Islamic Microfinance in Indonesia: A Comparative Analysis between Islamic Financial Cooperative (BMT) and Shari'ah Rural Bank (BPRS) on Experiences, Challenges, Prospect and Role in Developing Microenterprises

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By

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بسم الله الرحمن الرحيم

In The Name of ALLAH,
The Most Beneficent, The Most Merciful

ABSTRACT

Islamic Microfinance in Indonesia: A Comparative Analysis between Islamic Financial Cooperative (BMT) and *Shari'ah* Rural Bank (BPRS) on Experiences, Challenges, Prospect and Role in Developing Microenterprises

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Different institutions are engaged in the development efforts in Indonesia by appealing to different sectors of socio-economic life. Among such institutions, BMT (*Baitul Maal wat Tamwil*) and BPRS (*Shari'ah* Rural Bank) can be mentioned as the main players of *Shari'ah* microfinance institution in Indonesia. However, these two institutions are different in nature; while, as a bank BPRS enjoys sufficient support, regulation and monitoring from the Central Bank, BMT, on the other hand, as a *Shari'ah* cooperative has limited support, regulation and monitoring. In their attempt to contribute socio-economic development, these institutions overwhelmingly prevail in urban and rural part of Indonesia.

The main aim of this study is to explore role and potentials of BMT and BPRS in developing microenterprises (MEs) in East Java, Indonesia. In doing so, this study also aims to measure the impact that their clients have had in their economic and social well-being. This study also aims to propose strategies on how to improve their roles through an informed understanding of the findings established in the empirical part of the study.

To fulfil the objectives, this research adopted triangulation as a research method, in which quantitative and qualitative data collection (questionnaire and interview) and analyses methods were utilised. Thus, the empirical analyses in this research are based on the data collected from 348 completed questionnaires with the clients and 22 interviews with Directors/Managers of BMT and BPRS.

The findings suggest that despite their large numbers, potential and important role in the macro economy, MEs face challenges in gaining access to financing. Similarly, the BMT and BPRS also experienced challenges in terms of risk and moral hazard, difficulty in accessing borrowers' financial flows, lack of capital particularly during seasonal circumstances, managerial problems, lack of infrastructure, lack of personnel, lack of staff skills, lack of vehicles and lack of appropriate legal basis for BMT. With particular regard to the socio-economic impact, the empirical findings show significant statistical improvements in annual sales, business expenditures, net income and employment. It should be noted that the empirical evidence, therefore, show that the variables that correlate to the economic impact are assets owned, financing received and duration of relationship with BMT and BPRS. Similarly, a positive social impact is reported by less than half of the respondents, with fewer respondents reporting religious impact and other impacts. The strong predictor of the social, religious and other impact are social development programme/services, which indicate the importance of improving this services in term of frequency and coverage to improve the impact. Although they present a mixed picture, these findings suggest a reduction in the number of poor respondents after financing indicating positive impact.

In order to improve their role, this study suggests that BMT and BPRS should consider to improve the trainings services in collaboration with related educational institutions, to provide more information of financing services to wider community, to better train their customers to improve customers' understandings on Islamic terms used in financing products, and to be innovative in their financial product development to meet the particular needs of their clients. With such a proactive strategy, it is expected that a further positive impact can be achieved.

DECLARATION

I hereby declare that no portion of the work that appears in this study has been used in support of an application of another degree in qualification to this of any other university or institution of learning.

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ADB	: Asian Development Bank
AFI	: Alliance for Financial Inclusion
ABSINDO	: Asosiasi BMT Indonesia (The Association of BMT in Indonesia
ASBISINDO	: Asosiasi Perbankan Syariah Indonesia)
BI	: Bank Indonesia
BIMAS	: Bimbingan Masyarakat (Society Coaching)
BKK	: Badan Kredit Kecamatan (District Credit Institutions)
BKPD	: Bank Karya Produksi Desa (Production Village Bank)
BMT	: *Baitul Maal Wat Tamwil* (Islamic Financial Cooperative)
BPR	: Bank Perkreditan Rakyat
BPRS	: Bank Pembiayaan Rakyat Syariah (*Shari'ah* Rural Bank)
BPS	: Biro Pusat Statistik (Statistical Central Bureau)
BRI	: Bank Rakyat Indonesia
CGAP	: Consultative Group to Assist the Poor
CU	: Credit Union
RDS IBBL	: Rural Development Program, Islamic Bank of Bangladesh
ICMI	: Ikatan Cendekiawan Muslim Indonesia (The Association of Indonesian Muslim Scholars)
IDR	: Indonesian Rupiah
Inkopsyah	: Induk Koperasi Syariah (Centre of *Shari'ah* Cooperatives and BMTs)
IsMFI	: Islamic Microfinance Institutions
KIK	: Kredit Investasi Kecil (Small Investment Loan Programme)
KUR	: Kredit Usaha Rakyat **(**Credit for People's Business)
KURK	: Kredit Usaha Rakyat Kecil (Small People Business Credit)
KMKP	: Kredit Modal Kerja Permanen (Small Permanent Working Capital Loan)
KUPEDES	: Kredit Usaha Pedesaan (Credit For Rural Businesses)
LPK	: Lembaga Perkreditan Kecamatan (District Credit Institution)
NGO	: Non Government Organisation
NPO	: Non-Profit Organisation
P3KUM	: Productive Financing Programme for Cooperative and Micro Enterprises
PNM	: Permodalan Nasional Madani
PINBUK	: Pusat Inkubasi Bisnis Usaha Kecil (Center for Micro Enterprise Incubation)
PUSKOPSYAH	: Pusat Koperasi Shari'ah (The Center of *Shari'ah* Cooperatives)
ROSCA	: Rotating Savings and Credit Association
SHG	: Self Help Group
SME	: Small Medium Enterprises
OJK	: Otoritas Jasa Keuangan (Financial Service Authority)
UN	: United Nation
UNDP	: United Nation Development Program
WB	: World Bank

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Chapter 1
INTRODUCTION

1.1. BACKGROUND

Aspects of Islamic economics and finance have been used in different forms over the centuries in many parts of the Muslim world. Based on such practices and sourcing through Islamic ontology, in recent years Islamic finance has been reconstructed in a modern sense and has been institutionalised since the mid-1960s. With the impact of globalisation, it has become a widespread phenomenon all over the world, including Indonesia. The basic aspect of Islamic economics is its particular focus on being a value-oriented proposal by placing special emphasis on social justice in creating wealth. As part of such a social justice-oriented discourse, Islamic moral economy and finance also aspires to alleviate poverty by developing discursive and technical mechanisms of financing methods. In its construct, Islamic economics is perceived to provide a viable solution to the world's economic problems, as capitalist economics has not been able to generate human-centred economic development.

While Islamic commercial banking has gained recognition in different parts of the world regardless of religious (or non-religious) domination, some other Islamic financing methods have been developed to respond to the demands of less fortunate sectors of society. For example, Islamic micro financing provides an opportunity for the aspirations of Islamic economics (social justice) and the operational tools of Islamic finance to intersect. Therefore, Islamic microfinance has been developing for years in Indonesia, attracting a positive response from the public, both Muslims and non-Muslims. It represents a good opportunity for the public in the lower strata of society to gain a valuable and alternative source of capital other than general commercial banks. It is expected that such a development will provide great positive motivation for economic development by reducing poverty and unemployment among the young generation through the enhancement of economic capacity and social capital, as long as it is accompanied by an entrepreneurial spirit with moral and Islamic values.

Indonesia is a developing low-income country with a large population which, together with many Asian countries, faced a terrible economic crisis in 1997, resulting in the collapse of many large corporate banks and some commercial ones across the country. However, most micro enterprises (MEs) and Islamic Micro Finance Institutions (IsMFIs) managed to survive despite the harsh conditions of the financial crisis in 1997, as they are rooted in the real economy with the objective of making a difference on the ground. Despite the fact that MEs have less access to credit in comparison to banks, the position of MEs during the financial crisis showed that they were able to overcome the difficulties during the economic crisis much better than large corporations. It is also important to state that, during the economic crisis, MEs demonstrated significant support for the economy by maintaining a good level of employment, although there was a minor decrease in the initial period after the crisis due to the contraction in the business cycle. Comparing the share of MEs in the macro economy in relation to other types of business demonstrates that they play a significant role in the economy since they constitute the largest number of business units and also provide jobs for a large segment of the labour force, compared to other types of businesses.

Considering the important role of MEs in economic development, the Indonesian government through Bank Indonesia (Indonesian Central Bank) has developed a regulatory framework, particularly in financing aspects through Islamic banking. Bank Indonesia plays a significant role in the development of Islamic banking in Indonesia by providing a banking regulatory and legal framework. The latest regulation encouraging Islamic banking was the Banking Act No. 21 issued on July 16, 2008, applicable to Islamic Commercial Banks, Islamic Business Units and Islamic Rural Banks. This Act has provided a more adequate legal base for the development of Islamic banking in Indonesia, and it is expected to speed up the growth of the industry.

As regards IsMFIs in Indonesia, they are categorised and structured in three forms: Islamic Business Units, *Shari'ah* Rural Banks (BPRS) and Islamic Financial Cooperatives (*Baitul Mal wat Tamwil* or BMT). The first two forms are regulated and monitored by Bank Indonesia, while BMT as cooperatives are regulated by the State Minister of Cooperatives and SMEs. During the last 10 years, these institutions have shown promising growth. Thus, exploring IsMFIs' role in the development of MEs in the case of Indonesia through a large research study such as this should therefore be considered useful to investigate, explore and evaluate their potential, which is the main aim of this research.

An important aspect of IsMFIs is their impact on sustaining economic development. In other words, how the lives of the individuals who benefit from micro financing schemes are affected should be considered an important aspect of an evaluative study. This study also considers the impact of IsMFIs through their financing in an attempt to explore their effectiveness; moreover, it aims to locate their potential role in alleviating poverty in Indonesia.

1.2. RESEARCH AIM AND OBJECTIVES

This study focuses on Islamic MFIs, particularly BMT and BPRS, and MEs in Indonesia. The aim of this study is to explore and evaluate the potential of Islamic MFIs in East Java, Indonesia, as an alternative solution for reducing poverty and building capacity by developing MEs to attempt to solve economic problems in the lower strata of the community. This research also aims to make reference to financial deepening and financial inclusion in understanding the findings established.

In fulfilling these aims, the following objectives are developed:

(i) to analyse the development trajectories and also the prospects of BMT, BPRS and MEs in Indonesia;

(ii) to describe the major issues and problems of BMT, BPRS and MEs;

(iii) to examine the financing and financing-related services developed by BMT and BPRS for developing MEs;

(iv) to investigate the perceptions of stakeholders of MEs on the financing services provided by BMT and BPRS;

(v) to examine the relationship between BMT/BPRS and MEs;

(vi) to investigate what role BMT, BPRS and MEs can play in the economic development process;

(vii) to explore and evaluate the impact of BMT, BPRS and MEs in alleviating poverty;

(viii) to explore whether the findings of this study can explain financial deepening and inclusion is taking place in Indonesia as suggested by the relevant theories;

(ix) to propose appropriate policy recommendations to the government and other related organisations.

In addition to and in line with the research aim and objectives, the following research questions are addressed in this study:

(i) What are the prospects of BMT, BPRS and MEs?

(ii) What are the major issues and problems faced by BMT, BPRS and MEs?

(iii) What financing services and financing-related services are provided by BMT and BPRS for the development of MEs?

(iv) What are the perceptions of stakeholders of MEs on the financing services provided by BMT and BPRS?

(v) How has the relationship between BMT, BPRS and MEs been maintained?

(vi) What roles can BMT, BPRS and MEs play in the economic development process?

(vii) What particular impact do these institutions have on poverty alleviation?

(viii) Can the findings verify the financial deepening and financial inclusion in the case of Indonesia?

(ix) What policy recommendations might be suggested to the government and other related organisations?

The research questions identified within the research aims and objectives are responded through the empirical chapters and discussed and contextualised further in Chapter 9.

1.3. THEORETICAL FRAMEWORK

There has been a growing literature focusing on the relationship between financial development, measured by a number of variables, and economic growth (Berger, *et al.*, 2004: 198; Bhattacharya and Sivanubramanian, 2003; Khan and Senhadji, 2003: 109; Levine, 1997: 929) While financial development can broadly be considered from institutional development to financing instruments and from credit expansion to depositions, non-banking related developments should also be considered as financial development. Thus, financial development can be considered by banks and also by non-banking financial institutions. In addition, vertically it can appear as financial deepening and also inclusion in the sense of bringing in different sectors of the society into the financial real who traditionally have remained outside the remit of financial activity. The foundational theory of the relationship of financial sector development and economic growth, hence, generally shape the theoretical framework of this research.

