance to the poor people for reduction of poverty and by providing microfinance to the small and medium enterprises. In spite of these efforts yet the required results are not fully achieved (Dusuki, 2008). Conventional banks and financial institutions are a viable source for microfinance to the poor. Although these banks are regarded as a primary source for getting loan yet there are number of inherent problems that resist conventional banks from issuing loans. As central bank of a country impose restrictions on the credit creation limit to these banks (Hasan, 2008). Further, conventional banks normally charge higher interest on their financed money because it is a source of profitability for them (Ibrahim, 2006 and Dusuki, 2008).

Evidence shows that conventional microfinance institutions do not fulfill the demand for the microfinance. Nepotism and influence of the rich people grant them access to a large percentage of available finance. Hence shortage of resources leaves only a small fraction of microfinance available to the poor people and small entrepreneurs (Akhtar, 1997). Moreover, even if poor people are successful in getting micro finance it is still often hard for them to pay the required interest on the principle amount. Above all, poor people are reluctant to go to these conventional banks for taking loans because they are afraid of providing the collateral security requirements to the banks (Ahmed 2002).

The failure of the formal ways of credit creation leads the financial institutions to introduce a new group based lending system. Under this form of microfinance, every member of the group guarantees the repayment of the loan for all members. Although group based lending scheme[1] is beneficial for the commercial banks it has limited benefits to the poor people since the interest charged is higher than normal bank rate and leads to less profitability of the enterprise in the long run. According to Akhtar (1997), group based lending was opposed by both the concerned parties. Because borrower of the money was concerned that how much they will be earning from a certain project after paying the principle amount and interest charged on it. On the contrary, lender of the finance was worried about repayment of loans and amount they would lose or recover in case of default is made from its borrower.

The conventional banking system depends upon charging interest on the principle amount on the basis of the time period for which the loan has been taken. But even a small fraction of interest is not allowed in Islam. This notion proposed an ample opportunity for the Islamic banks to offer

[1]Grameen bank managed by noble prize winner Dr. Muhammad Younas is a viable example of group based lending (Ahmed, 2002). Under this method, loan is issued to a group of people who are willing to start small business.

interest free financial services especially in those areas where Muslims represents major inhabitants of a community (Taib, Ramayah and Razak, 2008). The above stated problems of conventional modes of financing opens a new horizon for the Islamic banking and provides a solid framework for Islamic way of microfinance that is based upon profit and loss sharing financing and partnership financing.

Akhtar (1997) argues that “partnership financing scheme provides compatible incentives to the banks and borrowers, whereby both the parties are agreed to share the actual profit and loss in a proportion on predetermined basis”. Partnership financing is equity based contribution where both the parties i.e. lender and borrower invests money and profit is being shared according to ratio of investment.

According to Ahmed (2002), “While conventional microfinance institutions (MFIs) have expanded their operations in the last two decades, poverty-focused MFIs based on Islamic finance are lagging behind”. Segardo (2005) argues, “Islamic financial institutions will find niches, although hybrid approaches, such as microfinance, which applies classical Islamic values using at the same time conventional lending practices”.

The conventional banks and financial institutions alone cannot meet the increasing requirement of loan and microfinance due to increase in population and poverty in the most developing countries. This notion leaves room for Islamic microfinance to capture the opportunities of that segment of the population which has not yet been able to get financial assistance. Further, the salient feature of the profit and loss system allows Islamic banks to lend money even to the volatile projects with greater risk-return. A distinguishing objective of the Islamic banking is the profit and loss sharing system rather than relying on the fixed rate of return in form of interest on the deposited money (Chong and Liu, 2008).

Since there are only few studies that have been made on Islamic way of microfinance thus Ferro (2005) argues that “Islamic finance, if inserted in a new paradigm, could be a viable alternative to the socio – economic crisis lived by the Western paradigm”. According to him, primary tools of Islamic finance, Profit and Loss Sharing, Partnership financing and cost plus mark up can be fit under the ambit of microfinance.

1.3. Problem Statement

To introduce microfinance under ambit if Islamic banking is not risk free. Profit and Loss Sharing is a primary Islamic means of microfinance but it provides partial control rights to its investor because in case of failure of the project, all the loss is borne by the owner of the capital. The lack of management and control right imbalances the governance system of the profit and Loss sharing (Dar and Presley, 2000). Likewise, partnership mode of Islamic microfinance is criticized for the distribution problems (Choudhury, 2001). Our study tends to capture the risk taking behavior of the borrowers of Micro finance. We will focus on the risk taking behavior of Islamic finance because there is an increasing need of proper monitoring in case of Islamic microfinance.

We will stick our study to the profit and loss sharing financing model of Islamic microfinance. As we have come to know from the theory of profit and loss sharing financing, that in case of loss all the loss has to be borne by the lender of the capital i.e. microfinance institution. Under such situation, it is very critical for Islamic microfinance institutions to monitor the attitude of their borrowers in order to ensure the proper and timely repayment of issued loan. Repayment of the loan is important because it is a source of sustainability for Islamic microfinance institutions. These institutions have limited funds and shortage of resources so same resources are used to help a number of poor people. So till previous borrower's has not repaid the amount of taken loan it may become difficult for microfinance institution to issue loan to new borrowers. In this scenario, proper repayment is of ample importance. Further, repayment can be ensured only with the help of effective and efficient monitoring procedure.

1.3.1. Research Question

Based upon the above discussion, we have developed our research question as follows:

How should Islamic microfinance institutions monitor profit and loss sharing loans (Mudarabah)?

1.4. Purpose

The main purpose of our research is to study if and how profit and loss sharing loans are monitored by the lender. We have chosen the topic to discuss the issue of monitoring in Islamic microfinance on the basis of the risk taking behavior of its customers. Because under conventional microfinance, the borrower is always the risk taker while in Islamic Microfinance, Lender is the risk taker sometimes. Profit and Loss Sharing Model of Islamic finance is based on the same rule in which profit is being shared according to agreed ratio but loss is only borne by the supplier of the capital unless loss is incurred due to misconduct, negligence, or violation for the conditions mutually agreed by both parties (Jobst 2007).

A key objective of our research is to analyze what is an effective monitoring policy for microfinance institutions. Monitoring can be beneficial in reducing loss and to reduce the risk of default borrowers in profit and loss sharing finance.

Chapter 2: Islamic Microfinance Models

Starting from the evolution of microfinance and brief background of Islamic microfinance this chapter further includes description Islamic microfinance models.

2.1. The Evolution of Microfinance

Microfinance is a young concept beginning in the 1950s, the urgency for need of social development led banks to introduce credit programs to financially support particular communities. The boom of Microfinance started after World War II because a number of countries were struggling and facing increased poverty. The popularity of microfinance begun in the late 1980s when so called microcredit program used. This program changed the conventional thinking that the poor people are not able to return the borrowed money within the scheduled time. Because evidence showed that poor people who were provided microfinance loan, not only they returned the original borrowed money also paid interest rates as well (Segardo, 2005).

Microfinance has been prospered during last two decades. This is because a number of financial institutions have come up with the aim of providing microfinance to the poor in the developing countries. The rise of the microfinance concept enables poor entrepreneurs to initiate their own business and expand the circle of their economic activities. Availability of small loans in the form of microfinance gives birth to the small enterprises which in turn generates employment for the poor people, increases the efficiency of their work and leads to the greater productivity (Akhtar, 1997).

2.2. Islamic Microfinance

2.2.1. Defining Islamic Finance

Islamic Finance has been construed as an alternative to conventional Finance. It allocates the resources in the direction of projects approved by the Islamic Law using Islamic financing instruments. Contrary to modern financing, the concept of Islamic financing differs on the basis of main Islamic rule which strictly prohibits interest. Islam does not take money as a commodity and hence it cannot be used to earn any profit or any extra surcharge imposed on it (Siddiqui, 1983, Taib, Ramayah and Razak, 2008). This means the money itself cannot be used to earn profit in the form of interest on the given amount. This is not allowed in Islamic law because if we provide loan to someone in form of money and then we charge profit or extra surcharge on it, this will be treated as interest which is not allowed at all.

The salient feature of the profit and loss sharing system allows Islamic financial institutions to lend money for a long term basis to volatile projects with greater risk-return profiles and hence leads to economic growth. A distinguishing objective of Islamic banking is the profit and loss sharing system rather than relying on the fixed rate of return in form of interest on the deposited money. A basic difference is due to the fact because charging of interest is not allowed hence Islamic banks invests the deposited money in some business and then profit and loss derived from that business is shared between the concerned parties according to agreed ratio. In such situation, it is necessary for both parties to work sincerely to earn more profit which is necessary for their mutual benefit.

2.2.2. Purpose of Islamic Finance

Conventional mode of development and production encompasses three basic objective, these are economic freedom and self-interest, maximization of profit, and supremacy of market forces. On the contrary, Islamic financial institutions which are working under the Islamic law need to fulfill social responsibilities that go against the western world view of maximization of wealth in form of profit (Ibrahim 2006, Dusuki, 2008). This is because Islamic financial institutions have to depend on legal sources of profitability which are allowed under Islamic law like equity based participation and profit and loss sharing models of Islamic Finance.

Islamic principles of finance encompasses two basic motives, first is the interest-free financing instruments in the private sector. Second is the development of financing instruments based upon Profit and Loss sharing and partnership participation. Akhtar (1997) argues "partnership financing scheme provides compatible incentives to the banks and borrowers, whereby both the parties are agreed to share the actual profit and loss in a proportion on predetermined basis". Partnership based financing is based upon equity contribution and provides benefits to the banks and borrowers because both the parties pursue the opportunities and puts their efforts to get maximum benefit from this transaction in the favor of their enterprises.

