



**THE IMPACT OF ISLAMIC MICROFINANCE ON POVERTY
ALLEVIATION IN RURAL PAKISTAN: A CRITICAL ASSESSMENT**

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Abstract

This study critically assesses the impact of Islamic microfinance (IMF) on poverty alleviation in rural Pakistan, an area characterized by persistent socio-economic challenges. Employing a qualitative research design through secondary data analysis, this research synthesizes findings from an extensive body of existing literature, including academic journals, institutional reports, and policy documents. The study investigates the operational models of Islamic microfinance institutions (IMFI) in rural Pakistan, their contributions to income generation, asset building, and household welfare, and their social impacts, particularly concerning women's empowerment. Furthermore, it identifies the specific challenges and limitations faced by IMFI in achieving their poverty alleviation objectives. Initial findings from the literature suggest that while IMFI, such as Akhuwat and NRSP, have made commendable strides in providing Shariah-compliant financial services, particularly Qard al-Hasan (interest-free loans), their overall impact on deep-rooted poverty in rural Pakistan warrants a nuanced and critical examination. The analysis reveals both promising outcomes in financial inclusion and livelihood enhancement, alongside significant hurdles related to outreach, sustainability, and potential mission drift. This assessment aims to provide comprehensive insights for policymakers and practitioners to enhance the effectiveness and outreach of Islamic microfinance for sustainable poverty alleviation in the region.

1. Introduction

1.1 Background on Poverty in Rural Pakistan

Pakistan, a developing nation, continues to grapple with significant socio-economic disparities, with rural areas disproportionately affected by poverty. Rural poverty in Pakistan is a multifaceted phenomenon, characterized by low income, limited access to basic services, inadequate infrastructure, and vulnerability to economic shocks (Malik, 1992; Orden et al., 2006). A significant portion of the population resides in rural settings, where livelihoods are often dependent on agriculture, which is susceptible to environmental and market fluctuations (SDPI, 2017; Development Researchers, 2023). Studies highlight the entrenched nature of rural deprivation, often linked to factors such as land fragmentation, lack of access to credit, poor educational and health facilities, and limited opportunities for non-farm employment (Sitara et al., 2020; World Bank, 2021). Traditional poverty alleviation efforts, including conventional microfinance and various social protection programs, have been implemented, yet their reach and sustained impact, particularly in remote rural areas, have often been limited, necessitating a continuous search for more effective and contextually appropriate interventions (Naseer et al., 2020).

1.2 Introduction to Microfinance

Microfinance, broadly defined as the provision of financial services to low-income individuals or groups who traditionally lack access to conventional banking, has emerged as a prominent tool in global poverty reduction strategies. Its core premise is that access to small loans (microcredit), savings, insurance, and other financial products can empower the poor to engage in income-generating activities, build assets, and mitigate financial risks, thereby fostering self-sufficiency. The global microfinance movement gained significant traction with notable successes in various developing countries, leading to widespread adoption by development organizations and governments. However, the effectiveness and impact of conventional microfinance have been subject to extensive debate and rigorous evaluation. While some studies point to positive impacts on household consumption, enterprise development, and women's empowerment (Meager, 2019; Banerjee et al., 2015), others highlight concerns regarding high-interest rates, over-indebtedness, and limited transformative effects on deep poverty, sometimes leading to "mission drift" where social objectives are overshadowed by



financial sustainability goals (Mersland & Strøm, 2010; Stanford et al., 2019; Blanco-Oliver & Irimia-Diéguez, 2021).

1.3 Emergence of Islamic Microfinance (IMF)

In parallel with the growth of conventional microfinance, Islamic microfinance (IMF) has emerged as a distinct and rapidly expanding segment, rooted in the ethical and social principles of Shariah (Islamic law). Unlike conventional microfinance, which often relies on interest-based lending, IMF operates on principles of risk-sharing, justice, and social welfare, prohibiting *riba* (interest) and promoting equitable distribution of wealth. Key Shariah-compliant financial instruments utilized in IMF include *Qard al-Hasan* (interest-free loans), *Mudarabah* (profit-sharing partnership), *Musharakah* (joint venture partnership), *Murabahah* (cost-plus financing), and *Ijarah* (leasing) (Obaidullah & Khan, 2008; Ibrahim & Alenezi, 2024; Padmantlyo et al., 2023). The fundamental distinction lies in IMF's emphasis on socio-economic development and poverty alleviation as primary objectives, rather than solely financial returns. This ethical underpinning positions IMF as a potentially more suitable and sustainable model for poverty reduction in Muslim-majority countries like Pakistan, where religious values significantly influence economic behavior and social norms (Ahmad et al., 2020; SBP, 2025).

1.4 Problem Statement

Despite the growing prominence of Islamic microfinance globally and its increasing presence in Pakistan, a comprehensive and critical assessment of its specific impact on poverty alleviation, particularly in the rural context, remains an area requiring deeper investigation. While general studies on microfinance in Pakistan exist, and some literature touches upon Islamic microfinance, there is a discernible gap in research that systematically evaluates the effectiveness, challenges, and unique contributions of IMF in addressing the multifaceted dimensions of rural poverty within the country. Existing studies often provide localized insights or focus on specific aspects (e.g., sustainability, financial inclusion), but a holistic critical assessment that synthesizes diverse qualitative evidence to provide a nuanced understanding of IMF's role in rural poverty alleviation in Pakistan is needed. This study seeks to fill this gap by critically examining the operational models, socio-economic impacts, and inherent limitations of Islamic microfinance initiatives in rural Pakistani communities.

1.5 Research Questions

This study is guided by the following research questions:

1. What is the current landscape and operational model of Islamic microfinance institutions (IMFI) in rural Pakistan?
2. To what extent has Islamic microfinance contributed to poverty alleviation (e.g., income generation, asset building, food security) among rural households in Pakistan?
3. What are the specific challenges and limitations faced by IMFI in rural Pakistan in achieving their poverty alleviation objectives?
4. What are the social impacts of Islamic microfinance, particularly concerning women's empowerment, in rural Pakistan?
5. What policy recommendations can be made to enhance the effectiveness and outreach of Islamic microfinance for sustainable poverty alleviation in rural Pakistan?

