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Islamic Microcredit And Poverty Alleviation In The Muslim World: Prospects And Challenges

[1]Murtada Mirghani, [2]Mubarak Mohammed, [3]Abul Bashar Bhuiyan and [4]Chamhuri Siwar

[1]DBA candidate, University Utara Malaysia (UUM), 7- 13th floor-block17-Sri Mahligai Condo-Sec 9-40100-Shah Alam-Drul Ehsan Selangor state-Malaysia.
[2]Deputy Dean of the Faculty of Finance and Administrative Sciences, Al Madinah International University Malaysia (MEDIU), 7- 13th floor-block17-Sri Mahligai Condo-Sec 9-40100-Shah Alam-Drul Ehsan Selangor state-Malaysia.
[3]Research fellow at Institute for Environment and Development (LESTARI), National University of Malaysia (UKM), Bangi- 43600, Selangor, Malaysia.
[4]Professor Emeritus & Senior Research Fellow at Institute for Environment and Development (LESTARI), National University of Malaysia (UKM), Bangi - 43600, Selangor, Malaysia.

Abstract: Poverty is the central problem to sustainable human development. While Islamic microfinance has been recognized as the best-fit alternative to conventional Microcredit which promises the same benefits based on Shariah. As the Islam provides the complete code of life, the religion covers poverty reduction as one of the premier agendas. Islam considers that poverty induces other indecent acts; therefore, poverty should be treated with much care. However, the Shari'ah encourages savings and investment rather than excessive consumer debt. Some of the most significant obstacles facing Islamic Micro Finance (IMFIs) lie in the rising costs, where the needs for implementation and follow-up to the field are greater than in conventional finance; poor awareness of systems and methods of Islamic finance among the target audience; and the execution of Islamic finance by certain authorities without having adequate knowledge in it, leading to wrong practices and loss of public confidence in Islamic finance. In addition to this, there is a scarcity of skilled personnel in the field of Islamic finance due to the lack of interest among academics in the Islamic finance in the Middle East region. Despite the prospects for microfinance, there are a number of specific challenges facing this industry under the Islamic financial systems, some of which include: There is an urgent need to build bridges between the religious institutions and the microfinance sector; the concept that there is a lack of convergence between the parties in terms of objectives; The challenge is to recognize the common grounds in human development, which will bring together these two parties; One of the challenges in addressing the sceptical perception prevalent among Muslim consumers, especially in the South Asian region, is about whether or not these products comply with the Shari'ah rules; and finally The Islamic finance industry needs to adapt and modify the range of products and operating models that are not used in accordance with the fundamental rules of Shari'ah in order to meet the needs of the poor.

Key words: Microfinance, Islamic Microfinance, Poverty, Shari'ah, & IMFIs.

INTRODUCTION

Islamic Micro Financial institution is at the central of economic growth and development of most societies today because of its key roles in developing human resources. It also makes significant contributions towards poverty alleviation and bridging the gap between the rich and the poor. During the advent of Islamic banking and finance, which is based on interest-free mode of financing, the industry suffered a great deal of criticism from both Islamic and conventional scholars. The debates were mostly centered on interest charge, saying that if the interest was removed, there would be nothing to balance out demand and supply in the economies.

Moreover, the banking sector is going to collapse; this argument found its root in the work of the classical economist Alfred Marshal (Becattini, 2006) who argued that saving is linked to interest, and so increase in interest rate would mean increase in the volume of saving, leading to the development of trade and commerce, and hence economic growth. This idea was refuted by Maynard Keynes, who argued that higher interest charge will instead damp down the volume of investment in the economy, and hence slow down the force of growth (Schoon, 2009). On the other hand from a missing holistic view in poverty reduction, the MFIs' have not ruminated on the spiritual, moral and ethical dimensions of human-socio-economic development, which is precious in sustainable human development (Ahmed, 2006; Alam, 2009).