In the study of improving economic growth, poverty alleviation through financial inclusion can be considered as financial development, while the core of development problem is poverty (Allen, 2000: 10; Elkan, 1995: 7; Todaro, 2003: 196; WorldBank, 1990: 24). Considering that there has been a paradigm shift on the economic development and poverty, which are now perceived as part of the micro dynamics of society, and changes in these can only be possible with the 'development of the individual', whereby the importance of human development and capacity-building is emphasised (Zaman and Asutay, 2009: 89). Therefore, poverty alleviation strategies through financial inclusion and deepening are essential to move the micro dynamics of a society for economic development.

Therefore, in attempt to empower individual and to lead economic development and growth, the role of MEs in economic development and poverty alleviation should be enhanced by enhancing financial inclusion. Considering that one of the main problems of MEs is financial access, then this financial deepening will contribute to social and economic development impact (Beck and Demirguc-Kunt, 2008: 389; Beck, *et al.*, 2007: 46; Demirguc-Kunt and Klapper, 2012 3-4; Mohieldin, *et al.*, 2012 56, 68). Therefore, financial development should be pro-poor and pro-growth (Beck and Demirguc-Kunt, 2008: 383).

With regards to Islamic microfinance, this sector could play an important role in financial inclusion and poverty alleviation through promoting profit and risk sharing financing and redistribution of wealth in the form of *zakah, waqf, sadaqat* and *qard hassan* (Ahmed, 2002, 2004; Asutay, 2010; Mohieldin *et al.*, 2012: 57; Obaidullah, 2008a; Rahman, 2010), but also it helps to bring in the people to the development paradigm through providing *Shari'ah* compliant financing to overcome financial exclusion at the same time.

Overall, financial inclusion and poverty alleviation should be included as integral part of financial development and economic growth equation, in which Islamic moral economy provides the rationale and also institutional solution. In this case, among others, Asutay (2012) suggests developments of non-banking Islamic financial institutions as the new institutional development within the Islamic finance industry, as the development objective are lacking in the Islamic commercial banking; and non-banking Islamic financial institutions can easily reach out the people on the street who are looking for economic development.

1.4. SIGNIFICANCE OF THE RESEARCH, ITS RATIONALE AND MOTIVATION

The above foreword has identified the importance of the role of MEs in micro development and their impact on the macro economy. Despite making such important contributions, they still face barriers to accessing finance, which can hinder the growth of BMT and BPRS on the periphery. Hence, a study focusing on the role of BMT and BPRS can play in developing MEs and alleviating poverty in Indonesia can enable a better understanding of the development dynamics in Indonesia and the importance of faith (Islamic) constructed around such institutions in this process. It should be noted that these two types of institutions are chosen as subjects of this research because they are popular among the Muslim population; thus, it is essential to examine the role of BMT and BPRS in providing services to MEs in order to determine their impact on economic development.

In addition, the existing literature on Islamic microfinance, particularly on its role in reducing poverty by developing MEs in urban areas, is very limited. As far as the existing body of knowledge is concerned, there is a lack of research providing an in-depth, comprehensive, empirical analysis of the socio-economic impact of Islamic MFIs across a wider area. In particular, in order to capture the social impact, this research includes new variables, as it attempts to gauge the religious impacts through Islamic knowledge and practices and the influence these have on the performance and effectiveness of MEs. Most previous research, particularly in Indonesia, has concentrated only on BMTs in Central and West Java, and has rarely analysed the socio-economic impacts. It should also be noted that studies on BPRS are virtually absent from the body of literature. Therefore, it is expected that this research will fill the gap and contribute to the body of literature.

As the research aim and objectives identify, this research is expected to provide a better understanding of the implementation of BMT and BPRS and their performance in developing MEs in Indonesia, particularly in East Java. This region is chosen because it is the second largest province in Indonesia and has the second largest number of MEs, which represent the backbone of economic development. In addition, the choice of this regional area is related to the fact that microfinance shows promising growth in providing financial services to MEs in this region.

This research provides a wider scope than previous studies since it covers a large sample of 348 respondents from 22 BMT and BPRS, covering twelve cities/towns in wide areas of East Java. Furthermore, this research also focuses on and compares empirically the roles of BMT and BPRS, an approach not previously attempted in the literature.

The application of a triangulation data collection method in this research also distinguishes it from the available research. In addition, the findings of this study might be considered useful for formulating policy related to BMT and BPRS in developing MEs, which may in the long run help to alleviate poverty.

This research also discusses the gap between two previous studies on Islamic MFIs conducted by Ahmed (2002) and Seibel and Agung (2005). Ahmed (2002) carried out a study on Islamic MFIs' provision of micro financing to MEs in Bangladesh. The result of the research demonstrates that Islamic MFIs have great potential to support the poor, based on empirical evidence from three IsMFIs (Ahmed, 2002: 116). On the other hand, Seibel and Agung (2005: 40), who conducted a study on IsMFIs in Indonesia, point out certain problems such as IsMFIs having low assets compared to conventional banking due to the lack of regulatory and supervisory aspects in Islamic values. There are two proposed options: firstly, to give undivided attention to Islamic commercial banks and the "establishment of branch networks with IsMFI products"; and, secondly, "to reassess the challenges and realistic opportunities for Islamic rural banks and cooperatives" (Seibel and Agung, 2005: 41). These two previous studies have obtained contradictory findings in their perception of the performance and role of Islamic MFIs; hence, this motivates the researcher to further explore the current reality in the field, particularly in relation to the socio-economic impacts and poverty alleviation in East Java in Indonesia, based on the institutional and clients' perspectives to obtain comprehensive information on the role of these institutions in economic development.

The economic development of developing countries brings additional complexities and poverty is just one of them. Obviously, as neo-classical growth theory also identifies, capital is required to solve the problems. However, these countries usually do not have the ability to exploit and generate resources to fulfil those needs in the macro economy. Indonesia, as a developing country, faces the same problem. Therefore, it is important to utilise the micro dynamics of society, which can also be beneficial in reaching the dual goals of building community development and encouraging a better quality of life for the people. Nowadays, community development is relatively explored broadly in the area of developing MEs. This, naturally, is closely related to microfinance, as financing is one of the common problems faced by MEs. This study therefore explores the potential of MFIs in Indonesia, particularly Islamic MFIs, to develop MEs, as these types of enterprises have demonstrated their strength during times of crisis.

1.5. DELIMINATION

Considering the difficulties in finding data in relation to the topic, the limited funds allocated and time constraints, this research focuses on BMT and BPRS in East Java, Indonesia. The main reasons for choosing East Java are as follows:

(i) East Java is a province with the second largest population in Indonesia, having more than 34 million people, which is 17% of the national population (Biro Pusat Statistik, 2012: 78);

(ii) According to Inkopsyah (Centre of *Shari'ah* Cooperatives and BMTs), there are 32 institutions in East Java, which is the third largest number in Indonesia (the largest number are found in West Java (92 institutions), followed by Central Java (75 institutions) (Inkopsyah, 2012). However, based on PINBUK's data (2005), East Java has the second largest number of BMTs (611) in Indonesia;

(iii) According to data from Bank Indonesia (2011), East Java has had the fastest-growing number of BPRS over the last six years, from 12 units in 2005 to 30 in 2011; hence, this number is considered the second largest in Indonesia (Bank Indonesia, 2011: 3);

(iv) According to 2009 data, the number of microenterprises in Indonesia was 50,697,659, around 23% of which are in East Java (Ministry of Cooperative and Micro Small Medium Enterprises, 2009: 24);

(v) According to 2009 data, the number of people working in microenterprises in Indonesia was 83,647,771; around 20% of them are in East Java, which is the second largest in Indonesia (Ministry of Cooperative and Micro Small Medium Enterprises, 2009: 24),

(vi) The number of borrowers in East Java, however, is unknown;

(vii) In East Java, among others, Malang and Surabaya have the highest level of potency in *Shari'ah* banking development (Ascarya, 2007).

1.6. RESEARCH METHODOLOGY AND FRAMEWORK

To fulfil the research aim and objectives and answer the research questions, this research adopts a qualitative research methodology, since it measures the respondents' perception as part of their understanding of social reality in the form of Islamic microfinance and its impact. Therefore, it is constructed as an inductive approach by establishing the patterns from the data collected from the field rather than testing theories. Due to the nature of the research questions, this research employs an exploratory, descriptive, survey and case-study-oriented research design in relation to BMT and BPRS in East Java, Indonesia. Triangulation is adopted as the method of data collection due to the multi-dimensional nature of the research questions. Thus, it involves quantitative data collection based on purposive sampling through questionnaires distributed to MEs that borrow from BMT and BPRS, and qualitative data based on interviews with the Directors/Managers of BMT and BPRS. It is expected that, by adopting this mixed method, this study will produce the most reliable and valid results. The quantitative data obtained from 348 completed questionnaires are analysed with the use of statistical tests including descriptive, Chi Square, Mann-Whitney-U Test, Kruskal Wallis, Wilcoxon-Signed Rank Test and Factor Analysis. In addition, the qualitative data gathered from 22 semi-structured interviews are analysed through codification and thematic analysis.

1.7. OVERVIEW OF THE THESIS

Chapter 1, being the *Introduction* chapter, provides a brief background to the research by focusing on the role of MEs in the macro economy and the importance of Islamic microfinance in providing financial access for MEs; this will be followed by the research aims and objective, its rationale and motivation, and the research methodology and framework.

Chapter 2 (Microenterprises and Poverty Alleviation: A Literature Survey) explores the theoretical framework, based on conventional and Islamic perspectives, on the issue of poverty, poverty alleviation through capacity-building, role of MEs in economic development, MEs' problems, and strategies to develop MEs.

Chapter 3 (Microfinance and Islamic Microfinance: A Literature Survey) elaborates the theoretical framework of microfinance through both conventional and Islamic views, including conceptual definition and working mechanism, development in microfinance in terms of models, strategies and policies, and impacts of MFIs in developing MEs.

Chapter 4 (Islamic MFI and MEs in Indonesia) presents the Indonesian experience in poverty alleviation strategies with special reference to micro financing, both conventional and Islamic. In particular, it provides an overview of poverty in Indonesia, MFIs and Islamic MFIs, particularly BMT and BPRS, strategies and policy in poverty alleviation, and strategies in developing MEs.

Chapter 5 (Research Methodology and Research Framework) presents the applied methodology in addressing the research questions identified in Chapter 1. This chapter explores research design, strategy, methods including data collection method, sampling, data analysis, research questions and data analysis method in a detailed manner.

Chapter 6 (Exploring Profile, Financing Performance and Socio-Economic Impacts on Indonesian Micro and Small Enterprises) provides a descriptive statistical analysis of data gathered through questionnaires administered to the borrowers of BMT and BPRS. The findings are rather mixed: while the average annual value of sales, net income, business expenditure, household expenditure and employment were found to have increased significantly after the financing received from BMT and BPRS, the perceptions of the participants on the impact mainly ranges from ‘no impact’ to ‘minor positive impacts’. The findings, importantly, also suggest that the financing has contributed to reducing the numbers of poor respondents. Then, this chapter also provides further inferential statistical analyses focuses on the MEs’ problems, their perceptions of financing and non-financing services provided by BMT and BPRS, and comparative socio-economic impacts before and after financing. The findings suggest statistically significant improvements after financing in terms of sales, net income, business and household expenditures, and employment. In particular, social impacts related to positive developments were observed; although the majority of respondents declare no effect, the findings show that these impacts are highly likely to relate to the provision of social services development programs delivered to MEs.

Chapter 7 (Exploring the Prospects, Problems and Economic Development Role of BMT and BPRS: Perception Analysis) presents the findings from the analysis of interviews with the Directors/Managers of BMT and BPRS, capturing their perception of the potential of BMT and BPRS, financing and non-financing services and their role in economic development. It is found from the analysis that, although BMT and BPRS are facing internal and external challenges during their operations in providing financing services to MEs, they have potential and an important role to play in developing MEs and improving local economic development.

Chapter 8 (Contextualising the Findings; an Interpretative Discussion) provides a discussion of the research findings, from both quantitative and qualitative analyses. In addition, an attempt is made to compare and contrast the findings of this research with some other studies with the objective of demonstrating the gap found in previous studies in relation to the Indonesian case. Generally, the findings are in line with the previous studies in terms of positive impacts on economic development and poverty alleviation; however, they also suggest that the main challenges faced by BMT, BPRS and MEs are still present.

Chapter 9 (Conclusion and Recommendation) aims to wrap up the main findings and provides policy recommendations to various stakeholders in order to improve BMT and BPRS in supporting economic development.