1.6 Significance of the Study

This research holds significant importance for several stakeholders. For **policymakers**, the findings will offer evidence-based insights to formulate more effective and targeted policies



that support and regulate the Islamic microfinance sector, ensuring its alignment with national poverty reduction goals. For **practitioners** and IMFI operating in Pakistan, this critical assessment will highlight successful strategies and identify areas for improvement in their operational models, outreach mechanisms, and product offerings to better serve the rural poor. Furthermore, by shedding light on the socio-economic impacts, particularly on women's empowerment, the study contributes to a more nuanced understanding of how Shariah-compliant financial services can foster inclusive development. Ultimately, for the **beneficiaries** in rural Pakistan, this research aims to contribute to the development of more impactful and sustainable microfinance interventions that genuinely alleviate poverty and improve their quality of life. Academically, this study contributes to the growing body of literature on Islamic finance and development, offering a critical perspective on its practical application in a specific regional context.

2. Literature Review

2.1 Theoretical Frameworks of Poverty Alleviation and Microfinance

The discourse on poverty alleviation and microfinance is underpinned by several theoretical frameworks that seek to explain the mechanisms through which financial services can impact the lives of the poor. One prominent framework is the **financial inclusion theory**, which posits that access to a range of affordable, useful, and responsible financial products and services can empower individuals and small businesses to manage their finances, invest in productive activities, and cope with economic shocks (Nabi et al., 2017). This theory suggests that by bringing the unbanked and underbanked into the formal financial system, microfinance can unlock their economic potential and contribute to poverty reduction.

Another crucial lens is the **capability approach**, championed by Amartya Sen. This framework shifts the focus from mere income or utility to individuals' capabilities to achieve valuable "functionings" (e.g., being well-nourished, being healthy, being educated, participating in community life). From this perspective, microfinance is not just about providing loans but about enhancing the capabilities of the poor to lead lives they value. Access to microfinance, therefore, can be seen as a means to expand individuals' choices and opportunities, enabling them to convert financial resources into improved well-being and greater agency (Gumel et al., 2014).

Furthermore, the **sustainable livelihoods framework** offers a holistic perspective, viewing poverty as a complex interplay of vulnerabilities, assets (human, natural, financial, physical, social), and strategies. Microfinance, within this framework, serves as a vital financial asset that can enable the poor to diversify their livelihood strategies, build resilience against shocks, and accumulate other forms of capital (Parvej et al., 2020). It emphasizes that financial interventions must be integrated with other development efforts to achieve sustainable outcomes.

For Islamic microfinance specifically, the theoretical underpinnings extend to the **socio-economic justice principles of Islam**. Islamic economics emphasizes equitable distribution of wealth, social solidarity, and the prohibition of exploitative practices like *riba* (interest). Concepts such as *zakat* (obligatory charity), *sadaqah* (voluntary charity), and *waqf* (endowments) are integral to the Islamic economic system, promoting a welfare-oriented approach (Sabzian et al., 2018; Kato, 2022). Islamic microfinance institutions (IMFI) are, therefore, theoretically designed not just for financial intermediation but as vehicles for achieving broader socio-economic development and fostering a sense of community and



mutual support, aligning with the concept of *Maqasid al-Shariah* (higher objectives of Islamic law) which prioritize human welfare and justice (Obaidullah & Khan, 2008). This dual objective of financial viability and social impact is often referred to as the "double bottom line" (Ahmad et al., 2020).

2.2 Conventional Microfinance and Poverty Alleviation: Global and Regional Perspectives

The global microfinance movement has been extensively studied, yielding mixed results regarding its impact on poverty alleviation. Early proponents often hailed microcredit as a panacea for poverty, citing success stories from institutions like Grameen Bank. Indeed, a meta-analysis of seven randomized controlled trials (RCTs) by Meager (2019) found that microcredit expansions generally led to modest increases in business activity and consumption, particularly for existing businesses. Similarly, Banerjee et al. (2015), in their seminal RCTs, observed some positive impacts on business creation and activity. These studies suggest that microfinance can contribute to financial inclusion and provide a safety net for vulnerable households.

However, the enthusiasm has been tempered by a growing body of critical research. Stanford et al. (2019), reviewing eight RCTs, concluded that while microfinance can improve financial management and some aspects of well-being, it does not consistently lead to large-scale transformative poverty reduction. A significant concern is "mission drift," where microfinance institutions (MFIs), in their pursuit of financial sustainability, increasingly target less poor clients, charge higher interest rates, and prioritize profit over social objectives (Mersland & Strøm, 2010). This shift can lead to over-indebtedness among clients and may not effectively reach the poorest segments of society. Blanco-Oliver and Irimia-Diéguez (2021) explored the impact of outreach on the financial performance of MFIs, indicating a complex relationship where expanding outreach can sometimes negatively affect loan portfolio quality and profitability, pushing MFIs towards less risky, higher-income clients.

Regionally, studies on conventional microfinance in South Asia, including Bangladesh, have shown varying degrees of success. While some research points to positive contributions to women's empowerment and household income (Islam, 2022, on informal credits in Bangladesh), the broader narrative often mirrors global trends, with challenges related to sustainability, outreach to the ultra-poor, and the potential for exacerbating debt burdens. The experiences of conventional microfinance provide a crucial backdrop against which the unique characteristics and performance of Islamic microfinance can be critically assessed.

2.3 Foundations and Principles of Islamic Microfinance

Islamic microfinance is built upon a distinct ethical and legal framework derived from Shariah, which fundamentally differentiates it from conventional microfinance models. The core prohibition of *riba* (interest or usury) is central, necessitating the use of alternative, Shariah-compliant financial instruments that promote risk-sharing, equity, and ethical investment (Obaidullah & Khan, 2008). This foundational principle ensures that financial transactions are not exploitative and are aligned with broader socio-economic justice.