Corresponding Author: Abul Bashar Bhuiyan, Research fellow at Institute for Environment and Development (LESTARI), National University of Malaysia (UKM), Bangi- 43600, Selangor, Malaysia.
E-mail: bashariu@yahoo.com

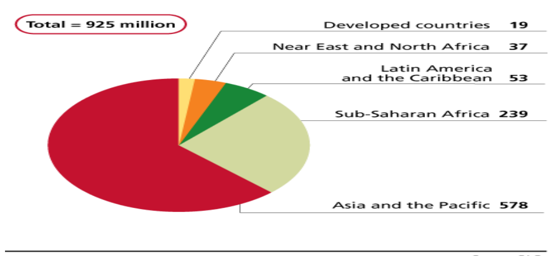
Furthermore, Islamic Micro Finance is an alternative mode of finance that has widely spread (Schoon, 2009) all over the world today because of its potential in this present global economic system. The power of Micro Islamic Finance in eradicating poverty and improving the living conditions of the poor cannot be over emphasized. It serves to complement and augment the Islamic banking industry. In the same way the high-growth Islamic banking, the best-fit alternative to conventional Microcredit is Islamic Microcredit, which promises the same benefits based on Shariah. As the Islam provides the complete code of life, the religion covers poverty reduction as one of the premier agendas. Islam considers that poverty induces other indecent acts; therefore, poverty should be treated with much care (Ahmed, 2006; Alam, 2009; Habib, M.A., *et al*., 2004; Mizanur Rahmana, 2008; Parveen, 2009; Rahman, 2010; Uddin, 2008).

Despite of the increasing religious sympathy and higher interest rate with the counterparts, IMFIs could not able to achieve significant progress in terms of outreach and socio-economic development. Therefore, it is the timely initiative for traceing out the prospective area as well as future challenges in the coming times for establishing sustainable IMFIs in the way of poverty alleviation. The study has significance for both policy makers and Islamic MFIs' (IMFIs'), in terms of setting up future goals and objectives for better Islamic Microcredit framework in the Muslim countries even in the world. It consists of three sections. Section one examines the scope of the prospects and challenges, while section two presents the conceptual framework of the study, as well as the theoretical and empirical models for the study. Section three provides the conclusion and recommendations drawn from the study.

Section-1:

Scope Of The Prospects And Challenges Of Islamic Micro-Finance (IMF):

Islamic Micro Finance (IMF) has been developed with the aims of providing loans to the poor as well as small and medium size enterprises that have little or no access to capital from the banking sector, which concentrates only on the bigger players in the economy. Recent publications (2010) on world's hungry people by Food and Agricultural Organization (FAO) reveal that some 925 million people are living in hunger, with Asia Pacific having the highest proportion of people living in poverty. The establishment of IMF in the Asia and Pacific region would have the prospect of bridging the gap between the rich and the poor; hence the demand for IMF



Hunger and Poverty pie Distribution, 2010.

Population and Poverty Distribution of Difference Regions.

Region	% in $1.25 a day poverty	Population (millions)	Pop. in $1 a day poverty (millions)
East Asia and Pacific	16.8	1,884	316
Latin America and the Caribbean	8.2	550	45
South Asia	40.4	1,476	596
Sub-Saharan Africa	50.9	763	388
Total Developing countries	28,8	4673	1345
Europe and Central Asia	0.04	473	17
Middle East and North Africa	0.04	305	11
Total		5451	1372

Source: See (World Bank, 2010).

The poverty index across the world is on the rise, challenging the holy doctrine of the World Bank's aims to eliminate poverty from the face of the earth. On the other hand as the Islam is the complete code of all mankind. It might be applicable in every sphere of life whether business, service or any other parts of human life. It has also placed central focus on poverty alleviation to establish dignity and self-reliance through a consciously participatory development agenda. But still cases of successful Islamic microfinance experiments in Muslim societies are small in number. Further, these institutions are not integrated into the formal financial systems, with the notable exception of Indonesia. Cases of Islamic banks practicing microfinance are even fewer. Islamic microfinance institutions display wide variations in the models, instruments and operational mechanisms. While, in terms of reach, penetration and financial prowess, Islamic microfinance institutions lag far behind their conventional counterparts they certainly score better in terms of richness and variety. Islamic microfinance institutions similar to conventional microfinance institutions, use group financing as a substitute to collateral, have a high concentration of women beneficiaries and aim at alleviation of poverty in all its forms.**[10]** In the same way IMF is the key to development through empowering growth and also raising the standards of living for the majority of the have-nots in the society. The effectiveness of the this institution with regard to its objectives cannot be underestimated due this fiat interest rate based monetary system that has completely replaced the Gold dinar and silver. Yet, it cannot change the function of honest money. Therefore, the existence of IMF within the system of interest-based money has not made it possible for MIF to attain its full objectives. Moreover, IMF is approaching the Conventional Micro Finance, thanks to the possibility to arbitrage within the system, where market participants take advantage of the rates differential within the different financing systems to make easy profit.