Chapter 2
MICROENTERPRISES (MEs) AND POVERTY ALLEVIATION:
A LITERATURE SURVEY

2.1. INTRODUCTION

Poverty remains an important issue in the world regardless of the large amounts of wealth generated in different parts of the world, and this is a problem faced not only by developing countries and less-developed countries but also by the industrialised nations. Currently the world's population is about 6,974 million people, 1,259.7 million (18.6%) of whom are living in countries rated as poor in the Human Development Index, which are mostly in Sub-Sahara Africa and South Asia (UNDP, 2011: 165). With regard to the Muslim world, which contains around 22% of the world's population, the Human Development Index is still low (mostly under 100 in the rankings) compared to other non-Muslim countries in the same group (UNDP, 2011). Based on the UNDP category of the number of individuals living on below US$ 1.25 a day, there were about 410.6 million Muslims living under such conditions in 2010, which is about 27.08% of the total population in Muslim countries (UNDP, 2010).

Over the years, many strategies have been developed nationally and by international agencies to tackle poverty. It is therefore essential to investigate poverty alleviation strategies, especially those relating to the role of Microenterprises (MEs) in economic development and poverty reduction. Since, in recent years, Islamic economics and finance have emerged with promising positions on poverty financing, it is important to explore Islamic strategies as well.

This chapter, hence, by taking conventional and Islamic perspectives, explores the conceptual definition of the term 'poverty', followed by strategies for poverty alleviation through capacity-building. Then, MEs are conceptually explored alongside problems faced. This chapter also presents a discussion on previous research into MEs' role in poverty alleviation and its potential for supporting economic development. Thus, by surveying the concepts, frameworks and problems, this chapter is expected to gather a broad understanding of how MEs can play an important role in economic development and poverty alleviation.

2.2. POVERTY: CONCEPTUAL DEFINITIONS

Before embarking on the discussion of poverty and the role of MEs in alleviating poverty, it is important to render conceptual definitions as these will form the framework of this thesis.

2.2.1. Poverty in the Conventional Perspective

Defining the exact meaning of poverty is a challenging task, since it varies across place and time; individual countries and international agencies have different definitions and measurements due to their different value systems, cultural norms and economic realities.

In an attempt to expand the conceptual definition beyond mere economic reasoning or material fulfilment, among others, Sen (2001) provides a fresh position regarding materiality and material need. He points out that material is just a tool, not an end, to fulfil human needs (Sen, 2001: 14), and emphasises the terms ‘functioning’ and ‘capabilities’ rather than mere availability (Sen, 1985; 2001: 74-76). ‘Functioning’ might refer to simple meaning, for instance the function of a product/service for a person, or the benefits of a commodity for a person (Sen, 1985: 10). However, it might have a more complex interpretation, such as what a person could contribute to a community, or having self-respect; these values could differ from one society to another (Sen, 1985; 2001: 10). Meanwhile, capability refers to “…the alternative combination of functioning that is feasible for her to achieve…is thus a kind of freedom” to achieve ‘functioning’ and to choose on how to fulfil their needs (Sen, 2001: 75, 90). In addition, he states that wellbeing means freedom of choice and refers to a person’s ability to control his/her own life, ‘the ability to survive’, and the ability to achieve ‘quality of life’; thus, his perspective emphasises that humanist aspects cannot be separated from the physical/material side (Sen, 2001: 24). Sen’s theory has been taken up by other researchers and organisations: the UN has indeed adopted his concept in developing the Human Development Index (Todaro, 2009: 19).

As a worldwide organisation, the United Nations (UN) has also paid serious attention to poverty and the relevant strategies to alleviate poverty. In the perspective of human development, the UN, by adopting a comprehensive policy, defines poverty as "… the denial of opportunities and choices most basic to human development - to lead a long, healthy, creative life and to enjoy a decent standard of living, freedom, dignity, self-esteem and the respect of others" (UNDP, 1997: 5). Therefore, the UN views poverty from a human development perspective, that is "a process of widening people's choices as well as raising the level of well-being achieved" (UNDP, 1997: 15). This description, which can be considered a micro foundational definition of economic development, demonstrates the comprehensive nature of the problem in terms of being beyond 'material need'.

Thus, it can be concluded that poverty is a condition where there is not only a lack of material, with people struggling to fulfill their basic needs (food, housing, other physical assets, income, and natural resources), but also a lack of access to health, education, decision-making, financing, role in society and political participation. Poverty must therefore be viewed as a complex and multidimensional problem in the economic, social and political senses, meaning that the relevant strategies must also address the multidimensionality in order to have a positive impact.

At this point, it is necessary to look at the relationship between poverty reduction and economic development. Allen (2000: 10) emphasises the importance of involving poverty alleviation in economic development. In the study of economic development, poverty is considered one of the important areas besides the issues of unemployment and inequality (Elkan, 1995: 7). In addition, in essentialising the nature and the scope of economic development, Todaro (2003: 196) states that the core of the development problem is poverty. Besides, the World Development Report of 1990, a report focusing on poverty, also states that "Reducing poverty is the fundamental objective of economic development" (WorldBank, 1990: 24). Therefore, it is obvious that poverty reduction and economic development are interrelated. This raises the existential question of what development actually is.

The word development can be defined as "…not only 'good change', but also all encompassing change which builds on itself, occurs at both societal and individual levels, and may be destructive as well as creative" (Allen, 2000: 48). In providing a process-oriented perspective, Elkan (1995: 6) defines it as "a process which makes people in general better off by increasing their command over goods and services and by increasing the choices open to them".

Todaro (2003:17) identifies the importance of conceptual change in a broader perspective by defining development as "… a multidimensional process involving major changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, the reduction of inequality, and the eradication of poverty". If economic development is mainly about efforts to improve the quality of human life, how important is economic development to poverty reduction?

Before embarking on further discussion of the importance of economic development to poverty reduction in the next section, it is important to examine changes in the concept of economic development as it has evolved over the years. The pre-1970 era explored and defined economic development mainly from the economic, functional and macro economic view, using such macro economic indicators as change or development assessment. However, Zaman and Asutay (2009: 89) argue that a paradigm shift has occurred gradually since then, as economic development, and hence poverty, is now perceived as a multidimensional issue at the heart of which lies 'micro (economic) dynamics'. Therefore, in the current times economic development and poverty are perceived as part of the micro dynamics of society, and changes in these can only be possible with the 'development of the individual', whereby the importance of human development and capacity-building is emphasised (Zaman and Asutay, 2009: 89).

2.2.2. Poverty in the Islamic Perspective

Islam, as a religion, requires a human being to live in balance and to maintain good relationships both in a vertical aspect with God and in a horizontal aspect with other human beings. Al Ghazali (1111, cited in Chapra, 2008: 12) introduces the *maqasid al-shariah* (objectives of the *Shari'ah*) which include five points: "…to promote the wellbeing of the people, which lies in safeguarding their faith (*din*), their human self (*nafs*), their intellect (‘*aql*), their posterity (*nasl*) and their wealth (*mal*)”. Indeed, a concept of *falah* (wellbeing or salvation), as part of *maqasid al-shariah* (goals of Islam being human wellbeing) has been initiated and is an important part of ultimate success, whereby eternal happiness in the hereafter can only be achieved if the human being has performed well in the world’s business, satisfying both aspects, material and non-material/spiritual (Chapra, 1992: 6). Correlating *maqasid* and poverty, one of the five primary objectives of *Shari’ah* is enrichment of self (*nafs*); hence, poverty is in conflict with this objective (Obaidullah, 2008b: 13). Besides, Ataul Huq (1993: 9) claims that all actions, including economic conduct, should have the intention to seek optimal blessing from God, both in this life and in the hereafter. He also points out that people should convert *Shari’ah* into economic activity not only by relying on the maximisation of proceeds but also by being concerned with the public interest (Ataul Huq, 1993: 10). This point becomes the fundamental difference between conventional and Islamic economics. While economic development in the conventional view emphasises only one aspect of life, which harms other aspects of life in this world, the Islamic view offers something beyond that. Thus, the Islamic concept is obviously much broader than the conventional one.

The Islamic concept of economics (*muamalah*) highlights the fundamental points to be created, with justice as one of the main points, as stated in the Qur’an verse 57:25 : “We sent a foretime Our Messenger with Clear Signs, and sent them down with them the book and the balance (of right and wrong), that men may stand forth in justice…”. This implies that the main purpose of the Messenger is to ensure justice for all human beings. In line with the above verse, Chapra (1992: 6-7) explains that Islamic economics strongly emphasises the importance of “socio economic justice” and an economic system that contains “moral values” and “a moral filter”. Although proponents of conventional economic development have argued that they can achieve their goal without the moral factor, they now admit that they are dedicated to “development with justice” (Chapra, 2007: 7), but Chapra (2007: 7) continues to assert that “…even material development with justice is not possible without moral development” because it “…requires an ‘efficient’ and equitable use of all resources…” and they cannot be accomplished

"…without the injection of a moral dimension into economic pursuit.". This strong statement supports the Islamic concept of economic development with the unique positive points offered, namely moral values, as distinct from conventional economic development. In addition, Naqvi (2003: 15-16) supports Chapra's position, arguing that Islam, as a religion, works as a way of life when it is integrated in the human's soul; then personal conduct will be more likely to be value-laden, encouraging human freedom and social justice in line with the requirements of one as *khilafah* (God's vigour on earth), and motivated to help others, particularly the needy. Islam, hence, promotes the campaign against poverty, since the existence of inequality in wealth and income implies that those principles are not well founded in reality. Moreover, Chapra (1992: 209-213) also believes that justice (*adalah*) can only be achieved within four dimensions: fulfilment of the basic needs of all people, encouraging people to work and fulfil their needs, accomplishing "equitable distribution of income and wealth", and achieving "optimal rate of economic growth and minimisation of economic instability".

Poverty, in the Islamic perspective, is viewed not only from the material side but also from the moral side, thus including spirituality, mental peace, happiness and social harmony within the framework of justice and human brotherhood regardless of gender, race, age, *etc.* (Chapra, 2008; 2007: 6). It seems that there is no exact definition of poverty in the Islamic perspective; however, Muhammad Baqir al-Sadr (cited by Chapra, 1992: 12) states that "…poverty and deprivation are due to inequitable distribution and the absence of a morally-defined framework of human relationships between the rich and the poor". In furthering this description, Naqvi (2003: 119) points out that poverty have three dimensions beyond mere economics: these are moral - since it reduces self-respect; social - because it excludes the poor from society; and political - because it is likely to create bigger gaps between society's social ranks.

Islam, obviously, counsels against severe inequality and poverty (Chapra, 1992: 43; El-Ashker and Wilson, 2006). Chapra (1992) argues that resources are entrusted to all humans, as the Qur'anic verse (2:29) states: "Is He Who Had created for you all things that are on earth…" Thus the existence of inequality in this world may imply that human beings are not performing well in managing the resources in a proper way. Besides, Chapra (1992: 1-2) asserts that to achieve wellbeing in the material aspect requires "elimination of poverty, fulfilment of basic needs for all", equal opportunity, and "equitable distribution of income and wealth". Siddiqi (1996: 8) also suggests that Islamic teaching clearly indicates the necessity of fulfilling the basic needs of the poor, and that poverty should be viewed as unwanted and something to be reduced. Furthermore, by comparing the same issue in three economic systems - capitalist, socialist and Islamic economics - Awan (1983: 49-50) and Ataul Huq (1993: 9-10) point out that Islamic economics is more capable of achieving the goals of equity and efficient distribution. Thus, in some aspects, the Islamic view on objecting to inequality and poverty seems to be in line with the conventional one, thus indicating a difference in ontology: while the Islamic view is based on the Qur'an and *hadith* from God, the other relies solely on rationality.

In attempting to alleviate poverty, Islam also imposes the important duty of the rich to the poor in the form of *zakah* and *awkaf*, which Ahmed calls the "social support mechanism" (Ahmed, 2004: 22). In addition to the private sector contribution to alleviating poverty, Siddiqi (1996:12) also emphasised the essential role of the state in communal responsibility as part of the "collective social duty" (*fard kifayah*) to help the poor. Likewise, Chapra (1992: 241-242) also argues that the wellbeing of society is mostly the government's responsibility, as its legitimacy is based on four aspects of liability: to God; to the people; to tailor all policies according to the holy Qur'an; and to ensure equality of all people and combat corruption. This means that poverty alleviation efforts can only produce maximum benefits for the poor if the community and the state are involved together actively in helping the needy through well-managed pro-poor institutions. MEs' empowerment will be one such means.

To alleviate poverty, various strategies have been developed by conventional and Islamic perspectives. However, this chapter, rather than broadly discussing poverty alleviation and its related issues, will focus on the role of MEs in poverty alleviation, as this is considered an important, pro-activity-oriented, capacity-building strategy to alleviate poverty.