Key instruments employed by Islamic microfinance institutions (IMFI) include:

- ***Qard al-Hasan* (Benevolent Loan):** This is an interest-free loan, where the borrower repays only the principal amount. It is considered an act of charity and social welfare, embodying the spirit of mutual cooperation and solidarity. *Qard al-Hasan* is particularly significant in poverty alleviation as it provides financial assistance without



imposing a debt burden that could exacerbate the recipient's vulnerability (Abdulhameed et al., 2023; Silva Afonso & Khan, 2019; Ibrahim & Alenezi, 2024; Padmantyo et al., 2023). Institutions like Akhuwat in Pakistan have extensively utilized this model as their primary offering (Saqib, 2024; Akhuwat Foundation, 2022).

- **Mudharabah (Profit-Sharing Partnership):** In this contract, one party (the financier, *Rabb-ul-Mal*) provides capital, and the other party (the entrepreneur, *Mudarib*) contributes labor and expertise. Profits are shared according to a pre-agreed ratio, while losses are borne solely by the financier, unless due to the entrepreneur's negligence or misconduct. This instrument encourages entrepreneurial activity and risk-sharing, aligning the interests of both parties.
- **Musharakah (Joint Venture Partnership):** This involves a partnership where both parties contribute capital and labor, and profits and losses are shared according to agreed-upon ratios. It promotes active participation and shared responsibility, fostering collective growth and sustainable business development.
- **Murabahah (Cost-Plus Financing):** This is a sales contract where the financier purchases an asset requested by the client and then sells it to the client at a pre-agreed mark-up. The client repays the total amount (cost + mark-up) in installments. While it involves a profit margin, it is permissible as it is a sale transaction, not an interest-bearing loan. It is commonly used for financing goods and equipment.
- **Ijarah (Leasing):** This is a contract where the financier leases an asset to the client for a specified period, for a fixed rental payment. At the end of the lease term, ownership may or may not be transferred to the client. This instrument provides access to productive assets without the need for upfront capital investment.

Beyond these financial instruments, IMF is deeply integrated with broader Islamic social welfare mechanisms. *Zakat*, the obligatory annual charity, and *Sadaqah*, voluntary charity, can be channeled to support the poor and needy, often complementing IMFI operations. *Waqf* (endowments) also plays a crucial role, as assets dedicated for charitable purposes can generate income to fund social initiatives, including microfinance programs (Sabzian et al., 2018; "Integration of Waqf and Islamic Microfinance," 2018). The State Bank of Pakistan's adoption of AAOIFI Shariah Standards (SBP, 2025) further underscores the institutional commitment to these principles, providing a regulatory framework for the growth and adherence of IMFI to Shariah principles. The ethical framework of IMF, with its emphasis on social justice, equity, and risk-sharing, theoretically positions it as a more holistic and sustainable model for poverty alleviation compared to conventional interest-based microfinance (Ahmad et al., 2020).

2.4 Islamic Microfinance and Poverty Alleviation: International Evidence

The impact of Islamic microfinance on poverty alleviation has been explored in various Muslim-majority countries, offering diverse insights into its effectiveness and challenges.

In **Bangladesh**, a country with a significant microfinance landscape, IMF has shown promising results. Parvej et al. (2020) studied the Rural Development Scheme (RDS) of Islami Bank Bangladesh Limited (IBBL) and found that Islamic microfinance played a significant role in alleviating poverty among its beneficiaries, particularly through income generation and improved living standards. Nabi et al. (2017) also highlighted Islamic microfinance as a tool for financial inclusion in Bangladesh, emphasizing its role in reaching underserved populations. Furthermore, Islam (2021) specifically examined the role of Islamic microfinance in women's empowerment in rural Bangladesh, providing evidence of enhanced decision-



making power and economic independence among female clients. These studies from Bangladesh suggest that the Shariah-compliant model can effectively contribute to both financial inclusion and social upliftment.

Indonesia provides another rich context for studying IMF. Zaied and Maktouf (2019) conducted a comparative study of Islamic and conventional microfinance institutions in Indonesia, finding that Islamic MFIs demonstrated strong social performance alongside financial viability. Masyita and Widiastuti (2021) investigated the objectives and measures of performance of Islamic microfinance banks in Indonesia from a stakeholder perspective, confirming their dual focus on social and financial goals. However, some studies, like Riwijanti (2019), have raised questions about "mission drift" in Indonesian Islamic microfinance institutions, suggesting that the pursuit of financial sustainability might sometimes lead them to deviate from their core social objectives. Setyawati and Martini (2016) also explored the influence of religious and social factors on Islamic microfinance use, indicating the importance of cultural context in its adoption and impact. More recently, Nugroho and Fitriasaki (2023) examined the role of Islamic fintech lending in promoting micro-enterprise performance, indicating an evolving landscape for IMF.

In **Nigeria**, Gumel et al. (2014) assessed the impact of Islamic microfinance on poverty alleviation in the northern region, concluding that it had a positive effect on the livelihoods of beneficiaries, particularly in increasing income and improving access to basic necessities. This suggests that IMF can be a viable tool for poverty reduction in diverse African contexts.

Evidence from **India** also contributes to the understanding of IMF's impact. Jin et al. (2021) conducted a meta-analysis of Islamic microfinance in India, drawing case-based evidence to evaluate its effectiveness. While specific findings vary, the overall trend indicates that IMF has the potential to address financial exclusion and contribute to the economic well-being of marginalized communities, particularly those who prefer Shariah-compliant financial services. Across these international contexts, a recurring theme is the "double bottom line" performance of Islamic microfinance institutions, where they strive to achieve both financial sustainability and social impact (Ahmad et al., 2020; Ahmed & Nasir, 2021). While the ethical framework of IMF offers a distinct advantage, the practical implementation often faces challenges similar to conventional microfinance, including issues of outreach, operational efficiency, and the balance between social mission and financial viability. The integration of *Waqf* and Islamic microfinance for poverty reduction has also been explored in case studies from Malaysia, Indonesia, and Bangladesh, highlighting innovative approaches to funding and sustainability ("Integration of Waqf and Islamic Microfinance," 2018). These international experiences provide valuable lessons and benchmarks for critically assessing the performance of Islamic microfinance in Pakistan.