2.2.3. Microfinance under Islamic Finance

According to Ferro (2005), "despite theoretical, historical and practical differences, analogies can be found between microfinance and Islamic banking. It is important to notice, however, that Islamic finance represents a solid reality, compared to microfinance, for volumes and level of originality, having become firmly established as a significant force in the global Economy".

First similarity is that both forms of financing focus on helping the poor and capital is provided to the small investors for the establishment of their business ventures. Second similarity is that both the methods aim to provide financing means to the poor people without any discrimination. Third similarity is that while Islamic finance bases upon religious principles that focus on the achievement of social goals and development, likewise goal of microfinance is also the social development through helping the poor people and small investors (Ahmed, 2007).

Since there are only a few studies that have been made on Islamic way of microfinance thus Ferro (2005) argues that "Islamic finance, if inserted in a new paradigm, could be a viable alternative to the socio – economic crisis lived by the Western paradigm". According to him, primary tools of Islamic finance like Profit and Loss Sharing, Equity Participation and Resale Contract can be fit under the ambit of microfinance. Because these instruments contains perceived values like profit and loss sharing, equity based participation that is beneficial for both the parties and both parties puts their efforts for the smooth running of the project in their own interest (Akhtar, 1997).

2.3. Models of Islamic Microfinance

In conventional Microfinance, repayment is usually made soon after the loan is sanctioned and disbursed. Repayment also includes a necessary interest payment that is levied on the original amount of the loan.

While in Islamic microfinance, where interest is strongly prohibited this might not be the case. Islamic microfinance use different instruments and repayment of microfinance differs under each of the Islamic Microfinance instrument. The following are the primary financing instruments used for the Islamic Microfinance initiative (Khan and BenDjilali, Metwally 1997, Wilson 2007):

2.3.1. Profit and Loss sharing Financing

This is a mutual agreement between the supplier of the capital and the entrepreneur, who are agreed to undertake a specific business project. In which one party is providing his capital in form of money and other party puts his efforts and knowledge to run the project. Both the parties are agreed to the profit sharing on a pre determined basis. But in case of loss, it is beard only by the supplier of the capital i.e. bank unless loss is incurred due to misconduct, negligence, or violation for the conditions mutually agreed by both parties (Jobst 2007).

According to Akhtar 1997, "Profit and Loss form of financing is quite suitable for professionals, artisans, and entrepreneurs who have innovative ideas/plans but cannot implement them due to the shortage of financing".

2.3.2. Partnership Financing

This concept is similar to business partnership or joint venture with little difference that the profits earned from a project are shared on the basis of agreed ratio but in case of loss, it is borne by the both parties on the basis of equity participation.

According to Akhtar 1997, following are distinguishing features of Equity Participation mode of financing.

A specific proportion of profitability should be granted to client as the "management fee". The remaining profit is to be distributed between the bank and the borrower i.e. client on the basis of funds invested by both the parties. The loss is also shared both by the bank and the client in respective of the nature of their contribution toward capital formulation. Profit and loss sharing ratio is pre determined and thereafter cannot be changed. It can be either continuous partnership or diminishing partnership for a certain period of time for instance for 12 months. Then after passing the time frame of partnership, the share of the bank ends through repayment of the agreed price and the whole project goes within the vicinity and control of the client.

Akhtar 1997 further suggest some measures that should be taken in order to ensure the proper practice of the partnership contract, these conditions are described hereunder.

A separate bank account should be maintained for the joint venture. Project material should be kept in safe custody and withdrawals made on agreed basis to use it efficiently. Material purchased for the contract should be supported by invoices and bills and this should be limited to the quantities and types mentioned in the contract. The client is required to submit period reports showing detailed results of the operations. Sales revenues should be deposited in the venture specific bank account regularly and detail for such revenues should be properly recorded in the sales book i.e. books of accounts. Above all, client should give adherence to the dates specified for the initiation and liquidation of the project.

2.3.3. Resale Contract Financing

Under this contract, the supplier of the capital purchases an asset on the request of the borrower and resale it to him on cost plus profit basis. Logic behind this resale contract is that Islam prohibits charging interest on the money but Islamic law doesn´t prohibits profit earning on the original cost. According to Jobst 2007, it involves following:

A sale-repurchase agreement for the borrowers requested asset. The lender purchases a tangible asset from a third party on the behalf of the borrower. Under this method, the resale price is based on the original price of the asset and the pre specified profit charged by the lender on the underlying asset.

Abdul Rahim 2007 suggests some other Islamic financial contracts that can be used as Islamic microfinance instruments.

2.3.4. Leasing

It is a type of operational lease that involves property or purchase of any equipment. This can be used as a tool for micro finance for home financing to the poor people and for helping in purchase of required equipment by the needy small low income entrepreneur.

According to Jobst 2007, Under leasing model, Islamic Financial Institution provides credit in return for rental profits for the time period of use of asset by the borrower and after the certain period when the agreed price of the property is paid in full then ownership can be transferred to the borrower. Here the lender of money, i.e. capital provider buys a requested asset and rent (leases) it to the borrower for an agreed price rental payable in installments according to an agreed schedule. The ownership of the asset remains with the capital provider till the duration of the transaction period ends.

Hence costs linked with the ownership have to be borne by the lender and costs incurred for the use of the assets have to be defrayed by the borrower. If the underlying transaction is a financing lease then rental lease payments also includes installment of the agreed resale price. This grants the borrower to get the equity ownership of the asset on the basis of the pre determined sale price (Call Option). If the borrower of the asset does not exercises the call option at maturity, the lender has right to the disposal of the asset (Put option).

Chapter 3: Monitoring the Microfinance Loan

In this chapter, we will be discussing the increasing importance of monitoring in microfinance. Starting with the rationale for monitoring, we elaborate on different problems which may occur when monitoring a microfinance loan. We discuss monitoring strategies than can be used in order to safeguard against anticipated loss or risk or default from the borrower.

Finally, we illustrate the importance of monitoring in Islamic Microfinance. In particular focus on the issue of monitoring in Profit and loss sharing model of Islamic microfinance since this is our topic of interest..

3.1. The Importance of Monitoring

Monitoring of a loan is important for each microfinance institution (MFI). Hence it is important to maximize the repayment rate because this is a driver of profit and sustainability. If an MFI has a higher repayment ratio, this will grant the organization with opportunity to lower its interest rate on the loans which in turn decrease the financial cost of credit and thus in the long run enables many more borrowers to access the available credit. Another important benefit of high repayment is that such performance can support MFI to reduce its dependence on subsidies from the donors that will take the organization to a higher sustainability level. Another argument in favor of repayment comes in form of gaining new funds because then it becomes easy for MFI to call for further funds and increase the vicinity of its financial support services to the needy ones (Marie Godquin).

3.2. The Rationale for Monitoring

Monitoring in microfinance is necessary due to the following two reasons.

Firstly, if there is risk regarding repayment from any project and it is deemed that such a contract is not proving beneficial for the microfinance institution (MFI) then the MFI would have the opportunity to abandon this project to safeguard from the risk of fraud or default from the borrower.

The second reason is that the microfinance institutions (MFI) are primary found in the least developed areas of the world. When these organizations set up themselves for helping the needy one´s in some unknown area then there is either no or limited information available about new borrowers. Such information asymmetry increases the risk for adverse selection and moral hazard. Hence in such a situation, it becomes necessary for a microfinance institution to carefully monitor its contracts and would seize a contract if chances of default are found in it.

3.2.1. Information Asymmetry

According to Godquin, "Information Asymmetries arise when gaining information on the characteristics or on the behavior of the borrower is costly for the MFI". Although use of collateral or Security can be a safeguard against such problems. However, it should be noted that such a security option is difficult due to lower availability of pledged assets from borrowers and lack of legal validity in form of *guarantee*. A higher concern in this regard is adverse selection because mostly borrowers of microfinance are poor clients not capable of providing any such security requirement (Rodríguez-Meza, 2000).

3.2.2. Avoiding Adverse Selection

Adverse selection denotes those borrowers who are chosen with undesirable characteristics. This notion is common in microfinance because it is often hard to get the proper history of the borrower. Especially in case when the Microfinance institution has started operations in a new place or when there is a new borrower for whom there is no background history available related to his/her repayment behavior.

Hence, asymmetric information may also leads to problem of adverse selection because if the MFI is unable to collect exact and complete information about their borrowers. Then it must rely upon the available information and would choose borrowers with undesirable characteristics. These are the borrowers with high risk profile or those with inability to take appropriate benefit of the credit.

3.2.3. Avoiding Moral Hazard

Moral Hazard in general terms relates to the unexpected acts from the agent. This is a common issue that is widely used in literature especially in Principle Agent theory. In Microfinance, moral hazard is of ample importance because if the borrower acts in an unexpected manner than this will lower the morale of the supplier of the capital i.e. microfinance institution. In this scenario, such acts from borrower would lead to the serious problems that sometimes results in seizing or abandon the contracts. Hence MFI may have to bear the loss resulting from abandoning a certain project.

Provision of microfinance facility to adversely selected clients also generates the problems of Moral Hazard in which borrower behave in an unexpected manner. For example borrower immorally utilizes the loan and makes only little effort to repay the loan. Hence, adverse selection and moral hazard together increases the ratio of the default borrowers or those clients who do not repay their loans on scheduled time. To safeguard against such acts the bank can monitor the borrower. There are different strategies of monitoring valuable for microfinance institutions.

3.3. Monitoring Strategies

Monitoring Strategy is a framework to carefully follow up the issued loan. Different strategies has been designed which use different set of rules to find a solution to contract enforcement problems in microfinance. Most of these contracts use either one or several of the following characteristics (Rodríguez-Meza, 2000).