Section-2:
Literature Review:
2.1.0 Conceptual Issues:

Micro finance institutions are established to maximize social benefits as opposed to profit oriented motives of businesses concerned. The purpose of Micro Finance is to create sound financial institutions that can offer effective and efficient financial services even at grassroots levels (Harran, 2010). By extension to this, it is only non poor borrowers (with income over and above international standard poverty line) that can perform wonderfully well with micro finance institutions and enjoy sizeable positive impacts (Chowdhury, 2009). Also, it implies the provision of financial services to both poor and low-income people, whose low economic standing precludes them from formal financial systems. Access to services such as credit, venture capital, savings, insurance and remittance are provided on a micro-level to enable participation of those already marginalized in the formal financial sector. The provision of financial services to the poor helps to stem up aggregate household income and economic security, as well as create demand for other goods and services such as nutrition, education, and health care; and thus stimulating the local economies (Obaidullah, 2008).

Furthermore, the needs of the down trodden in Islamic states are not any different from the absolute poor in the contemporary societies except that those in Islamic countries are conditioned and influenced by faith and culture in a balanced manner. This group of people needs financial services to augment their financial short falls (IRTI, 2007). More so, for some time now, micro finance has won recognitions as an important strategy against poverty. Most poor households face problems in generating a steady and substantial income to save for their near future and are also extremely vulnerable to economic and political downturns, a situation that when a little drop in income or increase in expenditure can have a catastrophic effect on their already low profile of living. Sachs (2005) observed that 20, 000 people die daily while 8 million people die every year globally because of their poor financial status.

Furtherance to the above, IMF is however faced with numerous challenges ranging from exploitation, injustice, discrimination, instability, high rates of interest and crisis, generating device militating against the conventional financial system(Ahmed, *et al.,* 2000). In addition to the above view, the World Bank gave an estimation of over 7000 Micro Finance Institutions (MFIs) serving well over 16 million poor individuals in the developing countries. This needs to stem up in order to serve a greater number of the world's poorest households. In overcoming the above shortcomings of the traditional micro finance, Islamic banks and Islamic economics have been designed to play a very unique role in creating a better future for the poor, who have been marginalized for far too long by the formal financial sector. This calls for a paradigm shift from a debt-based economy, which is characterized by an unjust, exploitative and inequitable economy to a risk sharing, stake holding, participatory, community oriented, and people and environment friendly economy (Ahmed, *et al.*, 2000)

By extension to the above immediate views, Islamic finance has emerged in recent past decades as one of the most important developments in the financial world, gradually winning recognition at the global level. Apart from the caring of the Muslim markets throughout the world specifically in the Middle East and Southeast Asia (including Malaysia), the combination of ethical, social and financial considerations makes Islamic finance increasingly attractive (Ayub, 2008).

Poverty is the biggest moral challenge of this present time. More than three billion human beings in this world, out of 6.8 billion, live in absolute poverty. Muslim societies' approach to addressing the problems of poverty seems to be worse than the rest of the world. The Islamic world is enormous, with over 1.2 billion people, stretching from Senegal to the Philippines – comprising six regions: North Africa, Sub-Saharan Africa, the Middle East, Central Asia, South Asia, and Southeast Asia. Except for a handful of countries in Southeast Asia and the Middle East, there are high and rising poverty levels in both urban and rural parts of most Muslim countries. The world over, it is apparent that while the majority of people are living below the poverty line, only few have more than what they need for sustainable livelihood. Such situations or phenomena typically characterize most Muslim countries, where poverty and unequal income distribution are widespread. Without further delay, there is an urgent need to eradicate and control poverty, it being devilish as it also dehumanizes (Obaidullah, 2008; Obadan, 1996).