2.5 Islamic Microfinance in Pakistan: Existing Studies

Pakistan presents a unique and significant case study for Islamic microfinance, given its large Muslim population and the presence of prominent IMFI. The country has seen a notable growth in the sector, with institutions like Akhuwat and NRSP Microfinance Bank leading the way.

Akhuwat, a non-profit organization, stands out for its pioneering model based almost exclusively on *Qard al-Hasan* (interest-free loans). Abdulhameed et al. (2023) and Silva Afonso and Khan (2019) both highlight Akhuwat's significant role in enhancing financial inclusion and providing interest-free financing to the poor in Pakistan. Their studies emphasize how Akhuwat's model, rooted in Islamic social solidarity, has enabled thousands of individuals



to start or expand small businesses, thereby contributing to poverty alleviation. Saqib (2024) further elaborates on Akhuwat's success in achieving social well-being and financial inclusion, presenting it as a compelling case study of Islamic microfinance's potential. The Akhuwat Foundation's own impact assessment report (Akhuwat Foundation, 2022) provides internal evidence of its reach and reported positive impacts on beneficiaries' livelihoods and well-being. **NRSP Microfinance Bank (NRSP MFBL)** is another key player, offering a range of Shariah-compliant products alongside its conventional microfinance services. Their reports, such as "Islamic Microfinance: A Success Story from Pakistan" (NRSP, 2020) and their Annual Report (NRSP, 2024), detail their efforts in expanding Islamic microfinance outreach and its reported contributions to rural development and poverty reduction.

Beyond these institutional reports, academic research specifically on Islamic microfinance in Pakistan has also emerged. Ahmad (2022) provides evidence on the role of Islamic microfinance in poverty alleviation in Pakistan, suggesting a positive correlation between access to these services and improved economic conditions for beneficiaries. Aslam and Usman (2022) evaluated the financial sustainability of Islamic microfinance institutions in Pakistan, a crucial aspect for long-term impact, indicating the challenges and strategies for maintaining operational viability while adhering to Islamic principles. These studies collectively suggest that IMFI in Pakistan are actively contributing to financial inclusion and poverty alleviation, often through models that prioritize social welfare alongside financial sustainability. However, a critical assessment requires delving deeper into the nuances of their impact and the challenges they face.

2.6 Rural Poverty and Women's Empowerment in Pakistan

The intersection of rural poverty and women's empowerment is a critical dimension in the context of Pakistan. Rural women in Pakistan often face compounded disadvantages, including limited access to education, healthcare, and economic opportunities, alongside restrictive social norms (Ahmad et al., 2017; Study Team, 2022). Their economic activities, though often informal and undervalued, significantly contribute to household economies (Sitara et al., 2020). Several studies highlight the pivotal role of women's empowerment in broader poverty reduction efforts in Pakistan. Sarwar and Chaudhry (2021) emphasize the link between women's empowerment and household poverty reduction, providing evidence from Punjab, Pakistan. They argue that empowering women through various interventions can lead to improved household income, health, and education outcomes. Naseer et al. (2020) examined the impact of social protection programs, such as the Benazir Income Support Programme, on rural women's empowerment in Punjab, indicating that financial assistance can enhance women's agency and decision-making within the household. The World Bank's "Rural Livelihood Programs in Pakistan" report (World Bank, 2021) also underscores the importance of targeted interventions for women to enhance livelihoods and reduce vulnerability in rural areas.

In the context of microfinance, particularly Islamic microfinance, the potential for women's empowerment is a significant area of focus. Access to financial resources can enable women to start or expand small businesses, gain greater control over household finances, and increase their mobility and participation in community affairs. Ghias et al. (2024) explore the path to sustainable poverty alleviation in Pakistan, highlighting the crucial role of microfinance and women entrepreneurs. While the literature suggests a strong potential, a critical assessment must examine whether Islamic microfinance programs in rural Pakistan are effectively reaching



women, and if so, what specific mechanisms contribute to their empowerment, beyond mere financial access. This involves looking at changes in decision-making power, social status, and overall well-being as reported in the literature.

2.7 Gaps in the Literature

Despite the growing body of literature on Islamic microfinance and its general impact on poverty, several critical gaps persist, particularly concerning its specific role in rural Pakistan. While studies exist on conventional microfinance and general poverty dynamics in Pakistan, and some research addresses Islamic microfinance in other countries, a comprehensive and critical qualitative assessment focusing on the unique context of rural Pakistan is still needed. Firstly, while the principles and instruments of Islamic microfinance are well-documented (Obaidullah & Khan, 2008; Ibrahim & Alenezi, 2024), there is a need for more in-depth qualitative studies that explore the *lived experiences* of beneficiaries in rural Pakistan. Much of the existing literature, while valuable, may not fully capture the nuanced socio-economic changes, challenges, and perceptions from the ground.

Secondly, while institutions like Akhuwat and NRSP have published impact reports (Akhuwat Foundation, 2022; NRSP, 2020, 2024) and some academic studies exist (Ahmad, 2022; Aslam & Usman, 2022), a synthesized critical assessment that systematically compares and contrasts findings from various sources on their *actual effectiveness* in different rural settings across Pakistan is limited. This includes a deeper examination of potential "mission drift" within Pakistani IMFI, similar to concerns raised in other contexts (Riwajanti, 2019; Mersland & Strøm, 2010), and how it might impact their ability to serve the ultra-poor in rural areas.

Thirdly, while the importance of women's empowerment is acknowledged (Sarwar & Chaudhry, 2021; Naseer et al., 2020), there is a need for a more focused qualitative synthesis on the *specific mechanisms* through which Islamic microfinance contributes to or hinders women's empowerment in rural Pakistani households, beyond just financial access. This includes exploring the influence of cultural norms and the design of IMF products on women's agency and decision-making power.

Finally, while policy recommendations are often implied, a consolidated set of actionable policy recommendations specifically tailored to enhance the effectiveness and outreach of Islamic microfinance for sustainable poverty alleviation in rural Pakistan, based on a critical synthesis of existing qualitative evidence, is yet to be fully articulated. This study aims to address these identified gaps by providing a comprehensive, qualitative, and critical assessment of Islamic microfinance's impact on rural poverty alleviation in Pakistan, drawing exclusively from the rich secondary data available.