3.3.1. Flexible Collateral Requirement

For first time borrowers, standardized contracts with collateral requirements are further improved with new terms and condition. This is important so that with each new loan, borrowers would reveal their capacity and willingness to repay. A number of innovative form of security requirement are introduced and being used as collateral that rely on the value in use of the pledged asset rather than relying on its market value. Another important concern in this regard is the development of a long-term relationship between the provider of the capital and the borrower. Under such scenario, trust of the borrower grant him access to further loans but such trust is only built if borrower has a good repayment history.

3.3.2. Delegated Monitoring / Peer Pressure

In order to improve repayment rate and to get rid of problems faced by microfinance, MFI uses strategies of direct or delegated monitoring, peer pressure and overall reputation regarding risk bearing repayment behavior of the client. Recovery and Collection department of an MFI is responsible for such steps. This department is liable for repayment and forces the borrower to repay the taken loan on scheduled time. Group pressure method can be used by the department in which they pressurize the borrower if he has not repaid any installment on due time.

3.3.3. Joint Monitoring

Many authors believe that joint liable group loans can be a suitable source to reach desired results of microfinance. It is argued that such group loans grants the lender with an opportunity to get rid of adverse selection due to asymmetric information and safeguard problems of moral hazard (Giné et al, 2006).

Another notion in the favor of joint liable group contracts is due to the reason that under this contract as each member of group is responsible for all others because all the group members are denied for future loan if anyone of them makes default of become unable to repay his part. This is how such act of social interaction facilitates higher repayment rate (Giné et al, 2006). According to Marie Godquin, “The joint liability lending mechanism is considered to be financial innovations

(Edgcomb and Barton, 1998) that make it financially sustainable for microfinance to lend to the poor”.

In Spite of the fact that group loans are considered as a remedy to deal with risks of asymmetric information and problems of moral hazard. A number of microfinance practitioners are not fond of the group lending contract (Conning, 2005). Hence it is argued that “When the use of such mechanisms is insufficient for the MFI to reach a first best repayment rate and when borrowers are heterogeneous in their probability of default, the MFI should also allocate loans of different size to the borrowers so as to maximize the proportion of outstanding debts repaid on time. If there is observable heterogeneity in the repayment probability of borrowers for a given size of the loan, the MFI then allocate larger loans to the safer borrowers with high repayment history and lower probability of default” (Marie Godquin).

3.4. Option to Terminate the Contract

Another important option used by MFI´s in order to ensure and improve repayment performance is seizing of assets and termination of the contract in case of serious repayment problems occurs.

The execution of this option depends on the borrower´s long term relationship with the credit provider. A major shift in the borrower’s attitude is clear from the fact that if the borrower is granted a onetime loan and there is no hope for the borrower to get a loan in the future then there is greater chance of default by the borrower. Under such scenario, there is no more surety for the repayment to be made on scheduled time. This notion generates principal agent theory to model relationship among the borrower and lender of microfinance.

3.5. Monitoring in Islamic Microfinance

A microfinance repayment can be made differently, one alternative is continuous repayment. This means that initially a small amount of loan is granted to the borrower. After he has successfully returned this amount then a slightly higher amount of loan is sanctioned and so on. Another form of repayment is installments. This implies that the loan is sanctioned and granted in full and thereafter it is returned in small installments. Finally the loan can be supplied in small installments that should be paid back i.e. returned in full at a certain period of time.

It should be noted that there is a different sequence of repayment used in Islamic microfinance compared to conventional microfinance. Repayment thus differs on the basis of mode of transaction (models of Islamic microfinance). In order to ensure the successful repayment of issued loan, there is need of careful monitoring for each model of Islamic Microfinance. We here focus on one such model that is profit and loss sharing financing.

3.6. Monitoring of Profit and Loss Sharing Loans

Under a profit and loss sharing loan the supplier of capital can be either a private investor or a bank and profit is shared on a predetermined agreed basis. In case capital is financed through a bank, "the bank charges profit in the form of a floating-point profit rate that is attached to the debtor's profits" (Ghayad, 2008). However, loss is borne only by the provider of the capital i.e. bank only. This notion leads to confusion which is called agency problem in simple terms because borrower of the capital can put ahead his personal goals. When the borrower thinks that he is free from any liability because loss is only borne by the lender then he may not work sincerely. In fact borrower can place his personal goal put ahead of corporate goals and may make default in this scenario.

Also the lending party has partial right due to asymmetric information because principle or capital provider has limited or imperfect information. On the contrary, borrower of the money i.e. agent has exact and full information. Thus this tend raise to the concept of moral hazard for the lending party i.e. banks. Research in the field of Islamic finance has outlined the following five main factors that can reduce agency problem for Profit and Loss Sharing contracts (Rahim, 2007). These are business skill, business reputation, business commitment, financial report of the project, length of the project.

Islamic Microfinance is a new and relatively emerging concept. When Islamic Microfinance Institutions are entering new market and launching their initiatives in new place. At first hand they do not have exact and complete information regarding their new borrowers. This notion leads to the problems of asymmetric information and adverse selection. As IMFI has to rely on the available information about the customer so it is of utmost importance for newly developed IMFI to carefully monitor the sanctioned loan in order to ensure its repayment on scheduled date. If an IMFI is not carefully monitoring the issued loan then it can causes less repayment rate. As discussed earlier, less repayment rate subsequently causes sustainability problems for the IMFI.

Under profit and loss sharing model of Islamic microfinance, we can see that now monitoring is of ample importance from two respective points.

Firstly, when IMFI is a new entrant to a market, there is problem of adverse selection of borrowers because there is no knowledge about good and bad clients. Secondly, due to agency Problem in which all the loss is to be borne by the bank only.

3.6.1. An Agency Problem

Agency problem occurs when manager put their personal goals ahead of corporate goals (Gitman, 2001). This problem is common for profit and loss sharing loans in microfinance because the borrower of the money who is also an acting manager of the business is aware of the fact that in case of loss, all is to be borne by IMFI. Hence there is a greater chance of fraud or negligence by the default borrower. It is human instinct that when such flexibility is granted to him/her, one will tend to use it in personal interest. Likewise, under a profit and loss sharing loan, the borrower will tend to use the available benefits in personal use and hence may not perform according to the expectation of the IMFI. This notion often leads to problem of Moral Hazard and creates conflicts between both the concerned parties.

Hence monitoring the profit and loss sharing loans under Islamic Microfinance is an emerging problem which we will tend to answer in the later chapter.

3.7. Features of a Secured Loan

According to Saurina (2002), a secure loan encompasses following characteristics. These are as follows.

1- Collateral / Repayment
2- Maturity (Time Period)

3.7.1 Collateral / Repayment

A secure loan is protected by some sort of guarantee or security against the default, this is referred to a collateral requirement. Collateral is required in order to secure credit and to assure timely repayment of the sanctioned loan.

Following are the repayment options that are deemed to be available to a borrower of the credit.

3.7.1.1 Incremental Repayment

Under this method, a small amount of credit is sanctioned first and after it is successfully returned then a slightly higher amount is sanctioned to the borrower of the loan and after successful repayment of it another bigger amount would be available for use and so on.

This can be graphically represented as follows.

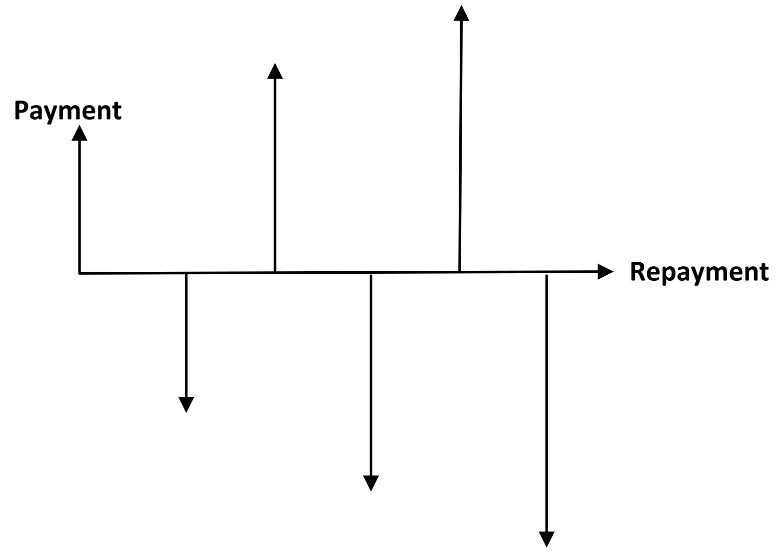


Figure 3. 1 Incremental Repayment

3.7.1.2 Installment Repayment

This is a type of Loan that can be returned in installments. After the loan is sanctioned, the original amount is paid in full to the borrower but repayment of this loan is made in installments. This type of credit provides confidence to MFI and self interest to the borrower as with each installment of repayment borrower gets a slightly higher installment of loan and so on.