2.1.1 Islamic Micro Finance (IMF):

Micro finance emanated as a result of the poor not being well served and treated by the conventional Micro Finance Institutions, which viewed them as non bankable public mainly because they lacked the surety that was necessary to protect a financial institution against a financial loss risk (Segrado, 2005).

2.1.2 Micro Finance As A Solution To Poverty:

(Sachs, 2005) Explored the competitiveness of Islamic Micro Finance, and put up an argument that Islamic Micro Finance could be potential heaven for investors who have become serious victims of the current financial global crisis to relieve them from the excessive speculations of the conventional system. In support of the above view, Karim *et al.*, (2008) conducted a survey of 125 countries and 19 Muslim countries. According to the study, Islamic Micro Finance providers have only reached 300, 000 clients, which is just one-third of those concerned in Bangladesh. The study suggests that in order to reach out to a greater number of people and build a sustainable institution, it is imperative that we pay attention to affordable products, training and re-training of skilled loan appraisal officers and administrators, improving operational efficiency and proper management of business risk.

In a similar vein, (Akhter, 2009) examined Akhuwat, an Islamic Micro Finance organization operating in Pakistan. The study's critical financial analysis of the institution indicates that it provides services for all those living below the poverty line, including the hard core poor. They found that interest free loans could be used as a powerful tool against poverty. The study, however, recommends that integrating Islamic Micro Finance with NGOs, *Zakah*, *Awqaf* and *Takaful*, as well as with professional training and capacity building institutions, would enhance the financial stability of Islamic Micro Finance institutions, and help achieve their objective of providing Micro Financial services to the poorest of the poor under one roof apart from the formation of human capital.

Meanwhile, (Ahmed, 2007) observed that the absence of institutional credit guarantee is a critical factor that de-motivates commercial banks to be involved in micro-credit activities for low income groups in society as well as small and medium enterprises. He maintains that it is essential to establish linkages among various institutions at micro, as well as macro level, for the growth of Islamic Micro Finance industries. He further asserts that if various organizations, including government agencies, Central Bank, commercial and Islamic Banks, Takaful and cooperative companies, as well as Non-Governmental Organizations (NGOs) could be interlinked, they can reach out to the target poor of a society and significantly contribute towards the development of micro-enterprises, enhancing the financial inclusion and alleviating poverty from the gross-root levels of a society.

In the like manner, (Ahmed, 2007) opined that contemporary Islamic finance has been largely disengaged from Micro Finance. On the one hand, most Micro Finance institutions (MFIs) are not Islamic as their financing is interest–based, which is against the Islamic foundation of the institution. On the other hand, Islamic financial system has been dominated mainly by Islamic banks. He further argues that MFI has to create enormous reserves to cover various risks which could arise due to the nature of both its assets and liabilities. He suggests that in avoiding withdrawal risks, the MFI could apply *takaful* and profit-equalization reserves so as to give depositors the desired competitive returns. The study also found that the proportion of *waqf* funds that could be allocated into micro financing would largely depend on *takaful* and economic capital reserves.

In the same vein, (Hassan, 2010) focused on the integration of *zakat*, *waqf* and Islamic Micro Finance to alleviate poverty by applying a conceptual method. He observed the hardships conventional microfinance had brought to the poor, instead of alleviating them from the dire situation. The proposed model is expected to be financially sound and sustainable in the long run, resulting from proper use of *zakat f*unds, which do not require a pay back. The author said that the model would combine all three techniques, namely: positive, preventive and corrective measures (engaging the Islamic tools aforementioned).

In the like manner to the above, the (IDLO, 2009) observed that microfinance remained less developed in the Arab world than, for example, in Asia, Africa or Latin America, and although it seems to have taken hold in many Middle Eastern and North African (MENA) countries, it remains largely undeveloped in Saudi Arabia and is in its infancy in the UAE. However, since 2006, the UAE has staged several high profile microfinance conferences, showcasing microfinance initially as an alternative business model, in which participants might like to engage, and subsequently as an alternative asset class, in which participants might like to invest.