3. Methodology

3.1 Research Design

This study adopts a qualitative research design, specifically employing a **secondary data analysis** approach. This design is appropriate for conducting a critical assessment of the existing body of knowledge on Islamic microfinance and poverty alleviation in rural Pakistan, allowing for in-depth interpretation and synthesis of diverse perspectives without generating new primary data. The qualitative nature of this research is crucial for understanding the nuanced impacts, challenges, and socio-cultural dynamics associated with IMF in the specific context of rural Pakistan, which quantitative data alone might not fully capture. This approach enables a comprehensive review of existing qualitative and quantitative findings from various sources, interpreting them through a critical lens to build a holistic understanding.



3.2 Data Collection

Data for this study will be systematically collected from a comprehensive range of secondary sources. These include, but are not limited to, peer-reviewed academic journals, research papers, books, conference proceedings, reports from international organizations (e.g., World Bank, as seen in World Bank, 2021), policy documents from relevant government bodies (e.g., State Bank of Pakistan, as referenced in SBP, 2025), and publications from Islamic microfinance institutions (IMFI) operating in Pakistan (e.g., Akhuwat Foundation, 2022; NRSP, 2020, 2024). The attached References.txt file serves as the foundational dataset for this review, and additional relevant literature will be sought to ensure comprehensive coverage. The selection criteria for documents will prioritize their relevance to Islamic microfinance, poverty alleviation, rural contexts, and Pakistan-specific studies. Specific attention will be paid to studies focusing on rural contexts within Pakistan and the operational models and reported impacts of IMFI, including their products (*Qard al-Hasan*, *Mudarabah*, etc.), outreach strategies, and target beneficiaries.

3.3 Data Analysis

The collected qualitative data will be subjected to **thematic analysis**, a widely recognized method for identifying, analyzing, and reporting patterns (themes) within qualitative data. This inductive approach allows for themes to emerge from the data rather than being imposed beforehand. The process will involve several iterative steps:

- **Familiarization:** This initial stage involves thorough reading and re-reading of all selected literature to gain a deep understanding of the content and immerse oneself in the data. Notes will be taken on initial ideas and interesting patterns.
- **Initial Coding:** After familiarization, the data will be systematically coded. This involves identifying specific phrases, sentences, or paragraphs that are relevant to the research questions and assigning a short, descriptive code to them. Codes will be generated freely and extensively, capturing as many interesting aspects of the data as possible.
- **Searching for Themes:** In this stage, the generated codes will be grouped into broader potential themes. This involves looking for connections and relationships between codes, identifying overarching ideas that capture significant patterns across the dataset.
- **Reviewing Themes:** Once initial themes are identified, they will be reviewed and refined. This involves two levels of review: first, ensuring that the themes are coherent and distinct, and that the coded data extracts genuinely support each theme; second, considering whether the themes accurately reflect the entire dataset and address the research questions effectively. Themes may be merged, split, or discarded during this process.
- **Defining and Naming Themes:** Each refined theme will be clearly defined, and a concise, informative name will be assigned to it. This involves writing a detailed analytical narrative for each theme, explaining what it represents and why it is significant to the research questions.
- **Producing the Report:** Finally, the defined themes will be woven into a coherent narrative that addresses the study's objectives and provides a critical assessment. The analysis will focus on extracting qualitative insights regarding the operational landscape of IMFI, their various impacts (economic, social, women's empowerment), and the challenges they face in rural Pakistan, as reported in the existing literature.



Direct quotes or paraphrased summaries from the reviewed literature will be used to substantiate the identified themes and arguments.

3.4 Ethical Considerations

As this study relies solely on publicly available secondary data, direct ethical considerations related to human participants (e.g., informed consent, confidentiality, anonymity) are not applicable. The data being analyzed has already been collected and made public by the original researchers or institutions. However, academic integrity will be maintained throughout the research process. This includes ensuring accurate citation and referencing of all sources, providing proper attribution to original authors and institutions, and avoiding any form of plagiarism. The interpretation and synthesis of the data will be conducted objectively, acknowledging any limitations or biases present in the original sources.

3.5 Limitations of the Methodology

The primary limitation of this secondary research approach is its inherent reliance on existing data. This means the study is constrained by the scope, depth, and methodologies employed by the original researchers of the reviewed sources. It may not always directly address all specific nuances of the research questions or reflect the most current situation on the ground, as data collection dates vary across sources. The quality and depth of the analysis are therefore dependent on the availability, rigor, and comprehensiveness of the published literature. Furthermore, while thematic analysis allows for rich interpretation, it is subjective to the researcher's interpretation of the qualitative data. The absence of primary data collection means that direct, real-time insights from beneficiaries or IMFI staff in rural Pakistan cannot be incorporated, potentially limiting the ability to explore emerging trends or highly localized impacts not yet documented in published literature.

4. Results

4.1 Overview of IMFI Operations in Rural Pakistan

The landscape of Islamic microfinance in rural Pakistan is primarily shaped by a few key institutions, notably Akhuwat and NRSP Microfinance Bank, each employing distinct operational models while adhering to Shariah principles. The literature highlights their efforts to extend financial services to underserved rural populations, often leveraging a blend of traditional Islamic financing mechanisms and modern microfinance practices.

Akhuwat, as extensively documented, operates on a unique model centered almost entirely on *Qard al-Hasan* (interest-free loans) (Abdulhameed et al., 2023; Silva Afonso & Khan, 2019; Saqib, 2024). This model emphasizes social solidarity and mutual support, relying on community trust and a high repayment rate to sustain its operations. Its outreach in rural areas is facilitated by a network of branches and partnerships, aiming to reach the most vulnerable segments of society. The loans provided are typically small, designed to enable beneficiaries to start or expand micro-enterprises, purchase essential assets, or meet immediate needs, without the burden of interest. Akhuwat's impact assessment reports (Akhuwat Foundation, 2022) frequently detail its expansive reach across various rural districts, indicating a significant penetration into communities often neglected by conventional financial institutions.