Installment loan can be graphically presented as follows:

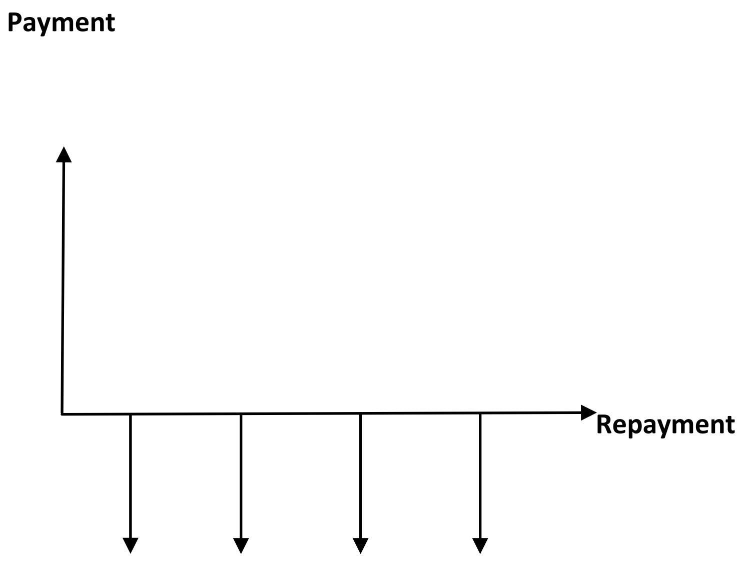


Figure 3. 2 Installment Repayment

3.7.1.3 Upfront Loan

This is a type of loan in which original amount is paid in installments and at the end of the time period it is returned in full. This type of credit is more risky than other two types due to inherited problem of default and should be managed carefully.

Pictorial Presentation of upfront loan is given below:

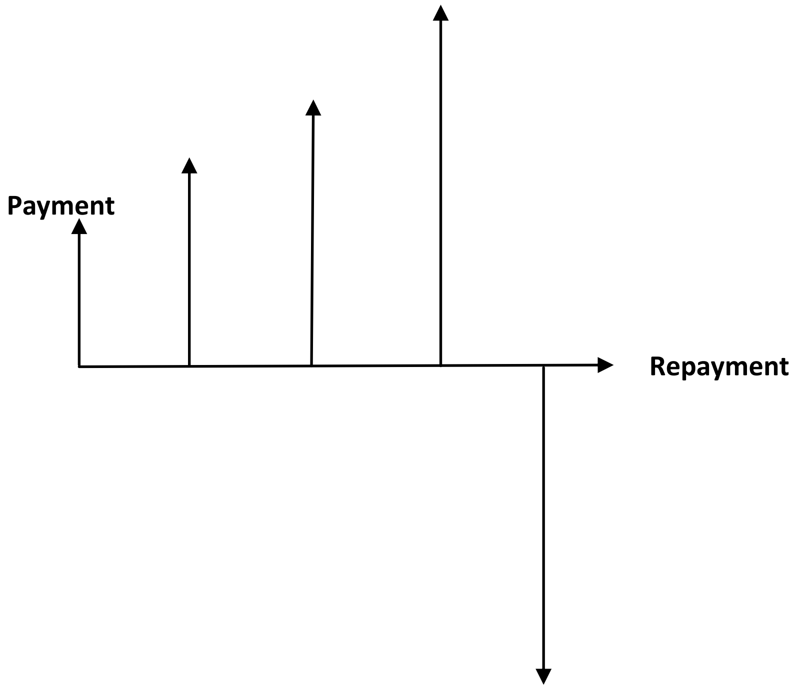


Figure 3. 3 Upfront Loan

In such a type of loan, as repayment is made once at the end of loan time and the loan is granted in installments. So there is an increasing chance of default which implies higher security risk for all the types of financial institutions and particularly for microfinance organizations. In such scenario there is increasing need for careful monitoring on such a type of loan so that borrower may not make default after getting many installments of loan and may not refuse to repay the loan at the end.

3.7.2. Maturity Time Period

Maturity time is of ample importance for a secured loan. For efficient use of a loan it is necessary that the loan is repaid back on scheduled time period.

Chapter 4: Research Method

In this chapter research methodology for pursuing our study will be discussed in detail through research design, research strategy and data collection will be explained. Moreover, validity, reliability and credibility in order to answer the research question and thus reveal valid results.

4.1. Conduction of Case Study

Different strategies are used to perform research. Good research is based upon having the right object at right place where strategies are chosen on the basis of suitability for research aspects. According to Paul and Eriksson (2001), there are three main research strategies that can be undertaken in order to find out solution to some underlying problem. These are experiments, surveys and case studies.

We have chosen the case study strategy for our research because such strategy is of ample importance in order to investigate the problem in detail. By studying the organization in depth with relation to our research question would reveal useful results and findings in the long run perspective (Zikmund, 1999).

Table 4. 1 Study choices: variable vs study objects

		Study Objects	
		Many Objects	Few Objects
Variables	Many Variables	Survey	Case Study
	Few Variables	Experiment	Survey/Experiment

Figure shows that case study technique is quite useful when we want to study many variables using few objects. We have shortage of time as our research task is time bound hence in order to study the underlying variables related to our study. In this scenario, we need to choose cast study method which is useful for finding answers in a quick and compact manner.

4.1.1. Arguments for case study

The goal of our case study is to acquire in-depth study of monitoring in the profit and loss sharing loan of Islamic finance. In this scenario case study is appropriate strategy to capture the experience of organization relevant to our research question. Yin 2003 pointed out that a case study investigates

a company, organization, entity or a region in depth. An important reason of choosing case study technique is because our underlying research topic is relatively a new and emerging issue and thus only a few people in general have sound knowledge related to practical implications of monitoring in profit and loss sharing loan.
Hence it is vital for us to rely on case study technique in order to obtain up-to-date information from the practitioners of Islamic microfinance. A higher concern to use case study is because we want to know that how Islamic microfinance institutions can monitor loan that is issued under profit and loss sharing system. Under such situation, we can get better result using a real life Islamic finance institution.

4.1.2. Sample Selection

Sample selection is of utmost importance in order to obtain credible results (Yin, 2003). In this research we have chosen a famous Islamic financial institution, Bank Islami is famous and among one of the rare Islamic financial institutions which is granting profit and loss sharing financing. Here it should be noted that majority of the islamic financial institutions operating in Pakistan are no longer working on profit and loss sharing financing due to greater risk and higher volatility.

A higher concern to choose this specific organization is because of the reason that it is still working on the profit and loss sharing financing of Islamic finance when some others have stopped working on it due to high degree of risk involvement in it.

Moreover, we have chosen this organization because it is continuously taking suggestions and advises from the Islamic Law experts to keep its products up to date and in accordance with Islamic financing Law. The organization has hired Islamic Law experts as their financial advisor and we have also taken an interview from one of their financial advisor.

4.2. Conduction of Interviews

Data that is gathered first hand in research is referred as primary data. Such data can be collected from various sources for instance from company reports, personal interviews and observation. As case study has applied in this thesis, so in order to get primary data we conducted personal interviews to have a deep insight into the research problem and to get credible results.

We conducted qualitative interviews with the executives of Bank Islami Pakistan who are also experts in Islamic Law. The reason of using interviews technique in our case study is because it is a compact way to obtain answer of research question. Follow up questions can reveal such results and findings that we may not find using other methods like questionnaire. Another benefit of using interview technique is that there are very less chances of miscommunication in one to one personal interview. Direct communication in form of interview minimizes the respondent's biasness to produce effective results.

4.2.1. Choice of Interview Technique

According to Yin (2003), Interviews can be taken in focused, panel, open ended, structured and Semi structured forms and it is the best approach in order to find out answers to such research questions which are complex in nature. A higher concern in this regard is because it provides flexibility and ease of answer to respondent to reply in his/her own words. Hence interview technique has ample importance to investigate the problem in detail and to get the accurate answers of the research questions at hand (Zikmund, 1999).

Another important reason of choosing open ended interview approach is due to the reason because Yin (2003) further argues that other interviewing techniques like structured interview requires specific questions that are predefined hence such approach is of limited use because it bound the respondent to answer the specific questions only which may generate greater chances of biasness.

The natures of the questions asked in interview were open ended and unstructured. We use unstructured questions because our chosen organizations issues profit and loss sharing ratio according to specific terms and conditions. As we read through the website of our organization www.bankislami.com.pk we come to know that provision of profit and loss sharing loan is characterized by individual rating and hence it depends upon the nature of the business and proposed business plan.

Hence amount of profit and loss sharing loan to one borrower is different from that is provided to another borrower. In this scenario, construction of structured questions is of limited scope and can result in incomplete and insufficient information that would generate void answers. Due to this reason we have to depend upon unstructured questions in our research.

4.2.2. Choice of Medium

We have used telephone media for interview. The reason to choose telephonic interview is not only time and distance hurdles but also because telephonic interview provide us the opportunity to discuss the topic in detail (Ghauri and Gronhaug, 2005). Currently we are living at the far distance from the organization which we have chosen as our case study so telephonic interview provides us the benefit to save the time rather than relying on other media for instance written questionnaire.

4.2.3. Recording of data

In order to ensure the respondent’s answers are completely understood and successfully interpreted in our research, taken interviews were recorded using a recording device. This step is essential to avoid chances of miss interpretation and miss communication.

While recording data, respondents were taken into confidence that such data will be purely used for the research purpose only and hence will not be used elsewhere. This is useful to inform the respondent about the reason for recording data in order to attract him and to get answers in an open and flexible manner.

4.2.4. Development of Interview Questions

Interview questions were divided in three categories. Firstly, we asked general questions to each respondent about their duties, designation and background information about the organization. Secondly, we asked questions to the respondents in relation to our research question that how they used to monitor the profit and loss sharing financing under different circumstances. Thirdly, there were follow up questions related to ongoing discussion about the topic of research.

4.2.5. Choice of Interview Subjects

We have conducted 3 interviews one from its branch manager who is responsible for the proper management and smooth running of its branch.

Second interview was conducted from an executive of customer services department. This department works with the aim of proper monitoring of all the types of issued loan including profit and loss sharing loan.