2.3. POVERTY ALLEVIATION STRATEGIES THROUGH PROMOTING CAPACITY-BUILDING: THEORETICAL AND POLICY ISSUES

2.3.1. Conventional Perspectives

Recently, the potential for developing MEs as a poverty alleviation strategy has been recognised globally. Among others, the UN poverty alleviation strategies emphasise the importance of human empowerment and building the assets of the poor, not only the economic assets but also the social and personal assets of both men and women (UNDP, 1997: 6). In supporting the policy position on this strategy, Todaro's policy suggestion on the importance of low-interest loans to MEs should be considered, as it aims to encourage MEs with adequate support and help them provide an outlet for the poor to graduate from poverty (Todaro, 2003: 241-242). Islam (2003: 27) states that MEs are one possible solution for poverty reduction in rural Asia, providing evidence that Grameen Bank, by providing micro financing for MEs, has successfully helped around five per cent of its borrowers to income levels above the poverty line every year.

A number of empirical studies provide findings evidencing MEs' significant potential (ADB, 2009; Servon and Bates, 1998). For example, Kimhi (2010) finds that encouraging rural entrepreneurship has increased income and reduced income inequality in Ethiopia; thus, such a strategy should be directed to communities with low incomes, low wealth and a lack of education. In addition, a study in Africa also found that microenterprises in Africa that trade in natural products play a significant role in poverty alleviation due to the increase of financial and non-financial benefits (Sackleton, *et al.*, 2008).

Therefore, to some extent, MEs have the potential to cover both strategies discussed earlier, *i.e.* increasing incomes and achieving equal distribution. The next section will provide further discussion of MEs and their role in poverty alleviation.

2.3.2. Islamic Perspective

Since Islam views poverty not only from a material perspective but also as a moral responsibility issue, this raises the question of how Islam can play a role. Chapra (2008b:

258) considers that Islam has a potential role in encouraging economic development through the positive values it offers: (i) Islamic teaching of high moral values; (ii) strong stress on socio economic justice; (iii) providing more suitable solutions, to economic, social and political problems, that differ from Western concepts; (iv) its ability to motivate people to do good things in life by considering social accountability in the hereafter; (v) giving examples of simple lifestyles, preventing people becoming corrupt; (vi) strong orientation to family and communal harmony, *etc*. Such values, rooted in the Quran and *hadith* and well known by the majority of Muslims, should be at the centre of the Muslim way of life; thus Islam might really contribute to solving the long-standing problem of decline.

In poverty alleviation strategies, *adalah* (justice) and *khilafah* (the individual's role as God's vicegerent on earth) remain the most important sources to develop solutions. Mannan (1986: 323) suggests that the foundational solution to poverty alleviation lies in establishing justice, as the Qur'an declares that: "Allah comment justice, the doing of good, and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion: He instruct you, that ye may receive admonition" (Qur'an, 16:90). In support of this, Chapra (1992: 213-224) points out that efficiency and equitable resource utilisation and distribution in Islam can be achieved by using dual moral filters: (i) to strike a blow against the greedy and their unlimited wants by forcing them to stay in line with *khilafah* and *adalah*; (ii) to utilise resources only for good purposes which can be performed through: (a) moral filter of the inner self; (b) motivation to find balance between self-interest and the interest of other people/public interest; (c) 'restructure the whole economy' with the goal of *maqasid* and limiting of scarce resources that must be utilised effectively; (d) a government highly-committed to actively practising Islamic values in economic policies to realise public wellbeing. Therefore, Islam, theoretically, recognises a thorough approach, blending the material and spiritual and not just relying on a single strategy on the material side.

As Akhtar (2000) points out, three main aspects of Islamic rules in poverty reduction can be mentioned: basic needs fulfilment, providing fair earning opportunities for all, and equal distribution of income and wealth. In expanding on this, Iqbal (2002: 4) identifies four basic points to alleviate poverty based on Islamic values: "endowment, opportunity, distribution and growth". First, obviously people must own capital, labour, physical resources and non-physical resources to create income. Second, 'opportunity' is also encouraged by restricting interest charged on financing because it can avoid injustice in wealth allocation and also overcome financial exclusion. Thus, the poor are expected to have better access to financing through the opportunity space created. Third, it is through 'distribution' that the rightful assets of society can be returned to society through *zakah*, *waqf* and charity for building capacity to empower the less fortunate. Consequently, the Islamic strategy of distribution aims at "guarantee[ing] fulfilment of basic needs of all, equity but not equality in personal incomes, and eliminating extreme inequality in personal income and wealth" (Iqbal, 2002: 6). The last aspect is 'growth', which is essential for delivering development and reducing poverty.

In further contributing to the strategy development, Mannan (1986: 334) suggests a comprehensive *Shari'ah*-based solution for poverty alleviation that includes the following:

(i) Providing guaranteed minimum provision (GMP), determined by the level and stage of social and economic development, to all concerned;

(ii) Initiating institutional and non-institutional reforms through legal and non-legal measures such as stress on agricultural and rural development, subsidies for the acquisition of skills, the removal of monopoly practices and regional disparities, and minimum wages in low-paid industries.

(iii) Reconstructing and reactivating the conventional tools of redistribution such as the collection and disbursement of *zakah* to achieve pre-planned objectives; redefining the scope and limits of intra-family obligatory allowances and the obligatory social provision of certain goods and services in a particular social context; the fuller implementation of Islamic laws of inheritance, and so on.

Besides, in considering absolute and relative poverty, Mannan (1986: 333) argues that Islam focuses on those in absolute poverty, the poor who are truly in a state of deprivation and starvation, as *zakah* recipients. Since *zakah* and *waqf* are considered among the main sources of financing any strategy for poverty alleviation, Ahmed (2004), by investigating the role of *zakah* and *awqaf* in poverty alleviation, discovered that GDP level affects the amount of *zakah* distributed to the poor, implying that countries with higher GDPs will be more effective in using *zakah* in poverty reduction (Ahmed, 2004). Oran (2009: 152) recommends a strategy to encourage the *zakah* performance in poverty alleviation by implementing a long-term strategic plan, focusing on the programme called "ruminant livestock raising programme" which provides help to the rural poor in particular. Yasin and Tahir (2002: 17) point out that the comprehensive implementation of full Islamic values through profit- and loss-sharing, in place of the interest system, and encouraging *zakah* will prove to be the best way of solving the poverty problem. It should be noted that elimination of interest alone is not sufficient; it must be supported by setting up an institutional body to force the rich to pay *zakah* as a compulsory obligation, because the rich sometimes do not perform this obligation due to lack of awareness, responsibility or even knowledge (Tag el Din, 2002: 187). Thus, the importance of *zakah* in reducing poverty is widely accepted and recognised. However, the collection and distribution side of *zakah*, to achieve optimum performance in taking some of the wealth of the rich and providing maximum benefit for the poor, remains a mission to be accomplished.

Another institutional approach is the *awqaf institution*, which might play an important role if it can persuade the wealthy in society to take part. Based on his research results, Ahmed (2004) proposes several policy recommendations for this, such as building institutions that incorporate *zakah* and *awqaf* into one development strategy, creating laws and regulations to increase *zakah* by avoiding double tax, increasing people's trust through trustworthy and transparent distribution of collected funds, and developing various *zakah* and *awqaf* institutions (Ahmed, 2004). Furthermore, Cizakca (2002: 263) also draws attention to the importance of the *waqf* system in poverty alleviation, suggesting the application of the *waqf* in providing public facilities such as health, education *etc* in Muslim societies. He believes that, if the *waqf* system is built well, those public facilities need not be the government's responsibility completely; thus, in the long run, it can reduce the government budget, cut state debt, decrease interest rates, and then promote higher growth in the economy (Cizakca, 2002: 263). Therefore, it can be assumed that both *zakah* and *waqf* can be utilised as among the main tools to alleviate poverty if they can be managed properly for the benefit of the *ummah*.

In line with the above strategy but specifically in regard to the financing issue for MEs through Islamic strategy, Obaidullah (2008b: 4) argues that "Central to the challenge of ending poverty is creating wealth through development of micro enterprises", for which microfinance has to be considered an essential institutional response. Obaidullah (2008b 13-22) proposes two Islamic approaches to poverty alleviation: (i) "charity-based and not-for-profit modes" in the form of common charity institutions such as *zakah*, *awqaf*, and *qard hassan* together with "economic empowerment", "debt avoidance", "cooperation", "family cohesiveness" and "*Shari'ah* compliance contract"; and (ii) 'market-based and for-profit modes' which include micro savings, micro credit and micro equity. Islamic strategy, hence, promotes economic empowerment including, but not limited to, providing for the needs of the poor, transformation of idle assets into income-generating assets, capacity-building, and transparent performance reports (Obaidullah, 2008b: 17). In addition, Islam demands mutual cooperation and unity as a fundamental rule (Qur'an,5:2); on this basis, group-based financing and mutual guarantee within the group are accepted (Obaidullah, 2008b: 18). Family empowerment and role-balancing between men and women is recognised in Islamic development strategy; hence, in MEs development, the 'women-only approach' is not accepted in the Islamic view (Qur'an, 51:49; Qur'an, 4:32) (Obaidullah, 2008b: 19). Finally, he also believes that, basically, there is no primary contradiction between the global microfinance 'best practices' and the Islamic approach to poverty elimination (Obaidullah, 2008b: 22). Therefore, the concluding remark from Obaidullah (2008b) is very comprehensive: "Islamic approach to poverty alleviation is more inclusive than the conventional one. It provides for the basic condition of sustainable and successful microfinance, blending wealth creation with empathy for the poorest of the poor…also…composite of mission-based and market-based interventions…favors equity-based and cooperation-based models in contrast to mechanisms that create and perpetuate debt." (Obaidullah, 2008b: 23).

Microfinance, particularly *Shari'ah* financing in micro credit for MEs, seems to be able to offer the potential for poverty alleviation. Chapra (2008: 36) argues that "In the present-day world, microfinance has proved to have great potential for expanding employment and self-employment opportunities and needs to receive high priority in Muslim countries". Based on the CGAP best practices, Obaidullah (2008b: 11) asserts that "Microfinance is a powerful tool to fight poverty".

2.4. CONCEPTUAL DEFINITIONS OF MICROENTERPRISES

2.4.1. Conventional Perspective

Microenterprises (ME) have the potential to make a unique contribution to micro-level economic development, and have certain characteristics that differ from other forms of enterprise, in terms of labour absorption, business form and capital used *etc*. Perhaps the earliest definition of small enterprises was presented by Kaplan (1948:17) as follows:

> "Small business means, typically, an identity of ownership, an absence of specialized staff for separate functions and of facilities designed specifically for research and analysis, inability to finance itself by floating securities or to secure its funds through sources such as investment bankers, a personal relationship between owners and employees and customers, the affiliation of the firm with a local community, and chief dependence for its market on the local area"

In addition, Kaplan (1948: 17-22) points out that the characteristics of small businesses are as follows: (i) relatively simple management; (ii) mostly owned by a single owner or partnership; (iii) tend to be independent of any control by another party; (iv) send their products and services to the local market or community; (v) the capital invested usually comes from the owner, who rarely tries to obtain additional capital from the financial market. The single-ownership characteristic is also pointed out by Johnson (2007), who states that most MEs are in the self-employment or proprietor category; such businesses can be identified as the largest single source of employment in Africa.

The data indicate that the majority of MEs are found in rural areas, mainly operating as sellers and small traders, although some can also be found in manufacturing. Women form the majority of ME owners, tending to concentrate their activities in narrow fields such as knitting, dressmaking, retail *etc*. In addition, Elkan (1995: 94-95) points out that most MEs, particularly in less-developed countries, are in informal sectors, setting up businesses in simple trading and services, such as small shops, crafts, producing cheap consumer goods *etc*.

As regards their performance, Johnson (2007: 2-5), among others, argues that the efficiency level of MEs is significantly higher than in large enterprises. Similarly, as Elkan (1995: 94-95) argues, although MEs are very small, they are likely to operate competitively and efficiently compared to larger enterprises, often without adequate protection from the government, as MEs are usually family-run, labour-intensive, requiring low skills, using small capital and sending products to the local area.

On the other hand, looking specifically at Asia, there are some weak characteristics of MEs, as most MEs in Asian countries operate in non-primary activities, tend to be unregistered formally, and are therefore often underestimated in number even though they are dominant enterprises; they are also owned by lower-income groups, are unproductive since they operate with traditional, low-productivity technologies, and produce relatively insufficient income for their owners and employees (ADB, 2009: 22-24).