On January 17, 2008, Noor Islamic Bank announced its commitment to serving the unbankable public of the UAE population and, on January 20, 2009, at the Arab Economic, Social and *Development* Summit in Kuwait City¸ the League of Arab States announced the formation of a US$2 billion fund run by the Arab Development Fund that was earmarked for microfinance programme, which was aimed at helping small businesses through the credit crunch, extending credit to cottage industries and reducing unemployment across the Arab world. Similar to this, (Kholis, 2009) examined the contribution of Islamic Micro Finance in Indonesia as it affects Pakem market Traders in Yogyakarta. The study revealed that the microfinance was established by group initiatives in order to help micro and medium entrepreneurs, especially in villages or traditional markets, operationally based on the S*hari'ah.* The study found that there were positive results from the Islamic finance activities.

In contrast to the above views, Consultative Group to Assist the Poor (CGAP) opined that the target group of microfinance is not constituted by the poorest of the poor, who are in desperate need of other interventions such as food and quality healthcare, unlike those poor who live close to the border of the so called international standard poverty line. Thus, those living close to the poverty line border mentioned above could reach more easily to a decent quality of life as they have entrepreneurial skills but lack access to formal finance. The condition of this group is much better than those referred to by (Sachs, 2005).

2.2.1 Theoretical Framework Of The Study:

From most of the literatures studied, the emergence of Micro Finance Institutions was decisively explained. The unlawful diversion of micro-credit to consumption smoothing has been one of the important sources of credit default in conventional micro finance. Aside from this, charging of generalized interest and at an unreasonably higher rate also stood against poverty alleviation through credit rationing and adverse selection difficulties. This issue of higher interest rate has sent uncountable number of poor people into their untimely grave as a result of financial incapability, coupled with pressure from the the financial institutions in an attempt to recover the loaned money. In view of the above shortcomings, and in order to get them resolved, Islamic Micro Finance institution has surfaced and has been designed in an integrated manner by incorporating two Islamic traditional institutions, *waqf* and *zakat*. Some other literatures had included *takaful* with Islamic Micro Finance into a single frame work.

Such integrated model is expected to make available adequate and abundant funds to Islamic Micro Finance through funds from both *zakat* and *waqf*. The *zakat* fund would be used to fulfil the basic consumption needs of the hardcore poor target group (especially the aged and handicapped), and this is not repayable and must be disbursed within one financial year. Also, the *zakat* fund could be applied as a capital investment or business initiation fund in which no return is expected either.

In addition to the above, the *waqf* fund could also be used as an investible fund in providing capital investment and working capital financing for individual poor micro-businesses. However, there should be a standard selection procedure, while the beneficiaries of both *zakat* and *waqf* for micro-businesses should be subjected to training before disbursement. Also, the microfinance should adopt a system of close monitoring of individual businesses in order to checkmate the abuse of funds, and observe their successes, as well as gradual economic transformation, which is the main purpose of the financial assistance to the poor.

By extension to the above views, the existence of microfinance in a single model will reduce the chances of loan default because the basic consumption needs are already provided. Therefore, the poor micro entrepreneurs will be in better shape with routine monitoring. It should be noted that *waqf* capital amounts are repayable (Qard Hasan), unlike *zakat* that requires no repayment. However, the repayment must be in compliance with the *waqf* laws. The microfinance must definitely have other sources of funds in order to remain in financial business. Funds from these sources could be used to give loans to those individuals who are not qualified for *waqf* loan. However, organizations handling this should engage in a *Murabahah* relationship with the beneficiaries since such loan is also interest free.

2.3.1 Empirical Aspect Of The Study:

Akhuwat, an Islamic Micro Finance organisation in Pakistan, has developed a unique mosque-centred structure. Islamic Micro Finance is dispensed by small interest-free charitable loans (Qard al-Hasan), with an administration fee of 5 per cent in a spirit of Islamic brotherhood. There is no funding from international donors or financial institutions. All activities revolve around the mosques and involve close interaction with the community. There are no independent officers and loans are disbursed and recovered in the mosque. It uses collateral-free group and individual financing based on mutual guarantees. Anecdotal evidence suggests that the fact that loans are disbursed in a mosque, also attaches a religious sanctity to the oath of returning them on time (Karim, 2008).