Third and last interview was conducted from the Financial Advisor of the organization who is also an expert person in Islamic Law.

Table 4. 2 Knowledge vs Role and duties

		Knowledge	
		Same	Different
Role and Duties	Same	Branch Manager	Research Manager
	Different	Islamic Law Expert	---------------------

Above figure shows that we have chosen interview subjects based upon their duties in relation to our research question and their knowledge in the underlying field. As our chosen subjects differs according to nature of their role and everyone from chosen people shares different knowledge than other. In such a way, we are hopeful that our research would reveal significant results based upon past experiences and suggestions of the concerned interviewed persons.

The questions were asked from the respondents in relation to their duties. Purpose of questions was to take evidences from their past experience. The current strategies of the organization for the risk monitoring in profit and loss sharing model and their future recovery policy for the issued loan was also discussed.

The questions asked from the respondents were supposed to be answered in descriptive manner rather than just relying on Yes or No questions, which would reveal authentic answers and hence generate credible results.

4.3. Data Analysis

In order to get valid results and to arrive at an effective conclusion, it is necessary to analyze the data in a good manner. We have performed the analysis based upon results we get from our research and by making a comparison of these with the results of previous studies.

4.4. Procedure for obtaining credible results

According to Zikmund (2000), credibility is gained by getting accurate information from the concerned persons. In our research, credibility will be ensured by interviewing those trustworthy people who are in touch with the profit and loss sharing model for years. All these people are Islamic finance practioners and have a grip on the underlying research question. Bank Islami itself is working on profit and loss sharing model since last 4 years and accredited by State Bank of Pakistan.

4.4.1. Capturing Active Response

In order to ensure that the answers received from the respondents are neutral and to minimize the bias results. In our research, we send questions related to our study to the respondents 10 days before through email. In such way, we give them adequate time to prepare their answer. In addition we use recording device while conducting interviews. Another effort in this regard is by taking the interview in our native language Urdu in order to avoid chances of error, and to get rid of miscommunication and wrong interpretation. Such criteria are being used just to ensure validity and to develop reliable results.

Chapter 5: Results and Analysis

In this chapter, we will be presenting our results based upon empirical data gathered from the Bank Islami officials. We would further analyze the collected data using three points time line model to justify the difference between the literature and practical implementation of the profit and loss sharing model of Islamic finance. We have developed an analysis model based upon time line of the the profit and loss loan.

5.1. Model of Analysis

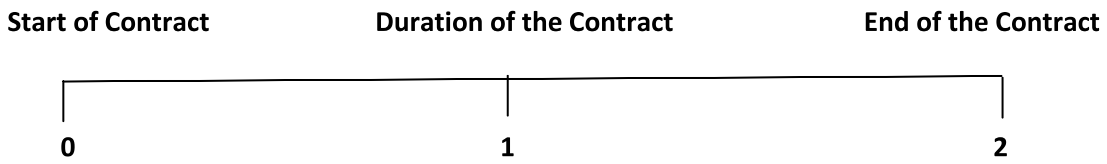


Figure 5. 1 Model of Analysis

According to above designed model. Point 0 represents the period at which profit and loss sharing contract is being started. Gap between point 0 and 2 represent duration of the contract. Indeed point 1 is the underlying area when there is increasing need of monitoring for the proper understanding and smooth running of the contract.

Starting from the introduction of the Bank Islami, we will present the results on the basis of data gathered from bank. Then we would specify our research in making analysis to our research question in detail.

5.2. Case Study of Bank Islami, Pakistan

5.2.1 Background of Organization

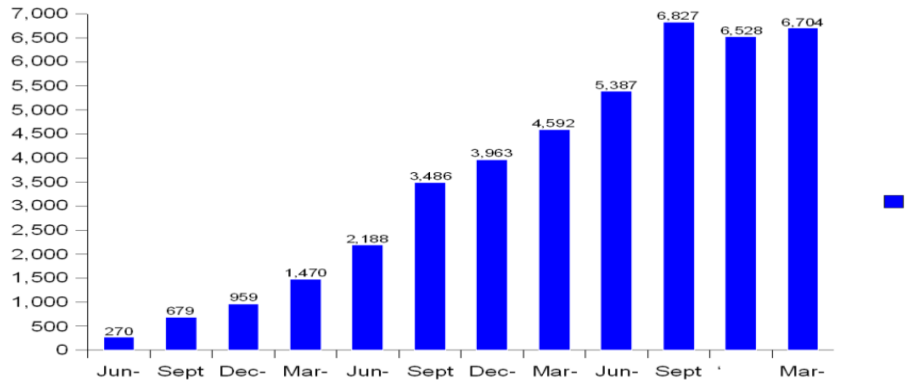
Bank Islami got accreditation from State Bank of Pakistan on August 19, 2004. Certification of Incorporation was issued on October 18, 2004. However bank started its business operation in April 2006. Today bank Islami has 102 branches in all over Pakistan and number of its employees are 1430.

There is a permanent and persistent increase in the financing operations of the bank Islami. In March 2007, Bank financing was amounted to PKR[2]. 1470 millions while in March 2009 it was raised to 6704 PKR. Figure 5.1 shows the growth in financing activities of Bank Islami during last 4 years.

[2] PKR = Pakistani Rupee, Currency Unit used in Pakistan.

Amount in Million

PKR.



Years

2006 2007 2008 2009

Figure 5. 2 Growth in financing sector of bank Islami Pakistan

Profit and Loss Sharing financing is used to fulfill project financing needs as well as working capital financing needs of Corporate Clients. Since this is based on pure profit and loss sharing arrangement, therefore the risks associated with such transactions are greater as compared to other financing modes. Due to this reason, profit and loss sharing transactions are executed subject to satisfactory review of feasibility of the proposed transaction/project.

In order to meet the increasing need of credit and to fulfill its customer's expectations, Bank Islami profit and loss sharing loan is used to fulfill the requirements of working capital finance and project finance.

Working Capital Finance is short term loan that is being offered to meet the running needs of a business enterprise. This is a low cost and flexible financing that is available in order to meet day to day financing needs of an organization.

Project Finance is a medium and long term financing. This is used to finance a certain project. Duration of such credit facility is dependent upon length of the project. Bank Islami provides Project finance using different modes of Islamic Finance.

5.3. Results

5.3.1. Forms of Contract

Interview from the bank Islami officials reveal significant results. According to respondents, there are two forms of Profit and loss sharing. In first case, bank Islami acts as the borrower of the capital and by taking investment from the customers it further invests in business projects. This means that when clients open account in the bank Islami using Profit and Loss sharing system. Bank keep their money as an investment loan and further invests this in different business and then profit and loss is being shared according to the agreed ratio on the basis of terms and conditions of the contract. In this scenario, all the loss is to be bear by the customer because he is acting as the investor of the capital according to theory of profit and loss sharing model.

In later case that is related to our research question, bank acts as an investor and provides financing to the borrower of the capital i.e. to the customer. In such scenario, all the loss is to be borne by the bank because here bank is acting as the investor of the capital according to the theory. Hence it is rare case and bank Islami is not as much active as it is thought to be in this respect. So before we would be elaborating our results it is necessary to note that in our research questions bank is investor of the capital and all the questions are answered in this case.

5.3.2. Answer to Research Questions

Respondent replied on question ***"As per theory of profit all the loss model, all the loss is to be bear by the investor of the capital i.e. (bank) is it true and up to which extent?",*** in order to overcome the risk of loss and to minimize the need of monitoring bank has introduced a strategy of providing physical assets rather than providing loan in form of money.

According to Chaudhry Waqas Safdar, Branch Manager *"Profit and Loss sharing is not a loan in fact it is an investment proposal in which one party makes financing and other party manages the smooth running of the business. But in case of Bank Islami, we are not providing financing in form of cash but we are providing physical assets in form of machinery or other required tools. Further cost plus profit of the asset is early disclosed at the start of the contract".*

This means that if the borrower needs some physical asset either to meet the running needs of the business or to start up a new project then he must pay the amount of agreed profit that is levied on the original cost of the asset. Above all, till the full payment of the agreed price, ownership of the underlying asset remains under the custody of the bank. But sometimes bank has to bear loss in the following cases.

1) *Bank has to bear the loss on the basis of contingency of the asset. So if the asset is as such whose values depreciates with the passage of time and customer makes default after some time to pay the installment amount. Although bank can sell the asset to fulfill its cost but still at that time cost of the asset may not fulfill the incurred cost by the bank.*

2) *Another reason of bearing loss is due to the reason because bank may have to incur many costs related to resale contract or in form of auction.*

Here it is vital to note the difference between loan and financing. Bank Islami is not providing any loan but instead financing transactions are undertaken using profit and loss sharing model. This means that bank provides required assets like in form of machinery on cost plus profit basis. Hence bank acts as a supplier of the capital but early disclosure of the profit at the time of the contract saves bank from anticipated loss and ownership right of the bank reduces the need of monitoring.

In answering a follow up question, interviewee replied that *"under profit and loss sharing financing, bank is the owner of the underlying asset which impels the borrower to work sincerely in order to successfully pay off his/her liability. At the end of the contract period if the borrower has paid the whole amount successfully then the ownership of the asset can be transferred to the borrower who thus becomes owner of the asset and whole project comes under his/her controls".*

Profit and loss sharing contract is binding upon down payment by the borrower. This means if the asset cost 200,000 rupee then customer is bound to pay agreed advance amount for instance 20% net payment i.e. 20,000 rupee. Now this advance payment can be used in following two ways.