Considering this overall description, in terms of definition of MEs there are differences in each region based on the criteria used, such as number of people employed, assets, turnover and business sector. Westall (2000: : 19) classes an ME as an enterprise employing up to 9 persons, which "includes self-employed sole traders and partnerships (with or without employees) and limited companies". In the Asian context, ADB categorises an ME as an enterprise having five or fewer workers, operating in informal sectors, generally engaged in non-agricultural and non-primary activities, and tending to be unregistered formally (ADB, 2009: 22). In Indonesia, based on the government regulation, a microenterprise is a productive individual business which has net assets, excluding land and buildings, of up to IDR 50 billion, and annual sales of up to IDR 300 billion (Act no 20/2008, Article 6).

2.4.2. Islamic Perspective

Ethical entrepreneurship as a business style and development strategy is not a new concept in Islam, as Islamic teaching demands business ethics and encourages entrepreneurship through a number of verses in the Quran, also giving the example of the Prophet (*pbuh*), who was a successful entrepreneur, starting his business from a microenterprise. Islamic strategy in poverty alleviation emphasises the importance of MEs (Chapra, 1992; Obaidullah, 2008a) and Islam requires MEs to be operated under the ethical principles set out in the Qur'an and *hadith*.

The Islamic ethical principles regulating businesses at the micro level are as follows (Durrani and Boocock, 2006: 150-152):

(i) honesty and reliability (Qur'an,33:70);
(ii) treating all business resources as a trust from God which must be managed with full responsibility and efficiency;
(iii) justice, which covers fair dealing in business (Qur'an, 5:8);
(iv) capability as the main concern when choosing the field of business;
(v) running the business with humbleness and dedication as part of *ibadah* and not causing harm to others (Qur'an, 25:63);
(vi) seeking brotherhood and cooperation to achieve the welfare of the *ummah*, not just personal benefit (Qur'an, 25:63);
(vii) commitment to charity (*zakah*) as part of social responsibility to help the needy;
(viii) paying adequate attention to research and development

In addition, Islam also urges business to follow other ethical strategies, such as the following (Durrani and Boocock, 2006: 155-157):

(i) ethical considerations in selecting the business field that does not cause harm to others (Qur'an, 5:90) - thus some businesses are not permissible, such as alcohol, gambling, pornography, tobacco, arms, *etc*.;
(ii) contracts must be obeyed and conformed with (Qur'an, 23:8. 5:1);
(iii) not producing misleading and untruthful advertisements (Qur'an, 11:85),

(iv) accurate measurements to protect customers (Qur'an, 17:35);

(v) not destroying surplus products to keep the high price in the market, but rather utilising them to increase society's wellbeing;

(vi) transparency in staff recruitment, providing equal opportunities for all, relying mainly on capability and credibility, rather than being based on favouritism, gender, race, *etc.*;

(vii) applying Human Resource management that provides a decent working atmosphere, sufficient remuneration, rational working time, *etc.*;

(viii) corporate liability and accountability, not taking others' wealth persuasively (Qur'an, 4:29);

(ix) protecting the environment, preventing pollution and not destroying nature;

(x) equitable wealth distribution, which can be achieved through SMEs;

(xi) prohibition of interest (Qur'an, 2:275).

The above foundational ethical principles are essential to MEs' development. In a detailed discussion of the role of microfinance in poverty alleviation through MEs' development, Obaidullah (2008a:10; 2009b: 4-6) allocates the MEs into two groups: (i) "livelihood enterprises" which are enterprises with the main aim of surviving from poverty; and (ii) "growth enterprises" which are more development-oriented. The key characteristics of livelihood enterprises are: (i) "…part-time and seasonal enterprise…" to cover family expenditure by getting family labour involved; (ii) require no skills; (iii) net income usually goes on household expenditure and rarely goes to investment; (iv) mainly handled and operated by women; (v) the main business types include farm animals, backyard poultry, food production and small trading (Obaidullah, 2008b: 5).

On the other hand, the key characteristics of a growth enterprise are as follows: (i) it is usually the family's major income source; (ii) it requires substantial skills; (iii) it has product specialisation; (iv) it is less dependent on seasonal factors; (v) it has the ability to produce a surplus which can be reinvested for the growth of the business (Obaidullah, 2008a: 29; 2008b: 6). Both types are important in the programmes of poverty alleviation; hence, both should be supported in many aspects, both financial and non-financial. They will then be able to play a greater role in economic development and poverty alleviation, as will be discussed in the following section.

2.5. THEORETICAL AND STRATEGICAL PERSPECTIVES ON POVERTY ALLEVIATION: FINANCIAL DEVELOPMENT, ECONOMIC GROWTH AND FINANCIAL INCLUSION

The role of financial development in economic growth has been widely recognised in the literature, suggesting that financial sector should be developed in order to achieve high growth (Levine, 1997). Financial development is considered as horizontal expansion of the financial services in terms of products, institutions and innovation, but also vertical expansion in terms of deepening financial sector by reaching out and including those people who would normally be not part of the financial system. In addition, financial development is also considered through the institutional impact in the form of banks and non-banking financial institutions. Thus, horizontal and vertical expansion of both type of institutions are considered to contributing to economic growth resulting into wealth and resource generation for economic growth and development. These institutions include stock market, capital market and also liquidity market among others, but also microfinance and other similar funds are considered as important financial institutions contributing to deepening of financial services.

It should be noted that there is a large literature supporting the importance of developing financial sector. For example, an empirical study by Khan and Senhadji (2003: 109) using regression analysis based on data from 159 countries, including developed and developing countries, strongly suggest positive relationship between financial depth and economic growth. Four financial depth indicators have been used in the study: domestic credit to privates sectors, stock market capitalisation, private and public bond market and stocks (Khan and Senhadji, 2003: 95). Similarly, Bhattacharya and Sivasubramanian (2003: 929), who examines the causal relationship between financial development and economic growth using time series data in India, points out that financial sector development led GDP.

Further study on this issues by Berger *et. al* (2004: 198) suggest that relative healthy small banks significantly correlate to improve the GDP growth faster. Moreover, in particular to the transmission mechanism from community banks to provision of financing to SMEs, this study suggests that small banks have positive association with SME employment and overall 'bank lending-to-GDP ratio' in both developed and developing countries (Berger *et al.*, 2004: 198). This implies that provision of financing to SMEs could positively improve the GDP growth; therefore, it is argued that the community banks improve financing to SMEs, which then stronger SMEs sector would force economic growth (Berger *et al.*, 2004: 170). This study utilise data from 1993 to 2000 on 49 developed and developing countries (Berger *et al.*, 2004: 170).

There are, however, other studies which contradict to the financial development and economic growth nexus; such as Dawson (2003: 833), whose study is based on panel data from 1994-1999 of 13 Central and East European Countries (CCECs). The findings shows that financial development has an insignificant effect to economic growth in CEECs (Dawson, 2003: 835). He further emphasises that political economy, rather than financial development, may provide sufficient explanation why some country are still under-developed.

In particular to financial development and SMEs, it should be noted that financial development is not necessarily related to poverty alleviation, hence, in order to promote economic growth through pro-poor development, attention should be given to poverty alleviation and financial inclusion (Beck *et al.*, 2007: 46; Mohieldin *et al.*, 2012: 56); and therefore financial development strategies should focus on financial deepening in order to have social and economic development impact. Financial inclusion is "a multi-dimensional, pro-clients concept, encompassing better access, better products and services, and better use" (Cohen and Nelson, 2011: 3). The concept of financial inclusion, thus, provides wider perspectives by including easy financial access for all, institutional sustainability, supportive regulation and supervision and healthy competition among financial institutions (Mohieldin *et al.*, 2012: 58)

In terms of responding to economic development issues, financial inclusion and deepening is expected leading to poverty reduction and income equality. To evidence this, (Beck *et al.*, 2007) study on the impact of financial development to income distribution and the poor based on cross countries study during 1960-2005 shows that impact of financial development on the poorest works by means of aggregate growth (60%) and income inequality reduction (40%). They also suggest that faster reduction in poverty is experienced by countries with deeper financial system.

In another research, Beck *et al.* (2009) explore how financial deepening reduce income inequality after financial deregulation in the US. This study suggest that deregulation tightened income distribution by helping the poor (Beck *et al.*, 2009: 24). Moreover, rather contradicting to the common believe that inequality could be reduced through expanding financial access and promoting entrepreneurship, this study found it is more important to encourage demand for unskilled labour, which can lead to improved wages and income distribution (Beck *et al.*, 2009 20-21).

In assessing the causal relationship between financial development, economic growth and poverty in developing country using panel data from 42 countries, Jalilian and Kirkpatrick (2001: 20) finds that financial development does contribute to poverty reduction through change in average growth of income of the poor. This also suggests that financial development strategies should be pro-growth and pro-poor (Beck and Demirguc-Kunt, 2008: 383).

In attempt to provide financial inclusion data worldwide, Global Financial Inclusion database (Global Findex) constructed based on interview survey data in 148 economies reveals that 50% of adult have an account at a formal financial institution worldwide; while the access was higher in developed countries (89% of adult) than in developing countries (41% of adults) (Demirguc-Kunt and Klapper, 2012: 20). The main barriers for this lack of financial access are lack of money, long distance from a bank, difficultly in providing required documentation and affordability to pay administration fee (Demirguc-Kunt and Klapper, 2012: 3-4).

To provide an overview of the current financial inclusion in the world, the comparative data among the G20 and BRICS countries is presented in Table 2.1a and Table 2.1b. As can be seen in the Table 2.1a, 20% of the adults in Indonesia have account at formal financial institution, in which only 9% had new loan in the past year. Compared to other developing countries, it seems that China has a better performance in providing access to formal financial institution since 64% of the adults have bank account; however, only 7% of adult had new loans in the past year. Developed countries such as Germany, France, Japan and UK apparently have shown very high percentage of adults having account at formal financial institution reaching more than 90% and credit card user reaching more than 30%.

Table 2.1a: Financial Inclusion in G20 Countries

	Account at formal financial institution	Saving, credit and insurance (%)				
		Formal saving account	New loan in the past year	Credit card	Mortgage	Insurance
Indonesia	20	15	9	0	1	1
G20						
Argentina	33	4	7	22	0	9
Australia	99	62	17	64	37	-
Brazil	56	10	6	29	1	8
China	64	32	7	8	5	47
European Union	N/A	N/A	N/A	N/A	N/A	N/A
France	97	50	19	38	27	-
Germany	98	55	13	36	21	-
India	35	12	8	2	2	7
Italy	71	15	5	31	10	-
Japan	96	51	6	64	16	-
Mexico	27	7	8	13	3	8
Russia	48	11	8	10	1	7
Saudi Arabia	46	17	2	17	12	-
South Africa	54	22	9	8	4	7
South Korea	N/A	N/A	N/A	N/A	N/A	N/A
Turkey	58	4	5	45	1	-
United Kingdom	97	44	12	52	31	-
United States	88	50	20	62	31	-

Source: Demirguc-Kunt and Klapper (2012: 50-52)

Table 2.1b: Financial Inclusion in BRICS Countries

	Account at formal financial institution	Saving, credit and insurance (%)				
		Formal saving account	New loan in the past year	Credit card	Mortgage	Insurance
BRICS						
Brazil	56	10	6	29	1	8
Russia	48	11	8	10	1	7
India	35	12	8	2	2	7
China	64	32	7	8	5	47
South Africa	54	22	9	8	4	7

Source: Demirguck-Kunt and Klapper (2013: 50-52)

As part of financial inclusion, therefore, financing the poor through microfinance, and small and micro enterprises brings an institutional solution to development of the poor, as otherwise they rely on personal capital or informal financial access (family, friends, moneylenders *etc.*), which are rather limited. However, they face difficulty to get access to financial services due to two main reasons: no collateral, both physical assets and steady future income, and high transaction cost in dealing with small loan (Beck and Demirguc-Kunt, 2008: 389). In addition, in providing evidence for non-accessibility, through a large dataset of over 4,000 firms in 54 countries, Beck *et al.* (2005: 170) find that problem related to financing are official procedure in relation to financing application, collateral and high interest rate. On the other hand, private financial sector are reluctant to offer services to the poor due to reasons including high cost related to credit assessment and monitoring and lack of collateral. Hence, to overcome this problem, Karlan (2007: 78) suggests utilising group lending which provides social connection to support monitoring and enforcement activities among members.

In particular to Indonesian case, based on survey data by BRI (Bank Rakyat Indonesia/Indonesian People Bank) including 1,438 respondents in six provinces in 2002 in order to identify 'untapped market', Jonathan and Morduch (2008: 524) found that 40% of the poor respondents living below poverty line were creditworthy and less than 10% of the poor household had borrowed from formal financial institution (bank and microfinance bank), which suggests the potential market but also indicates developing a financial strategy. It is also found that the credit worthiness increases in line with improvement of income and assets holding. (Johnson and Morduch, 2008: 525).