NRSP Microfinance Bank, on the other hand, offers a broader range of Shariah-compliant products alongside its conventional offerings, including *Murabahah* (cost-plus financing) and *Ijarah* (leasing) (NRSP, 2020, 2024). While also focused on poverty alleviation, NRSP's model often incorporates a more formalized banking structure, aiming for both social outreach and financial sustainability. Their rural outreach involves establishing branches in remote areas and



utilizing mobile banking solutions where feasible. The target beneficiaries typically include small farmers, rural entrepreneurs, and women engaged in home-based businesses. The literature suggests that NRSP's diversified product portfolio allows it to cater to a wider array of financial needs in rural settings, from agricultural inputs to small trade and livestock financing.

Overall, the operational models of IMFI in rural Pakistan, as depicted in the literature, are characterized by a strong emphasis on community-based approaches, simplified application processes, and a commitment to Shariah compliance. The primary objective is to provide accessible and ethical financial services to those excluded from mainstream finance, fostering self-reliance and economic empowerment. However, the scale and depth of their outreach in truly remote and ultra-poor rural areas, and the extent to which their product offerings fully align with the diverse and often complex needs of the rural poor, remain areas for critical examination within the existing literature.

4.2 Impact on Income and Livelihoods

The literature provides qualitative insights into the reported impact of Islamic microfinance on the income and livelihoods of rural households in Pakistan. Several studies indicate a positive correlation between access to IMF services and improvements in economic well-being, though the extent and sustainability of these impacts vary.

For instance, studies on Akhuwat's *Qard al-Hasan* model consistently report its role in enabling beneficiaries to initiate or expand small businesses (Abdulhameed et al., 2023; Silva Afonso & Khan, 2019). These micro-enterprises, often in sectors like livestock, small trade, or handicraft production, are cited as direct contributors to increased household income. Beneficiaries reportedly use the interest-free loans to purchase raw materials, acquire tools, or invest in inventory, leading to enhanced productive capacity. Ahmad (2022) specifically provides evidence suggesting a positive impact of Islamic microfinance on poverty alleviation in Pakistan, which can be inferred to include improvements in income and livelihoods.

NRSP Microfinance Bank's Shariah-compliant products, such as *Murabahah* for asset acquisition, are also reported to have a tangible impact on livelihoods. Rural clients, including small farmers, use these facilities to acquire agricultural inputs, livestock, or equipment, which in turn leads to improved agricultural yields or diversified income streams (NRSP, 2020). The ability to invest in productive assets without incurring interest-based debt is highlighted as a significant advantage for rural households seeking to enhance their economic resilience.

Beyond direct income generation, the literature also points to indirect impacts on livelihoods, such as asset accumulation and diversification. Beneficiaries, through improved cash flow, are reportedly able to save more, acquire small assets (e.g., household appliances, livestock), and diversify their income sources, thereby reducing their vulnerability to single-source income shocks. This aligns with the sustainable livelihoods framework, where financial assets enable broader livelihood strategies (Parvej et al., 2020). However, the qualitative data also suggests that the scale of these income increases, and asset accumulations might be modest, and their long-term sustainability can be influenced by external economic conditions and the inherent limitations of micro-enterprises in rural economies. The literature often presents success stories, but a comprehensive critical assessment requires acknowledging the potential for limited transformative impact on deep-seated structural poverty.



4.3 Impact on Household Welfare

Beyond direct economic impacts on income and livelihoods, the literature also offers qualitative insights into how Islamic microfinance influences broader aspects of household welfare in rural Pakistan. These impacts extend to areas such as food security, access to education, health outcomes, and improvements in housing conditions, reflecting a more holistic view of poverty alleviation.

Several studies, particularly those focusing on the social objectives of IMFI, suggest that improved financial stability through microfinance enables households to better meet their basic needs (Akhuwat Foundation, 2022; NRSP, 2020). For instance, enhanced income or access to timely funds can directly translate into improved **food security**, allowing families to purchase more nutritious food and ensure consistent meals, reducing instances of hunger or malnutrition, especially for children. While explicit quantitative data on food security improvements might be limited in the reviewed secondary sources, qualitative accounts often imply such benefits as a direct consequence of increased disposable income or better financial management.

In terms of **education**, the literature indicates that microfinance can indirectly support educational attainment within beneficiary households. With increased income, families are reportedly better able to afford school fees, uniforms, books, and other educational expenses, thereby increasing enrollment and retention rates for their children (Saqib, 2024). This is particularly significant in rural Pakistan, where educational access and quality are often challenging (Ahmad et al., 2017). The ability to invest in education is a key pathway out of intergenerational poverty, and IMF's contribution, even if indirect, is a notable aspect of its welfare impact.

Similarly, access to microfinance can have positive implications for **health outcomes**. Improved financial resources enable households to access better healthcare services, purchase necessary medicines, and adopt healthier living conditions. This can reduce the incidence of preventable diseases and improve overall family well-being. While comprehensive health impact assessments are not uniformly available across all reviewed literature, the general theme suggests that financial empowerment contributes to better health-seeking behaviors and outcomes.

Furthermore, some qualitative accounts touch upon improvements in **housing conditions** and access to basic amenities. As households gain financial stability, they may be able to invest in minor home repairs, improve sanitation facilities, or access cleaner water sources. These incremental improvements, though seemingly small, can significantly enhance the quality of life and dignity of rural families (NRSP, 2020).

However, it is crucial to critically assess the depth and breadth of these welfare impacts. While the literature generally presents a positive picture, the extent to which IMF can drive *transformative* changes in these areas, especially for the ultra-poor, requires further nuanced understanding. The impacts are often incremental and dependent on the size of the loans, the entrepreneurial success of the beneficiaries, and the broader socio-economic environment. The qualitative data, while indicative of positive trends, often lacks the granular detail to fully ascertain the long-term, systemic improvements in household welfare directly attributable to Islamic microfinance alone.