1) *Bank keeps this amount as a security deposit which can be returned at the end of the contract period.*

2) *Borrower can keep this amount as an investment in the bank where bank acts as the borrower.*

So in order to take control and to become the sole owner of the project it is necessary for the borrower to work effectively and efficiently take care of the underlying business project. Customer services executive replied about the question ***"How do you monitor the proper running of profit and loss sharing financed business".*** Cost plus profit ratio is arranged for every proposed project. Further profit ratio is not fixed and can be changed according to the terms of the contract and nature of the project.

During the contract duration, monitoring needs is minimized by taking advance payment of the underlying asset. Which acts as a security deposit of the asset yet monitoring is insured with the help of recovery and collection department. In case if borrower has not paid an installment on due time then this department is liable to remind the customer about the due payment. Although it is not the most case because bank Islami only provides financing solution to its trusted customers who either have a good history with the bank or have a good creditability i.e. business worth. Further provision of the Profit and loss sharing financing is subjected to feasibility of the proposed project. Nevertheless, if needed then delegated monitoring in form of peer pressure or group pressure can be undertaken to keep the customer on the track.

Respondents replied on the question, ***"In case loss in incurred due to negligence of the borrower, how would you recover your amount from the borrower".*** In case the loss is incurred due to the negligence of the borrower, bank provides him extra time to recover such loss and payback the agreed cost plus profit ratio according to the specific terms of the contract. If the borrower is failed to pay back the amount within that extra time, contract can be revoked by the bank as per Islamic Law and then bank can recover the loss from selling the asset.

When respondents were asked about the question, ***"Do you think Profit and Loss Sharing Model can be used to finance poor people, if so then how?"*** According to Walton road branch manager, profit and loss sharing financing of Islamic finance can be used to help the poor people in the same way. Although in practice bank is not yet offering small financing to the poor people but it is deemed that same system can be used to help the poor people who lacks collateral requirement. Apart from Loan, Profit and Loss Sharing financing can be used to help the poor people.

In such scenario, bank can help the poor people who have innovative business plan by providing them machinery or some other asset needed for start of the business. Special importance should be given to the business plan. Innovative ideas would be obviously appreciated in this regard especially those which requires small financing and would reveal higher return taking less risk. Poor people who lack collateral requirements can be bind with the cost plus profit system as implemented by the Bank Islami.

5.4. Analysis

5.4.1. Issuing Requirements and Monitoring

At Bank Islami, Profit and Loss Sharing Loan is a type of sale in which the seller discloses the cost of goods and profit to the buyer. Using this short term financing mode, Bank Islami can finance the asset purchase requirement of its customers. The Customer, intending to utilize the financig facility, identifies the commodities ('assets') it needs to purchase through profit and loss sharing financing. Bank Islami purchases the assets from Supplier and then sells the same to the customer against an agreed price (including disclosed profit portion) on deferred payment basis.

Profit and Loss sharing financing facility is available for short term, medium term and long term period. Provision of such financing is subject to nature of the proposed project and on the basis of feasibility of the business. Cost plus profit amount can be paid in small installments and can be spread from short time period up to longer time period according to the nature of the contract.

We have analyzed the results gathered from bank Islami officials on the basis of three points time line model. Our area of interest lies at Point I i.e. duration of the contract when there is actual need of the monitoring. Our analysis is expressed as follows.

5.4.2. Implications of risk in Monitoring

Bank Islami profit and Loss sharing financing reduces the monitoring cost to minimum level. As Bank Islami only finance asset purchase requirement using profit and loss sharing loan hence it reduces the risk of loss to possible lower level. Further, ownership of the traded asset remains under the custody of the bank as per theory of Profit and Loss sharing financing. Ownership is only transferred after the successful payment of the cost plus profit amount of the proposed asset. If customer successfully pays the total amount within the projected time period then the ownership of the asset is transferred to the customer.

So in order to become the sole owner of the asset and to pay off the liability customer is bound to pay all the installments of cost plus profit as agreed in the contract. However, if due to some reason customer is unable to repay the agreed amount or after some installments he is failed to carry on the transaction then special flexibility in payment period is granted to the customer. Hence customer can inform the Bank that he needs more time to pay the amount due to critical nature of the business or some underlying problems.

But if the customer is making default and willingly refused to pay the specific installment amount then bank can ensure repayment of the amount with the help of recovery and collection department.

Who can use the group pressure and delegated monitoring techniques to enforce the customer to pay back the due amount in every possible way. Nevertheless, if no option is remaining and customer has gone bank corrupt and its business is gone in loss then as the last option. Bank Islami has the right to sell the asset to fulfill the loss according to terms and conditions of Profit and Loss sharing financing contract.

5.4.3. Contingency of Asset Type

Bank Islami has the right to seize the contract at any time, till the full payment of the mutually agreed amount. Ownership right on the underlying asset grants facility to the bank to sell the asset and recover its loss if the customer is unable to pay the agreed amount within due time. Yet this option is not risk free and can lead to loss based upon contingency of the Asset Type.

Especially in form of machinery, as with the passage of time machinery depreciates and its market value reduces. Hence it might be the possibility that when customers is unable to pay some installment, at that time book value of the same asset is very less resulting in loss for the Bank. Due to such risky profile, Bank Islami only facilitates profit and loss sharing financing with specific terms and conditions that are dependent upon feasibility report of the proposed project.

In the feasibility report, description about type of asset needed, its market cost and nature of the underlying asset is presented. If the underlying asset has short life span and is such which can depreciate on early basis then profit and loss sharing financing is available for the shorter time period that is less than the depreciated value of the asset. But if the asset type has a longer depreciated life then the payment of the agreed amount can be extended to the longer period of installments.

Thus practice authorizes the bank to recover the cost of the asset in case if the customer is unable to continue the contract after some time because bank can sell the asset before expiry of its depreciated life. Such feasibility procedure at the very start of the contract reduces the need of the monitoring to the minimum level and result in getting higher profitability even with highly risky investment option of Profit and Loss sharing.

5.4.4. Agency Problem and Bank Islami

Principle agent theory tells us about the relationship between the parties. Such relationship can be in form of lender and borrower as well. Profit and loss sharing financing at bank Islami is provided for a certain project. During the project time period, it is necessary for the bank to carefully tackle the situation in an organized manner in order to ensure proper repayment. Bank Islami is also trying to get rid of agency problem with the help of providing flexible solution if the borrower is unable to repay the installment of loan on due time. Extension in repayment time period is granted by the bank islami to overcome the underlying issue of agency problem. Agency problem as discussed in previous chapters can occur in profit and loss sharing finance because in case of loss all has to be borne by the lender unless it is incurred due to the negligence of the borrower. In this scenario, Bank Islami is trying hard to keep its customers happy and away from any stress relating to loan. Such steps lead the customer to contact the bank without any hesitation in case of any problem related to repayment of taken loan. Further positive steps are taken by the bank by provide flexibility in repayment time period in case of any problem faced by its borrower.

5.4.5. Asymmetric Information and Bank Islami

Agency relationship can be either in form of employee-employer or lender-borrower. Information asymmetry is very critical in this case because bank Islami has less or limited information about its borrowers. Bank Islami overcomes the issue of asymmetric information with the help of spouse guarantee. Business reputation of the borrower is also examined in this regard because bank Islami usually grants loan based upon satisfactory review of the feasibility report of the project.

However in case no such feasibility report is available, advance payment of the requested assets also acts as collateral. Such effective steps by bank Islami provides a comprehensive solution to the problem of asymmetric information and thus adverse selection may not be a big case for Bank Islami.

5.4.6. Moral Hazzard and Bank Islami

Moral hazard is a situation in which lender of the loan i.e. bank is disturbed due to the default borrowers. Because if the borrowers are taking loan and not returning it on due time or if number of default borrowers is increasing then ultimately this will affect the business of the bank. Same danger is present for Bank Islami too but bank Islami model for profit and loss sharing financing provides shield against such risk.

In case of bank Islami, ownership of the financed asset remains under the custody of the bank till the full repayment of the cost plus profit. This efficient act forces the borrower to work sincerely in order to pay off the liability and to become the real owner of the asset. Because after the borrower has fully repaid the agreed price plus profit, whole the project goes under his/her control. However, in some cases if the customer is making default and do not repay the agreed amount on due time then asset can be sold out to fulfill the loss of the bank. This is how bank Islami is successfully dealing with the issue of moral hazard and overcomes it.

5.4.7. Difference between Theory and Practice of Profit and Loss Sharing Financing

Case study of Bank Islami reveals significant result related to profit and loss sharing loan. We have come to capture the difference between theory and practice of the Profit and loss sharing model of Islamic Finance. Because theory tells us that although profit is being distributed on agreed basis but loss is only charged to the investor of the capital. But from the real life practice of Bank Islami, we have come to know that there is no more chances of loss if profit and loss sharing is practiced wisely. Ownership right, early disclosure of the cost plus profit amount and down payment in form of security deposit acts as shield against anticipated loss and results in profitability for the organization.

As per theory of the profit and loss sharing loan, all the loss has to be borne by the investor of the capital i.e. Bank. But design of profit and loss sharing developed by Bank Islami attempts to get rid of such risk. Bank Islami fulfills asset purchase requirement of its customers. Such Asset can be needed either to start up some certain project or to expand the existing business as working capital finance that is exactly similar to the theory of the Profit and Loss sharing finance. Above all, we have observed that in reality there is no more risk involved in practice of profit and loss sharing model and hence less need of monitoring in case of Bank Islami.

Nevertheless, basic difference between theory and practice of profit and loss sharing model is based upon nature of transaction. Because Bank Islami do not provides loan in form of cash investment in some business. On the contrary to theory of Profit and Loss sharing, Bank Islami invests in form of provision of asset but not in cash or some money kind just to avoid loss and to reduce the risk to minimum level if not zero.