Overall, in responding to the question as to why financing SME and microenterprise is important, Mohieldin *et al.* (2012: 68) argue that SMEs are the 'engine of growth' in macro economy and microenterprises are the main source of income of the poor. Thus, empowering SME will lead to poverty reduction. However, SMEs need not just financing, but also enabling environment, which in the case of Islamic finance include micro-*takaful, zakah, sadaqat, qard hasan and waqf* (Mohieldin *et al.*, 2012: 74). Moheildin *et.al* (2012: 57) highlight further that Islam emphasize on three fundamental theory: social justice, inclusion and sharing of resources among the have and the needy through risk-sharing contract, and redistribution of wealth through *zakah, sadaqat* and *qard hasan*. These fundamental principles provide the rationale for the development of non-banking financial institutions for socio-economic development and capacity enhancement through Islamic spirit.

In an attempt to provide a structured and institutional response, Mohieldin *et.al* (2012: 100-110), hence, propose some policy recommendation to expand financial inclusion:

(i) Encourage the private financial sector to serve the poor and SMEs through provision of supportive regulatory and supervision and government financial inclusion reform plan to provide enabling environment;

(ii) Enhancing financial infrastructure for financial inclusion, particularly by developing current credit information system;

(iii) Encourage product diversification and improved risk management.

In terms of the long run impact and sustainability, when the microfinance have played their role effectively in developing SMEs, then this sector may provide higher contribution to support the macro economic growth.

In concluding, financial development and economic growth nexus should include financial inclusion as an essential strategy so that the poverty alleviation strategies can be developed. For this, Islamic moral economy provides the rationale and also institutional solution. However, Islamic banks, being commercial banks, are considered not being the right institutions to deliver such outcomes (Asutay, 2012), and therefore Asutay (2012), among others, suggests the developments of non-banking Islamic financial institutions as the new institutional development.

2.6. ROLE OF MES IN ECONOMIC DEVELOPMENT AND POVERTY ALLEVIATION

2.6.1. Conventional Perspective

As is well known, economic development aims to study the economic, social and institutional conditions in developing countries with their common problems in order to achieve a better quality of life in society by also paying particular attention to the poor (Elkan, 1995; Todaro, 2009). There are at least three objectives of development (Todaro, 2003: 23):

(i) "to increase the availability and widen the distribution of basic life-sustaining goods such as food, shelter, health, and protection;

(ii) to raise levels of living (…higher income,…more jobs, better education, greater attention to cultural and human values…);

(iii) to expand the range of economic and social choices…"

Since this is the objective of development, what then is the role of MEs in economic development?

MEs, in many developing countries, represent an important alternative solution and strategy for poverty alleviation and, hence, the promotion of economic development due to their direct reference to capacity-building. Encouraging the growth of MEs is about empowering the poor to be independent and self-reliant. It is a productive way of helping the poor to escape from their hopeless, stagnant situation. But to what extent have MEs been helping with economic development and poverty alleviation, and in what way? Liedholm (1999: 7) identifies the significance of MEs in economic development as follows:

(i) Contribution to household income and welfare:
- Providing income maintenance for those with few options;
- Providing basis for growth in income and welfare through asset accumulation, skill development, and access to more rewarding economic opportunities;
- Providing employment;

(ii) contribution to self-confidence and empowerment of the individual:
- recognition of the dignity of the individual;
- spreading the vision that change is possible;

(iii) contribution to social change, political stability and democracy:
- through increasing confidence in local, representative, community-based institution;
- through the development of individual feelings of responsibility and participation in the governance;
- through the creation of institutional structures reflecting people's needs and objectives;

(iv) contribution to distributional or developmental objectives:

- providing new opportunities for the poor;
- providing new opportunities for women;
- providing new opportunities for those in rural areas, and in isolated locations;

(v) contribution in the area of demographic change;

- through reduction in birth rates;
- through reduction in rural-urban migration;

As can be seen, the potential contribution of MEs relates to various dimensions including economic, psychological, social, demographic and political. In supporting this, Elkan (1995) also identifies the same points regarding the role of MEs and their contribution to economic development. According to Elkan (1995: 91), MEs firstly have significant potential to create more employment, which is positively intensifying the labour market; secondly, since they are small and relatively easy to establish, they can spread the benefit of economic development widely. Thirdly, enterprises' skills can be exercised better in small businesses.

By way of empirical evidence, a recent study by Khandker *et al.* (2013) finds that improved access to financing, particularly through MFIs, could contribute to the development of MEs and reduce poverty in Bangladesh. Based on a large amount of national data, the empirical findings confirm that households with additional income from MEs have much better living conditions than households without MEs, since MEs "…could raise income additionally by 6%, consumption by 5% and reduce moderate poverty by 2% and extreme poverty by 4% per year" (Khandker, *et al.*, 2013: 28).

Focusing on Asian countries, ADB (2009: 3) shares the same view, strongly arguing that "Assisting microenterprises can be an important way to alleviate poverty, and some micro-entrepreneurs have considerable potential to expand their businesses and should be helped in doing so".. MEs have the potential to create job opportunities, as indicated so far by the number of people employed in MEs. Accordingly, Bhatt and Tang (1998) support the idea of microenterprise development to reach the goal of human development and job creation. Their study focuses on financing MEs, particularly group-based microfinance as a promising vehicle to disburse small loans, so that millions of MEs would be able to extend their businesses.

2.6.2. Islamic Perspective

Considering that the Islamic perspective on economic development mainly refers to microdynamics in terms of empowering individuals through ‘functioning’ and ‘enabling’ strategies (Naqvi, 2003), MEs should be considered an important strategy. In particular, with the expansion of Islamic finance, conducting MEs through Islamically available finance would overcome financial exclusion by raising finance for MEs on the peripheries of the Muslim world.

MEs and self-employment seem to be a strategic and potential gateway through which the poor can escape from poverty. The deliberation of wealth and power is one of the causes of poverty, and Chapra (1992: 268-269) believes it could be reduced through rural land reform and the creation of small and medium-sized enterprises (SMEs). The benefits of encouraging the growth of microenterprises might include the following: increasing self-sufficiency; enhancing enthusiasm to work harder in order to own a successful business; creating motivation to be more competitive and more efficient; and stimulating greater employment opportunities (Chapra, 1992: 268-269). Hence, Chapra (2008:70) emphasises the need to encourage MEs to develop employment and self-employment opportunities, which in turn will contribute to the development of social justice for economic development. It is also considered that the potential of self-employment in the form of SME as an approach can facilitate the poor in increasing their income, despite the common reality that large companies might not be able to solve unemployment and poverty problems (Chapra, 1992: 315). In detail, Chapra (1992: 315) discusses the potential role of SMEs in enhancing economic development as follows:

- (i) SMEs have the potential to create new employment and incomes of other businesses by increasing the need for supplies of tools, material and services;
- (ii) SMEs are ‘labour-intensive’ and also tend to depend on their own savings, requiring a smaller amount of assets compared to large businesses;
- (iii) SMEs are more innovative in creating new products;
- (iv) SMEs are “…as efficient as large industries”; and
- (v) SMEs are less costly and more profitable compared to large industries.

The Islamic Development Bank (IDB), as an influential bank contributing to the development of its member countries, also recognises the importance of MEs in economic development. Through the Board of Executive Meeting in 1999, a guideline on formulating and implementing a scheme for financing SMEs and MEs in IDB Least Developed and Low Income member countries was announced (Islamic Development Bank., 2002: 5). This financing scheme resolution aims to reduce poverty by providing opportunities to create micro businesses, to encourage entrepreneurial skills, and to promote Islamic banking. Hence, support from banking institutions has materialised, so it is now up to the member countries to utilise the bank's support in order to empower MEs in their own countries.

A number of theoretical and empirical studies have also appeared in recent years. For example, Obaidullah's (2008a) study on poverty alleviation through MEs and microfinance examines the important role of microfinance in poverty alleviation by studying lessons learnt from three member countries of IDB: Indonesia, Bangladesh and Turkey. While Indonesia has a good linkage programme between banks and MFIs in providing small credit to MEs, Bangladesh has been a good example of developing 'livelihood enterprises' (Obaidullah, 2008a: 27). He also notes that the Grameen model has been drawn on as an example and adopted by large numbers of MFIs, including Islamic MFIs (IsMFIs), with some variations (Obaidullah, 2008a). The third country in the study, Turkey, has had different experiences from Indonesia and Bangladesh; Turkey benefits from the establishment of KOSGEB (small and medium development business services - a government agency providing non-financial support for small and medium-sized enterprises), which also acts as *al-kafala* (credit guarantor) for MEs, since this has been the main problem faced by MEs in gaining access to credit (Obaidullah, 2008a: 34-35). It can clearly be seen from his study that Islamic microfinance can be a useful tool for poverty alleviation due to the nature of microfinance in helping MEs to become self-reliant and independent.

On the other hand, Ibrahim's research (2003) on Sudanese Islamic banks' experiences found that financing MEs is not an effective way to alleviate poverty as only a very small number of loans are distributed to MEs compared to the large number of people living in absolute poverty. However, he also notes that Islamic banking principles have the potential to help the MEs.

2.7. MICROENTERPRISES' PROBLEMS

The role of microenterprises in economic development has been generally recognised, as discussed so far. However, MEs continue to experience challenges in developing their businesses, including financial problems, input material, markets, management and external factors. Since this research mostly focuses on financial problems, particularly access to financing, the discussion will centre on financial issues.

2.7.1. Conventional Perspective

The literature generally indicates that limited capital and lack of access to financing are the MEs' hardest problems (Barber, *et al.*, 1992; Khandker *et al.*, 2013). Banks do not tend to risk making loans to MEs since they have limited or zero collateral and, given the banks' high administration costs, preference is given to larger and established enterprises with good credit ratings. Thus, to solve the capital problem in Bangladesh, MEs borrow money from family members, moneylenders or other informal sectors who charge very high interest, sometimes reaching 180% to 240% per year (Khandker *et al.*, 2013: 25).

There are certain reasons why MEs have difficulties in accessing finance. For example, in European countries in particular, these could include "discrimination in assessment criteria", which is a common problem as people with assets have higher credit ratings; loans are refused on the basis of "previous county court judgements"; "preference is given to those with an employed spouse and many of the unemployed have non-working spouses"; "preference is given to existing customers"; and there is "poor presentation of business proposals to finance providers"(Westall *et al.*, 2000: 82).

The problems faced by MEs have also been explored by Liedholm (1999) based on survey results from five countries in Africa. He locates three main problems: capital, markets, and access to raw materials including other intermediate inputs. His research does not show strong evidence that government control and regulation is the most important problem. He also looks deeply at problems in each stage of MEs' development: start-up, the growth period, and the situation at the time of the survey. Each stage has quite different problems: while 'starting-up', businesses have problems finding fixed capital, 'growing' businesses have problems in expanding, such as finding tools, equipment, transport and workers. When the survey was being conducted by Liedholm (1999: 75-79), most enterprises claimed that access to raw materials and intermediate inputs was the biggest problem.

It should be noted that finance is indeed not the only problem; other problem include legal underdevelopment and corruption could hinder a firm's growth, in which the smallest size of firm are the most negatively affected (Beck *et al.*, 2005: 170). On top of such matters, financial difficulties tend to create further problems, such as inability to reach a wider market outside the local community, and inability to create higher-quality products, as well as failure to utilise the proper technology (ADB, 2009: 36).

Other problems to be considered by MEs include 'management', 'poor attitude and motivation' of both owner-manager and employee, 'lack of managerial training', 'lack of entrepreneurship skills', 'poor response to technology', and 'unfavourable quality background' (Barber *et al.*, 1992: 9-10).

2.7.2. Islamic Perspective

Since they mostly concern operational issues rather than conceptual ones, the problems faced by Muslim and non-Muslim MEs seem to be the same, and mostly involve access to financing. Chapra (1992: 328) argues that there is an unequal distribution of credit and wealth among different groups of enterprises, which results in most credit going to large enterprises. Generally, SMEs are considered to have potential; however their poor condition is due not to a lack of spirit or a disinclination to work or becoming micro entrepreneurs, but mainly to a lack of capital sources (Chapra, 1992: 329). In exploring the financial exclusion issues, Chapra (1992: 330) identifies some reasons why the banks do not want to serve the SMEs: (i) serious economic disadvantage; (ii) the high risk and expense of providing the services. However, Chapra (1992: 328) asserts that propagation of and support for the development of SMEs to reach large numbers as a tool to reduce poverty will remain a dream unless serious attention is given to financial access, since this financial aspect seems to be the biggest challenge for SMEs.