Outreach Of Islamic Micro Finance By Country.

Region	No. of Institutions	%Female (Avg.)	Total no. of Clients	Total Outstanding Loan Portfolio (US$)	Avg. Loan Balance (US$)
Afghanistan	4	22	53,011	10,347,029	162
Bahrain	1	n/a	323	96,565	299
Bangladesh	2	90	111,837	34,490,490	280
Indonesia	105	60	74,698	122,480,000	1,640
Jordan	1	80	1,481	1,619,909	1,094
Lebanon	1	50	26,000	22,500,000	865
Mali	1	12	2,812	273,298	97
Pakistan	1	40	6,069	746,904	123
West Bank and Gaza	1	100	132	145,485	1102
Saudi Arabia	1	86	7,000	586,667	84
Somalia	1	n/a	50	35,200	704
Sudan	3	65	9,561	1,891,819	171
Syria	1	45	2,298	1,838,047	800
Yemen	3	58	7,031	840,240	146
Total	59		302,303	197,891,882	541

Source: CGAP Survey, 2007 as referred by (Karim, 2008).

The Table above shows the outreach of Islamic Micro Finance CGAP global survey in 2007 as referred by (Frasca, 2008) in which information was collected from over 126 Islamic MFIs and MFI experts in 19 Muslim countries. The survey reveals that Islamic MFIs have a total global outreach of 380, 000 clients (or an estimated one-half 1% of total microfinance outreach). Of this, 80, 000 of the above clients are served through a network of Indonesian cooperatives, while another 100, 000 are served by two large MFIs in Bangladesh. It must be stressed that the MENA region is particularly underserved as the CGAP's survey revealed that Islamic MFIs are concentrated in three countries, mainly Indonesia, Bangladesh and Afghanistan, accounting for only 80% of the global outreach.

Section-3:
Conclusion And Recommendations:

Islamic Micro Finance is an institution that is ready and prepared to serve larger population of the target poor individuals. It is unlike conventional micro finance that serves only those poor people who are close to the border of international standard poverty line because of the belief that they would be able to oblige repayment and turn around their economic fortune for good. The poor group (hardcore poor), meanwhile, is marginalized as they are not recognized by the formal financial sector.

Most Islamic Micro Finance Institutions embrace the integration of Islamic economic tools against poverty such as *zakat* and *waqf* to form its major sources of funds. This move will enable the hardcore poor to have funds for their basic consumption, while the productive poor would get money for starting their respective businesses, either through *zakat* if found eligible or *waqf*. Funds from *zakat* to either hardcore or relative poor are not repayable. Therefore, the issue of pressure from financial institutions on the poor for repayment is out of the issue. The funds disbursed to the relative or productive poor for micro business are expected to be strictly used for the intended purpose since basic consumption needs are already taken care of. Also, the funds from *waqf* should be regarded as loans to the beneficiaries and by virtue of this, they are repayable though interest free. This benevolent loan is regarded as (Qard al Hasan).

However, this paper suggests that before the disbursement of funds, either through *zakat* or *waqf* for micro business, the beneficiaries should be listed for vocational training through which they will be re-oriented with business and management skills, as well as the right attitude to enable them to perform wonderfully well in their respective micro businesses, eventually having better economic status. Those who are not qualified or eligible to either *zakat* or *waqf* could obtain loan from operational funds. It is expected that interest will not be paid while repayment of such loans should be in line with Islamic injunctions. This paper suggests a Murabahah relationship between the Islamic Micro Finance and the borrowers.

Furthermore, this paper recommends that the institution should monitor the beneficiaries' businesses in order to check any abuse of funds, which may likely arise from unlawful diversion. It should be noted that the essence of this financial assistance is to make the poor rich through gradual economic transformation, and in view of this, abuses must not be condoned. For better and successful performance of this holistic institution, governments should provide a legal framework, apart from making available a conducive and friendly environment, which will support and spur on the enhancement of the institution's vision and dream.

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