Another difference between theory and practice is clear when we talk about early disclosure of the cost plus profit. Because in theory of the profit and loss sharing model we do not find any such characteristics that facilitates the early disclosure of the cost plus profit as we practically observed in our case study.

Chapter 6: Conclusion and Recommendations

6.1. Summing Up

As per the literature review we come to know about the increasing importance of microfinance. Many Authors believes that Islamic finance should play its role in meeting the demands of microfinance because conventional microfinance institutions alone can not fulfill the requirements (Ferro, 2005).It is further argued that Islamic financial instruments including Profit and loss sharing model can be used to fulfill the needs of microfinance (Akhtar, 1997).

But high risk profile of the profit and loss sharing model turned out to be a problematic situation for the microfinance institutions. Because as per theory, all the loss is to be borne by the investor of the capital thus resulting in careful review of the feasibility of the proposed business project and during the project it required effective monitoring to ensure the repayment that is the only source for sustainability of the microfinance institutions.

In our current research, we have tried to find out the answers to the underlying problem of profit and loss sharing model with the help of case study of Bank Islami. Bank Islami is probably the only organization in Pakistan who is offering financing under profit and loss sharing model of Islamic finance. Hence on the basis of our case study, we hope that our findings would prove beneficial for Islamic Microfinance institutions to get rid of underlying problems of monitoring in profit and loss sharing model.

Cost plus profit design as being developed and implemented by Bank Islami tends to get rid of underlying risk of loss and thus reduces the need of monitoring to the minimum level. Although our selected organization is a newly established organization but it is working on profit and loss sharing model since start of its business operation.

Further, financing history of the bank Islami signifies a gradual growth. On the basis of high growth of bank Islami financial operations it is clear that profit and loss sharing model of bank Islami is progressing by leaps and bounds. We could easily conclude that if wisely implemented that profit and loss sharing loan can result in profitability as in case of our bank Islami. Early disclosure of cost plus profit, ownership right of the bank and security deposit in form of advance payments acts as a shield against anticipated loss and thus reduces the needs of monitoring to least possible level.

Above all, it is concluded that poor people who lacks collateral requirement can be benefited from profit and loss sharing financing on the basis of careful review of the feasibility of the proposed project. Because if it is deemed that a person has some innovative idea that requires small amount of financing and would reveal higher return than Islamic Microfinance Institutions can facilitate financing on the basis of cast plus profit basis as being implemented by the bank. Although in case of bank Islami a compulsory advance payment is needed in order to bind the contract but poor people who requires small amount of financing can be granted exemption from such requirement.

Ownership right of the Islamic Microfinance Institution upon the asset can get rid of risk of loss because in case of default is made by the customer same asset can be resold in order to fulfill the loss. At the end of the contract period if the customer has successfully repaid the whole amount than subsequently ownership of the asset would be transferred to the customer making him sole owner of the proposed project.

6.2. Findings and Recommendations

Research on the Profit and loss sharing model to fulfill the microfinance needs is of limited scope. Although Bank Islami profit and loss sharing model reveals positive results yet they are somehow in contrast with the basic theory.

In reality, bank Islami model for profit and loss sharing financing is almost similar to the resale contract (Murabaha) model of Islamic finance. This implies huge need of further research in order to make a clear distinction between the models of Islamic finance and their practical implementation at the Islamic financial institutions.

On the basis of our research, we also find out that in reality the practical implementation of Islamic finance models at Islamic financial institutions is not in line with the theory of these models. Especially in case of profit and loss sharing model because either no Islamic finance institution is working on it and if working on this model then in such scenario, they itself acts as the borrower of the capital.

Customer deposit money in profit and loss sharing account and bank invests their money in some business to share profitability in agreed ratio but in case of loss all is to be borne by the investor of the capital i.e. customer itself. On the contrary, if bank Islami is offering profit and loss sharing financing than its practical implementation is not according to the principles of the theory.

On the basis of difference between theory of Profit and loss sharing model and practical implementation of Bank Islami we recommend that Bank Islami should expand its profit and loss sharing model to meet the cash demands of the customers. Provision of asset may not be always the solution for the poor people who are in need of microfinance loan and it is also not in line with the theory of the profit and loss sharing model.

Based upon efficient working of Bank Islami profit and loss sharing financing, it is deemed that same procedure can be utilized to help the poor people. We believe that soon in future they ought to expand provision of profit and loss sharing financing to help the poor clients as well. Because nature of transaction does not need collateral requirement if small investment in form of low cost machinery is needed. It is recommended that provision of such facility is not only offered to those who have innovative ideas of doing business but financing incentive should also be made to poor people who are traditionally enriched with adequate skills i.e. layman and formers who want to get financing to fulfill their basic needs.

6.3. Future Research

On the basis of our findings, it is vital to note that there is increasing need of further research on the profit and loss sharing model to meet the financing needs of the poor customers. Once such results are gained which would impel profit and loss sharing model in meeting needs of the poor people. Than we are hopeful that Islamic financial institutions should also play their part in practically implementing this model to help the people in getting loan from this model.

It is therefore argued that there is a need of further research on this topic that how profit and loss sharing facility can be utilized to fulfill the cash requirements of the poor people.

7: REFERENCES

1- ADB- Asian Development Bank “Finance for the poor: Microfinance Development Strategy”, Research Report by Asian Development Bank, 2000.

2- Ahmed, Habib 2002, “Financing Micro Enterprises, An analytical study of Islamic Microfinance institutions”, *Islamic Economic Studies,* Vol.9, No. 2.

3- Aktar, Muhammad Ramzan 1997,”Partnership financing of microenterprises”, International Journal of Social Economics, Vol. 24 No.12, pp. 1470-1487.

4- Case Study, “Islamic Microfinance and Socially Responsible Investments” by Chiara Segardo at University of Torino, August 2005.

5- Chong, Beng Soon and Liu, Ming-Hua 2007, “Islamic banking: Interest-free or interest-based?”, Pacific-Basin Finance Journal 17 (2009), pp. 125–144.

6- Choudhury, Masudul Alam 2008, “Islamic Venture Capital, A Critical Examination”, Journal of Economic Studies, Vol. 28 No. 1, 2001, pp. 14-33.

7- Choudhury, Masudul Alam and Hussain, Md. Mostaque 2005, “A paradigm of Islamic money and banking”, International Journal of Social Economics, Vol. 32 No. 3, pp. 203-217.

8- Department of Economics, “Lack of Profit Loss Sharing in Islamic Banking: Management and Control Imbalances” by A. Dar, Racha and R. Presley, John at Department of Economics, Loughborough University, Year 2000-01, United Kingdom

9- Dhumale, Sapcanin, 1998 “An Application of Islamic Banking Principles to Microfinance”, A study by Regional Bureau for Arab States, United Nations Development Programme in Cooperation with the Middle East and North Africa Region, World Bank.

10- Dixen, Ritchie and Siwale 2006, “Microfinance: accountability from the grassroots”, Accounting, Auditing and Accountability Journal, Vol. 19 No. 3, 2006, pp. 405-427.

11- Djojosugito, Reza 2008 “Mitigating legal risk in Islamic banking operations” Humanomics Vol. 24 No. 2, pp. 110-121.

12- Dusuki, Asyraf Wajdi 2008, “Understanding the objectives of Islamic banking: a survey of stakeholders perspectives”, International Journal of Islamic and Middle Eastern Finance and Management Vol. 1 No. 2, pp. 132-148.

13- Dusuki, Asyruf Wajdi 2008, “Banking for the poor: the role of Islamic banking in microfinance initiatives”, Humanomics, Vol. 24 No. 1, pp. 49-66.

14- Feroz, Goud, Rahman, 2008, “The Development and Implementation of Shariah Based Microfinance using Grameen Group Financing Methodology”, prepared for the Islamic Microfinance workshop at the 8th Harvard University Forum on Islamic Finance Cambridge, Massachusetts, U.S.A.

15- Ghannadian, Farhad F. and Goswami, Gautam 2004, “Developing economy banking: the case of Islamic banks”, International Journal of Social Economics Vol. 31 No. 8, pp. 740-752.

16- Ghauri, Pervez and Gronhaug, Kjell 2005, ‘Research Methods in Business Studies’ 3rd Edition, Prentice Hall, Essex England.

17- Ghayad, Racha 2008, “Corporate governance and the global performance of Islamic banks”, Humanomics, Vol. 24 No. 3, pp. 207-216.

18- Hasan 2008, “Credit creation and control: an unresolved issue in Islamic banking”, International Journal of Islamic and Middle Eastern Finance and Management, Vol. 1 No.1, pp. 69-81.

19- Iqbal, Zamir and Mirakhor, Abbas 1999, “Progress and Challenges of Islamic Banking”, Thunderbird International Business Review, Vol. 41(4/5)3 81-405.

20- Islamic Research and Training Institute, “Frontiers of Islamic Banking: A synthesis of Social Role and Microfinance”, by Ahmed, Habib, Islamic Research and Training Institute at Islamic Development Bank, Jeddah, Kingdom of Saudi Arabia.

21- Jobst 1997, “The Economics of Islamic Finance and Securization”, Journal of Structure Finance, Vol. 13, No. 1.

22- Keveos, 2004 “Financial Services for the Poor: Assessing Microfinance Institutions”, Mangerial Finance, pp. 70-95.

23- Khan and BenDjilali, “Modeling an exit strategy for Islamic venture capital finance”, International Journal of Islamic Financial Services, Vol.4, No.2.

24- Khan, M. Mansoor and Bhatti, M. Ishaq 2008, “Development in Islamic banking: a financial risk-allocation approach”, The Journal of Risk Finance Vol. 9 No. 1, 2008 pp. 40-51.