The same problem is also identified by Obaidullah (2008b: 4-6), who assumes that the main problem facing poor people is lack of access to financial services: on average, only 20%-30% of the population of a developing country can be served by financial services, and the rest are neglected. However, lack of financial access is not the only problem; the poor, particularly the self-employed, have inadequate assets, and the majority of them use assets belonging to others, which then may create exploitation and asymmetry between efforts and earnings due to ownership (Haq, 1996: 221). This basic problem must be resolved, and there is a need for the government and other related institutions to be more active in providing such access.

Another related problem is collateral; Obaidullah (2008b: 6) points out that this is a consequence of people's lack of assets. The bank requires collateral to reduce the risk of non-repayment of credit. Without collateral it is hard for the bank to provide credit; hence, an alternative approach to replace collateral should be devised.

However, the issues discussed so far are not necessarily generalisable to all parts of the world. For example, a study by Nasr (2002: 186) points out that the lack of financial access is not the major constraint in Egypt, where there are other more essential problems affecting the growth of microenterprises. These are impoverished market circumstances and inadequacy of appropriate public services, including utilities and healthcare. Nasr (2002) finds a relationship between religious background and financing pattern.

2.8. STRATEGIES IN DEVELOPING MICROENTERPRISES

2.8.1. Conventional Perspective

In developing MEs, Johnson (2007) suggests that one should consider the complexity and diversity of MEs, as they can be categorised at three levels: new start, non-growing business, and growing business. This implies that, depending on the point in their lifecycle, MEs must be treated differently. He suggests two approaches for new MEs, considering that they do not have experience in the new business they are initiating; this new experience can be given through internships and on-the-job training, based on past experience analysis. Treatment for non-growing businesses is quite different, considering that this type is trying to survive; credit is very beneficial in increasing the family's income. However, Johnson also finds that credit is not the only requirement: savings facilities are also necessary, since most of these MEs tend to use savings as capital. Moreover, to help them develop the business, non-financial indirect assistance seems to be more effective. Johnson (2007: 106-112) proposes indirect programmes, as a change in policy will: (i) encourage MEs' growth; (ii) help them to gain easier access to materials; (iii) create a link between MEs and other businesses in order to build a better marketing system. The government can play a role in MEs' development through intervention in macro policies in two channels: providing resources for production, and collaboration with NGOs to provide training and services (Ledgerwood, 2000: 29).

Acknowledging the potential of MEs to assist poor people to become self-sufficient, Servon (1998: 25-27) proposes some strategies to enhance MEs' development: (i) providing bigger loans to qualified MEs to improve the business; (ii) encouraging MEs to reach a larger market rather than simply focusing on the low-income population, as this will aid the business's growth; (iii) managing specific skills training for potential MEs, removing the gender barrier, and assisting them to work with other organisations as an entry point to build up larger networking and experience; and (iv) focusing only on trustworthy and hardworking MEs when delivering resources.

On the other hand, Elkan (1995:104) argues that MEs' development strategies undertaken by improving financial facilities, providing training in management and accounting and developing better infrastructure are misplaced. They are more suitable for application in larger businesses rather than informal businesses. Elkan (1995) considers technical training supported by volunteers to be more appropriate for MEs than management training. Thus, he suggests, they need indirect assistance, such as developing the market for the informal sector, rather than direct assistance as above.

As a strategy to expand MEs' market, Miller (1994) suggests building links and networks among MEs and wholesalers, particularly in rural-based MEs in developing countries

(Miller, 1994). Links and networking with large enterprises can also be created in the form of franchising and subcontracting (Islam, 2003: 35).

Further, Westall (2000) suggests a comprehensive strategy for developing microenterprises, by 'creating enterprise communities'. The proposed strategies cover vast areas, from community-led enterprises to encouraging larger corporations to supervise MEs in developing markets (Westall *et al.*, 2000: 9-15).

The best practices of the CGAP (Consultative Group to Assist the Poor, a multi donor association committed to enhance microfinance services for the poor through providing steady, diverse, and convenient financial access) suggest some lessons to be learnt on how to develop MEs through microfinance. Those include the following (Obaidullah, 2008b: 8-9):

(i) MEs need more than just credit - they need other services such as savings, insurance, and money transfer services;

(ii) "Microfinance is a powerful tool" in poverty alleviation as it enables the poor to increase earnings, develops property, *etc.*;

(iii) Successful micro financing can only be realised by integrating it with the state's financial system;

(iv) "sustainability through a shift from a charity-based, donor-dependent approach to a market-based, for-profit approach";

(v) Committed local financial institutions are the main points of departure for developing MEs, managing all funds collected through household savings into loans and other services for the neighbourhood area;

(vi) maximum interest rates for the borrowers must be removed;

(vii) capacity-building, in terms of building solid and sound institutions and administrators, must be the focal point;

(viii) transparency throughout the disclosure of accounts, and accurate financial and social reports.

The above best practices imply that microfinance is about more than just providing micro credit; it covers the provision of non-financial services and, hence, calls attention to the notion that "…*access* and not the *cost* of microfinance should be the main focus in designing and implementing a micro finance program for poverty alleviation" (Obaidullah, 2008b: 9). Besides, those best practices cover a wide area in terms of how to build a robust microfinance process in providing services to MEs, which in the long run can contribute to poverty alleviation.

2.8.2. Islamic Perspective

The appropriate strategies in developing MEs should also reveal the difficulties they face. In view of MEs' need for financial access and education, Chapra (1992, 2008) suggests that the following solutions can be considered: (i) opening wider access to credit by implementing *Shari'ah* microfinance (Chapra, 1992: 329); (ii) providing vocational training suitable to SMEs' requirements; and (iii) provision of infrastructure and marketing facilities in both rural and urban areas (Chapra, 2008: 70).

The financial structuring system is offered with the intention of removing the disadvantages faced by conventional banking in providing credit for SMEs (Chapra, 1992: 330-331). In general, there are two reasons – as discussed in the previous subsection – why the banks tend to neglect SMEs: great disadvantages of SMEs' business and high costs involved in maintaining the small amount of credit. Hence, removing these disadvantages requires the willingness of the government to pay more attention and commitment to help SMEs rather than large businesses; the government should also provide a "loan guarantee scheme" to secure the risk of default, although some studies have found that the repayment rates of SMEs are high (Chapra, 1992: 330). To some extent, this structuring system, especially the guarantee scheme, has been implemented in Turkey and seems capable of helping microenterprises to obtain credit and achieve more sustainable growth (Obaidullah, 2008a).

Beside the financial solution, Chapra (1992: 317) proposes some other strategies to promote and encourage the development of SMEs: (i) appreciating and consuming local products; (ii) change in political and bureaucratic policies in supporting SMEs; (iii) increasing the SMEs' capabilities in management and technological aspects, by providing adequate training; and (iv) removing the unfair treatment of SMEs compared to large-scale companies.

Considering the needs of MEs, which include having collateral to obtain credit and other services, Obaidullah (2008a: 34-35) examines the success of a Turkish government agency called KOSGEB in developing SMEs; this provides non-financing services, such as credit guarantee services (*al-kafala*) and business development services. This service plays an important role in developing MEs, which then helps the MEs to grow and sustain themselves.

In conclusion, Obaidullah (2008b: 10) states that "The Islamic approach puts overwhelming emphasis on micro enterprises development through financial and non-financial assistance, empathy and cooperation…is also more inclusive with greater emphasis on the needs of the poorest of the poor". Thus, it can be implied from the strategies for developing MEs that the conventional and Islamic perspectives are similar. However, the Islamic view on developing microenterprises is more human-oriented and covers what the conventional view has left behind, *i.e*. empathy.

2.9. CONCLUSION

This chapter discusses poverty alleviation and the development of MEs from two perspectives. Distinct from the conventional views, Islam views poverty not just in the material aspects but, most importantly, from the moral side; hence, the strategy for poverty alleviation must also bring the values of justice and equal distribution.

In regard to the role of microenterprises, both conventional and Islamic perspectives take a similar view of poverty and how microenterprises can play a role in alleviating it. However, Islamic teaching offers a broader perspective, as it imposes a moral and social responsibility as part of the religion in shaping the business environment with the objective of capacity-building through ethical values. It is highly likely that the microenterprises' role will be improved if they are well supported in solving their problems, particularly the lack of finance. In this regard, Islamic microfinance might offer a contribution by overcoming financial exclusion through the provision of financial services that are *Shari'ah*-compliant and developmentalist-oriented.

Chapter 3
MICROFINANCE AND ISLAMIC MICROFINANCE, A LITERATURE SURVEY

3.1. INTRODUCTION

The previous two chapters presented economic development problems, which mainly focusing on financing difficulties for development, followed by the discussion on the paradigm shift from macro development to micro development in economic development discourse in terms of capacity building. Hence, the importance of micro financing has been widely discussed and recognized. With the emergence and the development of Islamic finance, Islamic microfinance is considered a fresh approach to respond to the development needs in the Muslim societies and beyond.

This chapter, hence, explores microfinance, both from conventional and Islamic perspectives, by making reference to conceptual definition and working mechanism, development in microfinance in terms of models, strategies and policies. It will be followed by a discussion the same topics from Islamic perspective. In addition, it also discusses the current state of Islamic microfinance, which includes issues such as sustainability and the creating for funds from Islamic charitable acts to finance micro financing. Furthermore, it also discusses further on the economic impacts of micro financing, particularly in microenterprises level.

3.2. MICROFINANCE: CONCEPTUAL DEFINITION AND WORKING MECHANISM

Exploring the conceptual definition and how the microfinance operate is a fundamental step in building an understanding of the framework of micro finance before discussing further as part of development tool, which include models, strategies and policies. This section aims to discuss and present only the concept in conventional finance perspective and the Islamic microfinance is explored later in this chapter.

3.2.1. Conceptual Definition of Microfinance

The history of microfinance can be traced back to early 1970s, when various agents of the governments of developing countries commenced to provide rapid disbursement of subsidized credit to help the poor. With the main aim of improving the welfare of the poor through productive credit, the government funds were distributed mostly through the government institutions in local areas. However, according to Ledgerwood (2000: 2) this policy went under criticism due to large losses of funds as a result of high level of non-repayment and inefficient management resulting in not reaching the targets. Such financial inefficiencies within state owned and operated institutions due to corruption, wastefulness, high deficit, large amount of overdue debt, inability to reach the poor, high credit cost are also highlighted by Robinson (2001: 7). This led to the emergence of market driven initiatives resulting in the development of microfinance 1980s microfinance through private initiatives, as part of financial system, which again has targeted the poor with the objective of creating community based and sustainable organization (Ledgerwood, 2000: 230).

A number of definitions of microfinance are offered in the literature, most of which represent how these organisations work. Despite similarities, there are certain nuances distinguishing these definitions, resulting from how they analyze the operation of microfinance. Robinson (2001: 9) defines microfinance as the provision of "small scale financial services - primarily credit and saving provided to … microenterprises". A broader perspective of microfinance is described by Ledgerwood (2000: 1), as she perceives it not only from an economic perspective but also in terms of social aspect, defining micro finance as an economic development tool intended to benefit 'low-income clients' and the self-employed to provide not only 'financial intermediation' which might include credit, saving, insurance, payment *etc.*, but also 'social intermediation services', such as "group formation, development of self-confidence, training in financial literacy and management capabilities among members of a group".

In their definition of microfinance, Hulme and Mosley (1996), to a certain extent similar to Ledgerwood's conceptualisation, makes references to the need for saving by arguing that the clients need not only credit, but also saving facilities and consumption loan. Similarly, Armendariz and Morduch (2010: 4) also point out the importance of providing savings and insurance services for low income clients, and underline that “for the poorest of the poor, saving is more important”. Moreover, institution such as BRAC in Bangladesh even goes beyond this by assisting the client to distribute and market their products (Armendariz and Morduch, 2010: 15).

In providing entirely different perspectives, definition from Micro Credit Summit 1997 put more emphasis on self-employment, stating that microcredit as a “program extends small loans to very poor self-employment projects that generate income, allowing them to care for themselves and their families” (Summit, 1997: 9). In a more technical terms, Karim *et al.* (2008: 8) defines a microfinance institution as “an institution targeting the poor and whose average income loan size is less than 250 percent of the country’s gross domestic product per capita”. It seems that the 1997 Micro Credit Summit’s definition has the closest approach to human development compared to other previous definitions.

Thus, it clearly can be seen from the above definitions that they are all make reference to the same concept and target; microfinance aiming to provide financial services including saving and insurance to the poor with the objective of empowering them. However, Ledgerwood (2000) also emphasizes institutional aspect of microfinance by making reference to its social services dimension whereby it complements the financial services. It is this social dimension which is aligned with the Islamic values attached with Islamic Banking and Finance (IBF), as discussed in a later section.