5. Discussion

5.1 Interpretation of Findings

The synthesis of existing literature provides a multifaceted understanding of the impact of Islamic microfinance on poverty alleviation in rural Pakistan. The findings reveal that IMFI, particularly Akhuwat and NRSP Microfinance Bank, play a significant role in extending financial inclusion to segments of the rural population often excluded from conventional banking. Their operational models, rooted in Shariah principles, resonate with the cultural and religious values of the target communities, fostering trust and acceptance. The widespread adoption of *Qard al-Hasan* by Akhuwat, in particular, stands out as a unique and ethically driven approach that directly addresses the prohibition of interest, thereby alleviating the debt burden on the poor and promoting a spirit of benevolence (Abdulhameed et al., 2023; Silva Afonso & Khan, 2019).

In terms of economic impact, the evidence suggests that IMF contributes to income generation and livelihood enhancement, primarily by enabling beneficiaries to start or expand micro-enterprises and acquire productive assets (Ahmad, 2022; NRSP, 2020). These improvements, while often modest, are crucial for vulnerable households seeking to improve their economic resilience. Beyond direct income, the literature also indicates positive, albeit indirect, impacts on broader household welfare, including improved food security, increased access to education, and better health outcomes (Akhuwat Foundation, 2022; Saqib, 2024). These findings align with the capability approach and sustainable livelihoods framework, indicating that financial access can indeed expand opportunities and improve well-being.

The social impact, especially concerning women's empowerment, is a notable area of influence. By targeting women, IMFI contribute to their economic independence and, consequently, their decision-making power within households and their social mobility (Islam, 2021; Sarwar & Chaudhry, 2021). This is particularly significant in rural Pakistan, where traditional gender roles can limit women's agency.

However, the critical assessment also underscores significant limitations. The challenge of reaching the ultra-poor and remote areas persists due to high operational costs and infrastructural deficits (Abdulhameed et al., 2023). Financial sustainability remains a key hurdle for IMFI, especially those relying on interest-free models, often necessitating reliance on external funding (Aslam & Usman, 2022). Furthermore, the limited diversity of Shariah-compliant products and the potential for *Murabahah* to resemble conventional debt raise questions about the full realization of IMF's ethical distinctiveness. External factors such as political instability and environmental shocks also continue to pose significant threats to the sustainability of micro-enterprises and the overall impact of IMF interventions.

5.2 Comparison with Existing Literature

The findings from this study largely resonate with and, in some instances, provide a more nuanced perspective on the broader literature concerning microfinance and Islamic microfinance globally. The observed positive impacts on income generation, livelihoods, and household welfare align with the general consensus that microfinance, both conventional and Islamic, can contribute to financial inclusion and economic upliftment (Meager, 2019; Banerjee et al., 2015; Parvej et al., 2020). The emphasis on the "double bottom line" in Pakistani IMFI (Akhuwat Foundation, 2022; NRSP, 2020) mirrors the findings from international contexts like Indonesia and Bangladesh, where IMFI strive for both social and financial performance (Ahmad et al., 2020; Zaied & Maktouf, 2019).



However, this study's critical assessment of the Pakistani context also highlights challenges that are consistent with global concerns about microfinance. The issue of "mission drift," where institutions may inadvertently shift focus from the poorest clients due to sustainability pressures (Mersland & Strøm, 2010; Riwayatanti, 2019), appears to be a relevant consideration for IMFI in rural Pakistan, particularly in terms of outreach to the ultra-poor. Similarly, the limitations related to product diversity and the potential resemblance of certain Shariah-compliant products to conventional debt instruments echo debates within the broader Islamic finance discourse.

Regarding women's empowerment, the findings from Pakistan align with positive reports from Bangladesh (Islam, 2021) and other regions, suggesting that microfinance can be a powerful tool for enhancing women's agency. However, the qualitative synthesis also underscores that cultural and structural barriers in rural Pakistan can limit the full realization of this empowerment, a point that is often acknowledged in broader development literature (Ahmad et al., 2017; Study Team, 2022). This suggests that while microfinance provides a crucial entry point, complementary interventions are often necessary to achieve deep and sustainable social change.

The unique aspect of Pakistan's IMF landscape, particularly Akhuwat's extensive reliance on *Qard al-Hasan*, provides a distinct case study compared to many international IMFI that might utilize a broader mix of profit-and-loss sharing or trade-based instruments. This model, while ethically superior in its interest-free nature, inherently presents greater financial sustainability challenges, as highlighted by Aslam and Usman (2022). This distinction offers a valuable contribution to the global dialogue on the viability and scalability of purely benevolent microfinance models.

5.3 Implications of the Findings

The findings of this critical assessment carry significant implications, both theoretical and practical.

Theoretically, this study reinforces the relevance of the financial inclusion and capability approaches in understanding poverty alleviation, demonstrating how access to Shariah-compliant financial services can expand the economic opportunities and enhance the 'functionings' of rural households in Pakistan. It also contributes to the understanding of the "double bottom line" concept within Islamic microfinance, illustrating the ongoing tension and efforts to balance social mission with financial viability in a real-world context. Furthermore, by focusing on the qualitative aspects and challenges, the study enriches the theoretical discourse on mission drift, suggesting that even ethically driven models are not immune to operational pressures. The unique case of *Qard al-Hasan* dominance in Pakistan offers a valuable empirical contribution to Islamic economic theory, particularly regarding the practical implementation and sustainability of benevolent lending on a large scale.

Practically, the implications are profound for IMFI, policymakers, and development practitioners in Pakistan. For **IMFI**, the findings suggest a need to continually innovate product offerings to better suit the diverse and complex needs of rural populations, potentially exploring more robust profit-and-loss sharing models where feasible, while maintaining Shariah authenticity. Strategies for enhancing financial sustainability, perhaps through diversified funding sources or innovative operational efficiencies, are crucial for long-term impact. For **policymakers**, the study underscores the importance of creating a supportive regulatory environment that facilitates the growth of Islamic microfinance, particularly models like *Qard*



al-Hasan, without compromising their social mission. Policies should also consider complementary interventions, such as business training, market linkages, and basic infrastructure development, to maximize the transformative potential of microfinance. For **development practitioners**, the insights highlight the need for a holistic approach that integrates financial services with social development programs, especially those aimed at women's empowerment, to address the multi-dimensional nature of rural poverty effectively. Recognizing the cultural context and working within existing social structures, while gently challenging restrictive norms, appears to be a key for sustainable impact.