25- Khan, M. Mansoor and Bhatti, M. Ishaq 2008, “Islamic banking and finance: on its way to globalization”, Managerial Finance Vol. 34 No. 10, pp. 708-725.

26- Khan, M. Mansoor and Bhatti, M. Ishaq 2008, “Why interest-free banking and finance movement failed in Pakistan”, Humanomics Vol. 22 No. 3, pp. 145-161.

27- Khan, M. Mansoor 2008, “Main features of the interest-free banking movement in Pakistan (1980-2006)”, Managerial Finance Vol. 34 No. 9, 2008 pp. 660-674.

28- Metwally, M.M. 1997, “Economic consequences of applying Islamic principles in Muslim societies”, International Journal of Social Economics, Vol. 24 No. 7/8/9, pp. 941-957.

29- Michael S. Barr, “Microfinance and Financial Development”, Michigan Journal of International Law, Vol.26, PP.271-296.

30- Monetary and Capital Markets Department (MCM), “The Economics of Islamic Finance and Securitization”, by Jobst, Andreas A., Monetary and Capital Markets Department (MCM) at International Monetary Fund (IMF), February 2007, Washington DC, USA.

31- Morduch, 1999, “The Microfinance Promise”, Journal of Economic Literature, *Vol. XXXVII,* pp. 1569-1614.

32- Murray, U. and Boros, R. (2002), *“A Guide to Genders Sensitive Microfinance”, presented at International Conference on "Women's empowerment or feminisation of debt? Towards a new agenda in African microfinance" held in London, 21-22 March 2002.*

33- Quaegebeur, Marthi, 2005, Centre for Micro Finance Research, “Linkage between microfinance and effective education with a focus on parental involvement”, Center for Micro Finance Research, Institute of Financial Management and Research.

34- Rahim 1197, “Islamic Banking and Finance: Between Ideas and Realities”,IIUM Journal of Economics and Mangement 15, no.2, pp. 123-141.

35- Sengupta, P.Aubuchon, 2008, “The Microfinance Revolution: An Overview”, Federal Reserve Bank of St. Louis Review 90 (1), pp.9-30.

36- Shields, Frankiewicz, Miamidian, Steeren, King and Comion, 2004, “Financing Microfinance Institutions, The Context for Transition to Private Captial”, Micro Report # 8, USAID.

37- Siddiqui, Anjum 2008, “Financial contracts, risk and performance of Islamic banking”, Managerial Finance Vol. 34 No. 10, pp. 680-694.

38- SIEV – Sustainability Indicators and Environmental Valuation, “Value through diversity: Microfinance and Islamic finance and globalization”, by Nicoletta Ferro at Fondazione Eni Enrico Mattei, June 2005, Milan, Italy.

39- Taib, Ramayah and Razak, 2008, “Factors influencing intention to use diminishing partnership home financing”, International Journal of Islamic and Middle Eastern Finance and Management, Vol. 1 No. 3, 2008, pp. 235-248.

40- Wilson, Rodney 2007, “Making Development Assistance Sustainable through Islamic Microfinance”, *IIUM Journal of Economics and Management* 15, no. 2, 197-217.

8: APPENDIX

8.1. Conventional and Islamic Microfinance

Table 8. 1 Difference Between Conventional Microfinance and Islamic Microfinance

NO	Features	Conventional Microfinance	Islamic Microfinance	Difference	Implication
1.	**Models of Microfinance**				
a)	**Loan Types**	Individual Lending, Group lending, Credit Unions, Village Banking	Modarahba, Musharakah, Murabaha, Ijarah, Istisna, Quard Al Hasan, Wakalah Model (Zakah)	Islamic Microfinance is interest free and based on equity participation and profit and Loss sharing.	Partnership based financing provides incentives to both the parties like distribution of profit on predetermined basis.
b)	**Supplier of Funds (Liabilities)**	External Funds gets support from Govt and Donor Agencies and Profitability.	External Funds like Islamic Charitable Sources from Rich Muslims and Savings of Clients.	Zakat Fund is a charitable source for Islamic Finance made from necessary annual contribution.	Due to presence of generous fund, Islamic Microfinance can fulfill the requirements of the extreme poor.
c)	**Mode of Financing (Assets)**	Interest Based and High Interest	Interest Free financing using Islamic Financial Instruments based on partnership and Equity distribution.	Conventional MF based upon conventional finance principles whereas Islamic MF based upon Islamic Law.	Islamic MF provides an incentive for the Muslim world to fulfill their necessities with Islamic mode of Finance.
2.	**Features of Contract**				
a)	**Support for Extreme Poorest**	Extreme Poorest are left out	Extreme Poorest are supported using Islamic Charity Fund called ***Zakah***	Islamic MF have flexible solution for extreme poor	Conventional MF is not much beneficial for the extreme poor.
b)	**Mode of Payment (Funding)**	Cash	Goods	Conventional Microfinance charge interest on Cash while Islamic Microfinance receives profit on the provided goods.	Islamic microfinance can fulfill the religious obligation of avoiding charging interest as it is profit based microfinance solution.

c)	**Contract Cost**	When the loan is sanctioned then conventional MFI usually deduct a portion of the granted money as security / emergency fund but interest is charged on the whole sanctioned amount though it is not fully granted. This resulted in an increase in the effective interest rate.	Under Islamic Microfinance, Goods is transfered instead of payment of Cash. No deducation is made on issuing of goods. But on the contrary to Cash Payment by MFI, Goods cannot be alternatevely used.	No hidden contract cost for Islamic Microfinance yet goods cannot be alternatively used as cash provided by conventional MFIs can put into different usage.	Whereas Conventional microfinance has some deduction but it provides flexibility of use to the borrower of the Microfinance which may not be the case for Islamic microfinance.
d)	**Target Group / Clients**	Women and poor households	Family and Small Entrepreneurs	Conventional MF aims to support and empower women while Islamic MF based of partnership is useful of small entrepreneurs.	Profit and Loss sharing tenet of Islamic MF would play its role in the economic development from the grassroots.
3.	**<u>Ownership and Control Issues</u>**				
a)	**Client Relationship / Ownership**	Moneylender and Borrower	Partnership, Equity based	Islamic MF establishes such relationship that can be converted into ownership.	Islamic MF provides an ample opportunity to the provider of the capital by converting its investment into ownership.
b)	**Benefits for the Target Group**	Empowerment of Women	Ease of Availability	Islamic MF is attractive because of ease of availability	Whereas conventional MF focuses on Women empowerment Islamic MF aims on whole family empowerment.
4.	**<u>Security</u>**				
a)	**Collateral Requirement**	Collective Monitoring and Reputation	Group/Spouse Guarantee	Only group or even spouse guarantee is enough to get loan under Islamic MF.	Collateral Requirement is not a big issue under Islamic MF.
b)	**Liability for Repayment/ Risk Taker**	Recipient	Recipient and Spouse are liable for Repayment	In case of default or some accident, Spouse would be	Conventional MF assumes that only Receiver of the loan is liable for repayment hence

				held liable for the repayment in Islamic MF	other members of family would not be held liable in case of default or accident.
5.	**Social Development**	Secular Behavior, Ethical and Social Development.	Religious Behavior, Islamic Ethics	Conventional MF is based upon secular principles of social development while Islamic MF is based upon Islamic principles of finance that would lead to social development.	No matter MF practice for both the concepts is bit different yet the primary goal of both is social development that would lead to economic development in the long run.
6.	**Limitations**	Unable to fulfill the increasing microfinance requirements.	Ownership and Control Issues	Conventional Microfinance is unable to meet the increasing demands while Islamic MF is also criticized for ownership and control issues.	Both the concepts of MF have a limitation that needs proper attentions and hence there is a need of study to be taken on this concept.

Source: Table Complied on the basis of Data collected from Ahmed, 2002 and Keveos, 2004.

8.2. Questionnaire

1) Since how long you are offering financing under Mudarabah (profit and loss sharing model) model?

2) What are the requirements for getting loan under Mudarabah (Profit and Loss Sharing) model?

3) Does small borrower without any collateral (security) requirement can be benefited from the Mudarabah (profit and loss sharing loan)?

4) How many types of Mudarabah loan is available to the borrowers, can you explain each type in detail?

5) At what ratio profit is distributed between bank and borrower of the loan?

6) Whether profit sharing ratio of Mudarabah is fixed for all borrowers or it is flexible and depends upon nature of the borrower?

7) As per theory of Mudarabah it is deemed that in case of loss all has to borne by the investor of the capital i.e. bank, is it true and up to which extent?

8) How do you monitor the proper running of Mudarabah financed business?

9) How would you judge that borrower of the Mudarabah loan is sincerely working for the smooth running of project?

10) What type of monthly reports if any would you demand from the borrower to judge that the project is going in right direction?

11) What is the loss sharing ratio in case loss is incurred due to negligence of the borrower?

12) In case loss in incurred due to negligence of the borrower, how would you recover the granted loan from the borrower?

13) In case borrower makes default i.e. fraud, then how would you recover your money?

14) What is average rate of return, profitability ratio of the bank from its Mudarabah Loan?

15) Bank Islami is probably one of the only banks in Pakistan working on Mudarabah model, what motivates you to opt this high risk Mudarabah model?

16) What are your future plans? Do you think Mudarabah Model of Islamic Finance can be used to help the poor people who lack collateral security requirements?

17) Do you think Mudarabah Model can be used to finance poor people, if so then how?

a. What criteria can be used to help poor using Mudarabah model?

b. What would be requirements for poor people in absence of collateral?