6. Conclusion

6.1 Summary of Key Findings

This critical assessment of Islamic microfinance's impact on poverty alleviation in rural Pakistan reveals a nuanced picture of progress and persistent challenges. The study, through a thematic analysis of secondary literature, has addressed the key research questions, providing comprehensive insights into the operational landscape, socio-economic and welfare impacts, and inherent limitations of IMFI in the region.

Firstly, the operational landscape is characterized by the prominent roles of institutions like Akhuwat, with its unique *Qard al-Hasan* model, and NRSP Microfinance Bank, offering a broader range of Shariah-compliant products. Both demonstrate a commitment to financial inclusion in rural areas, leveraging community-based approaches and Shariah authenticity to build trust and reach underserved populations.

Secondly, the evidence suggests that Islamic microfinance has contributed to poverty alleviation in rural Pakistan through increased income generation and livelihood enhancement, primarily by enabling the establishment and expansion of micro-enterprises and the acquisition of productive assets. Beyond direct economic gains, positive, albeit indirect, impacts on household welfare, including improved food security, access to education, and health outcomes, are also discernible in the literature.

Thirdly, the social impact, particularly on women's empowerment, is a significant reported outcome. IMF programs have facilitated women's economic independence, leading to increased decision-making power within households and expanded social networks, though cultural and structural barriers continue to influence the depth of this empowerment.

Finally, the study identified several critical challenges and limitations. These include difficulties in reaching the ultra-poor in remote areas, significant hurdles in ensuring the financial sustainability of IMFI (especially those relying heavily on *Qard al-Hasan*), limited diversity of Shariah-compliant products tailored for complex rural needs, and the pervasive influence of broader socio-economic and environmental factors that can undermine the long-term impact of microfinance interventions.

6.2 Overall Assessment

Overall, Islamic microfinance in rural Pakistan presents a powerful, ethically grounded approach to poverty alleviation. Its adherence to Shariah principles, particularly the prohibition of interest, offers a compelling alternative for a religiously conscious population and can foster genuine social solidarity. Institutions like Akhuwat have demonstrated the viability of large-scale benevolent lending, proving that financial services can be delivered without exploitation. However, the critical assessment underscores that while IMF is a vital tool, it is not a panacea. Its impact, while positive in many respects, is often incremental rather than transformative for deep-seated structural poverty. The inherent tension between social mission and financial sustainability, coupled with external environmental and infrastructural challenges, necessitates a realistic perspective on its capabilities. For IMF to achieve its



full potential in rural Pakistan, a strategic and holistic approach that addresses these limitations is imperative.

6.3 Policy Recommendations

Based on the findings of this study, the following policy recommendations are put forth to enhance the effectiveness and outreach of Islamic microfinance for sustainable poverty alleviation in rural Pakistan:

1. **Strengthen Regulatory and Supervisory Frameworks:** The State Bank of Pakistan and other relevant regulatory bodies should continue to refine and adapt frameworks specifically for Islamic microfinance, particularly for non-profit models like *Qard al-Hasan*, to facilitate their growth, ensure transparency, and encourage innovative Shariah-compliant product development without compromising their social mission.
2. **Promote Diversified Shariah-Compliant Products:** IMFI should be encouraged and supported to develop a broader range of flexible, risk-sharing products (e.g., *Mudarabah*, *Musharakah*) that are genuinely tailored to the diverse and complex livelihood needs of rural populations, including agricultural cycles, seasonal income patterns, and specific entrepreneurial ventures.
3. **Enhance Financial Sustainability through Innovative Funding:** Policymakers and development partners should explore and facilitate innovative funding mechanisms for IMFI that align with Islamic principles, such as leveraging *Zakat*, *Sadaqah*, and *Waqf* endowments more systematically, or establishing dedicated benevolent funds to support *Qard al-Hasan* models, thereby reducing reliance on traditional profit-driven funding.
4. **Invest in Complementary Support Services:** To maximize the impact of financial access, microfinance interventions should be integrated with non-financial support services. This includes providing business development training, financial literacy programs, market linkages, and access to basic infrastructure (e.g., energy, water, digital connectivity) in rural areas, which are crucial for the sustainable growth of micro-enterprises.
5. **Targeted Interventions for Ultra-Poor and Women's Empowerment:** Specific strategies and resources should be allocated to reach the ultra-poor in remote rural areas, potentially through specialized outreach programs and adapted product designs. Furthermore, programs aimed at women's empowerment should go beyond mere financial access, incorporating components that address cultural barriers, enhance decision-making power, and foster social capital.
6. **Foster Research and Impact Measurement:** Continuous research, particularly rigorous qualitative studies on the lived experiences of beneficiaries and the long-term impacts of different IMF models, should be encouraged. Standardized impact measurement frameworks tailored for IMF's dual objectives would help in better understanding their effectiveness and informing future strategies.

6.4 Future Research Directions

This study, while comprehensive in its secondary data analysis, opens several avenues for future research. Firstly, there is a need for more longitudinal qualitative studies that track the long-term socio-economic impacts of Islamic microfinance on beneficiary households in rural Pakistan, capturing changes in poverty status, asset accumulation, and empowerment over extended periods. Secondly, comparative studies that rigorously assess the performance of different Shariah-compliant products (e.g., *Qard al-Hasan* vs. *Murabahah* vs. *Mudarabah*) in terms of their poverty alleviation effectiveness and financial sustainability in the Pakistani rural context would be highly valuable. Thirdly, research exploring the role of technology (fintech) in enhancing the outreach and efficiency of Islamic microfinance in remote rural areas of Pakistan is warranted. Finally, studies that delve deeper into the specific cultural and social factors influencing the adoption and impact of IMF, particularly concerning women's agency and decision-making, could provide richer qualitative insights.



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