Currently, it should be noted that there are shifts from microfinance to more broader perspective, from narrow focus on the institution focusing on clients financial needs and behaviour, from ‘narrow supply-led view’ to more broader financial ecosystem, from expanding outreach through conventional office branches to utilisation of ‘branchless banking’ using technology and agent networks; hence, the terms financial inclusion, financial access and inclusive finance are now commonly used (Ledgerwood and Gibson, 2013: 15-16).

3.2.2. Working Mechanism of Microfinance

The operational nature of microfinance has evolved over the years, from a traditional concept of micro loan provider to a modern institutional concept that considers microfinance in more than just the simple provision of micro loan, rather it is a development tools for its clients (Ledgerwood, 2000: 1; Torre, 2006).

It should be noted that before the term of 'microfinance' enter common parlance, the term of, 'microcredit' is commonly used to refer to the provision of small credit for poverty reduction and community transformation or 'social change', as practised by Grameen Bank (Armendariz and Morduch, 2010: 15). For this, Robinson (2001: 2) identifies this as a "poverty lending approach" as opposed to a more functional and sophisticated endeavour called the "financial system approach". As part of this trajectories, the conceptualisation of microcredit later shifted to be explained as 'microfinance', motivated by the recognised demand for a broader range of financial services that would encompass not only credit but also saving and other services, as households might need credit but they also able to save which needed to be institutionalise and facilitated (Armendariz and Morduch, 2010: 15). In this issue, Robinson (2001: 2) discusses extensively the 'microfinance revolution' underlining the shift from traditional microfinance, an institution based on government subsidy or donor fund, to a more sustainable, business and profit oriented microfinance. Thus, it can be concluded that microfinance is a way forward, more comprehensive and more development oriented than microcredit and may be better able to achieve the goal of capacity building.

The history of microfinance can be tracked back to Rotating and Saving Credit Association (ROSCA), a kind of self-help group (Robinson, 2001: 225), and credit cooperative (Armendariz and Morduch, 2010: 67). ROSCA, a simple informal mechanism in which the leader of the local group accumulate money from members and distribute it as credit to other members, might first appeared more than two hundred years ago. There is no obvious historical documentation as to pinpoint when this institution began. However, the first credit cooperative, a more formal institution with legal status, was initiated in 1850 by Friedrich Raiffeissen, a rural community's leader in Germany, with the purpose of providing financial facilities for poor people (Armendariz and Morduch, 2010: 79; Helms, 2006: 3). These two models emphasizes how saving is important for poor people, a point which later paved the way for the development of microfinance model (Armendariz and Morduch, 2010: 86). In later years, these models were improved for the wider community.

Inspired by the Grameen Bank of Bangladesh in the 1976, which was widely known as the early innovative microfinance model has currently replicated in about forty countries, which provides loans to low level income groups and microenterprises through a group based approach leading to being one of the best known model (Hulme, 2009; Khandker, *et al.*, 1995; Zaman, 2004) In this approach, no assets collateral is required as the poor clients would not be able to provide it, rather it is based on 'joint liability' and trust as social collateral (Hulme, 2009: 168; Yunus, 2004). Then, as loans are given to members of a small group, the other group members will act as guarantors (Zaman, 2004). This 'peer support', and sometimes 'peer pressure', which is based on casual relationship between neighbours (Armendariz and Morduch, 2010: 14), is considered useful for reducing the cost of loan observation and imposing of repayment (Armendariz and Morduch, 2010: 100), and to prevent moral hazard (Armendariz and Morduch, 2010: 109) by basing on trust as a social capital. In this model, repayment is usually made on a short term basis, occasionally based on negotiable schedule; most loans are repaid by weekly instalment in front of the other members (Hulme, 2009). If the repayment is well maintained, then the group will have further opportunities to obtain larger loans (Armendariz and Morduch, 2010: 14). To provide a better services and to address the different needs of customers, Grameen Bank has developed its services from 1990s onwards by providing more varied financial services (Zaman, 2004: 6). As can be seen, this original Grameen model appears to be simple, which internalised some lessons learnt from informal financial sectors and combine it with development banking (Armendariz and Morduch, 2010: 15).

It should be noted that the Grameen model works well in Bangladesh, where it has achieved 98% repayment rates and works for more than two million landless borrowers (Armendariz and Morduch, 2010: 327). However, it may not work with the same level of success in other countries, due to some certain disadvantages of this model in borrower perspective: these are hidden cost, moral hazard due to conspiracy not to fulfil the contract among borrowers and emerging tension caused by group punishment if one member has default (Armendariz and Morduch, 2010: 123), which may not be easily be accepted in other countries. Thus, it can be argued that the Grameen model is not a perfect one, some adjustment and modification are required to suit the specific needs of a particular country and institutional formation.

Another critic of Grameen model has also been pointed out by Robinson (2001). She argues that, although the Grameen model which adopts a 'poverty lending approach' might be widely replicated, it may not be possible to implement it in all part of the world since as it does not provide a significant amount of loans and savings services. Thus, commercial microfinance might be more appropriate for other areas (Robinson, 2001: xxxi).

Therefore, before replicating the Grameen model in another countries, Khandker *et.al* (1995: 88) suggest some key points:

> (1) why such banking system is needed; (2) what the credit needs of the poor are and what should determine their participation; (3) whether social mechanisms serve as a vehicle for credit delivery to the target group; (4) whether people are socially and individually accountable; (5) whether group- or individual-based lending is feasible and cost-effective; (6) whether the cost of administration can be recovered through the interest rate charged; and (7) whether the poor can bear the full cost of financial and social (if necessary) intermediation.

3.2.3. The Goal of Microfinance

According to Ledgerwood (2000: 34), the goal of microfinance as a development tool should be "to service the financial needs of un-served or underserved markets as a means of meeting development objectives"; these development objectives include: (i) to decrease poverty; (ii) to empower women or other disadvantage groups; (iii) to promote employment; (iv) to assist the client to develop or expand their business; and (v) to support the improvement of innovative enterprises.

In addition, the long term goals of microfinance are sustainability and outreach (Ledgerwood, 2000; Torre, 2006; Vento, 2006). 'Sustainability' means the ability to provide frequent loans, to cover the operating costs and to produce sufficient returns (Vento, 2006: 55). 'Outreach' is related to 'depth', which refers to the poverty level of the clients', and 'breath', in which basically concerns to the total numbers of clients that could be reached and served by the MFI (Vento, 2006: 58).

In addition, after studying lending for small and microenterprises project in World Bank, Webster *et al.* (1996) summarize the objective of MFIs as development tools for microenterprises as follow:

(i) Strengthening financial and technical assistance institutions that should serve SMEs;

(ii) Job creation at low capital cost; and

(iii) Increasing small firms' access to financial and technical services.

Moreover, the core purpose of microfinance is to enable microenterprises to develop their businesses; this presupposes that the common business cycle will clearly take shape in terms of receiving a loan, investing, receiving an income, and repaying the loan. Robinson (2001: 114) notes that, for the 'economically active poor', loans and savings might be useful for expanding businesses and improving profits by investing the funds from both sources; however, it should also be noted that they tend to use loans for more than one purpose, particularly "to break down old barriers", and they also repay them from more than one source. In terms of improving the quality of life of the poor, although microfinance services might not directly affect their lives they can still benefit from the indirect effects of microfinance's development, such as the expansion of employment which enables the poor to find jobs (Robinson, 2001: 17)

Hence, it is expected that, after the provision of micro financing, the 'virtuous cycle' will take place in the following form: the low-income people who obtain loans from microfinance will invest the funds in productive businesses; hence, they will garner more income, which will motivate them to obtain more credit. This leads to more investment and, hence, more income (Hulme and Mosley, 1996: 108). However, this assumption is not always accurate as, in some cases, only part of the loan may be used for financing, with the rest going on consumption.

3.2.4. The Credit Market, Supply and Demand of Microfinance

Before going on to the discussion on demand and supply of microfinance, it is necessary to present the theory of credit market. Based on the villages survey in Egypt covering 200 households, Mohieldin and Wright (2000: 667), suggest that informal credit financial sector in Egypt is more active as compared to formal counterpart; ROSCA is the most popular. However, they conclude that informal sector could not substitute the formal credit market in Egypt. It should be noted that loan provided by informal sector is less than the fund from formal financial sector. The reseaarch also show that the characters of the borrowers of formal and informal seems to be different as the formal sector are highly likely accessed by high and steady income customers who could provide collateral. The reason to borrow money is also different: fund from formal institution mostly for production purposes, while funds from informal sector are used for non production purposes (Mohieldin and Wright, 2000: 667).

The informal credit sector in Nigeria seems to be different compared to others. Based on a survey to 198 households in northern Nigeria, Udry (1990: 267-268) presents a unique feature of credit market this area, in which the community manage to have informal lenders with low dependent on collateral, administrative flexibility and access to information to borrowers. Hence, free flow of information exists between lenders and borrowers, in contrast to the problem of asymmetric information that commonly occur in other countries. Therefore, it is a challenge for formal financial institution to compete with informal lenders.

Regarding the objective of financial institution, Stiglitz (1991: 35) argues that raising capital should not be the only main objective of financial institutions; they should also consider distributing the capital to the ‘most profitable opportunities’ based on good selection process and how utilised funds must be properly monitored. However, he also asserts that the role of financial market in development process was very limited in developing countries which called the government attention to mitigate it, among others, through promoting securities market (Stiglitz, 1991: 25). In further discussion of funds monitoring, Stiglitz (1990: 353) proposes a model of the advantages of utilizing peer monitoring in credit market since this might transfer the risk of banks which then lead to borrowers' benefit. He suggest that peer monitoring are likely to be success if there is an incentive in monitoring provided for member of peer group (Stiglitz, 1990: 361).

In the some cases in the credit market with imperfect information, credit rationing might occur. Credit rationing is described as the condition of unequal opportunity in accessing loan in which some potential borrowers could not get loan even if they show willingness to pay higher interest rate and to provide higher collateral. (Stiglitz and Weiss, 1981:394-395). To explain this condition, Stiglitz and Weiss (1981: 395, 404) propose some models involving some key variables include interest rate as screening devise and risk of loan.

The microfinance suppliers, the institutions who provide microfinance services, can be categorised into (i) community-based providers, which include 'indigenous provider' such as money lenders and ROSCA and 'facilitated providers' such as Self-Help Groups, and (ii) institutional providers (Nelson, 2013: 149-150). Community based microfinance provider offers some advantages such as flexible services, wider accessibility due to minimum administrative procedures and flexible terms; however, they have limited products/services and tend to be unreliable and more indefensible to collapse or fraud (Nelson, 2013: 149). On the other hand, institutional providers, which are formal, registered and regulated institutions, include NGOs, MFIs, financial cooperative, *etc*, offer broader financial services. This classification seems to be slightly different as compared to the conventional classification: formal, semi-formal and informal (Ledgerwood, 2000: 12; Rutherford, *et al.*, 2013; Torre, 2006: 5-8).

As regards to the demand side, recently, there is a shift from the traditional target of 'the poorest of the poor', particularly women, to microenterprises, who are mostly self-employed and family business who could not access financing services from commercial banks (Torre, 2006: 3), they can thus be categorised as 'unregulated' and the 'informal sector' in the macro economy (Robinson, 2001: 11). Therefore, in targeting microenterprises as clients, MFIs must consider three types of microenterprises since each type has different needs and characteristics: (i) existing, who need working capital, or start-up; (ii) level of development; (iii) the fields of business, be they in production, commerce, or services, as these have different needs and characteristics (Ledgerwood, 2000: 42-43). It should be noted that their requirements are not limited to financial services, as they may also need skills training or other assistance.

3.2.5. The Operation of Microfinance

For an effective and efficient running of a microfinance institution, securing fund and managing the funds in an efficient manner is the main issue. In the 1980s, the funds for microfinance came mainly from donors; however, the funds now come from other sources, such as clients' savings and other market funding sources, as the microfinance institutions have realised the importance of not relying solely on donor funds due to the requirement to become sustainable (Ledgerwood, 2000: 2). Furthermore, funding sources differ according to the type of institution: NGOs gather funds mainly from donors, but they offer more social services than banks; however, the main sources of funding for banks, savings banks and credit unions are customers' savings and business credit (Ledgerwood, 2000:2).

In regard to products and services, microfinance can offer a broader range of services that might include both financial (credit, savings, micro insurance) and non-financial services, which include social and enterprise development services. Many believe that provision of financial services without social services are not sufficient to support the clients (Bennet, *et al.*, 1996: 274; Trezza, 2006). A social service or 'social intermediation' is broader than just provision of social welfare services, this service involve "…the willingness to make substantial investment in building up the human resources and the local institutions needed to help marginalized group become self-reliant" which covers services to improve the clients' wellbeing such as health services, education and literacy training (Bennet *et al.*, 1996: 275). The microenterprises development services are more practical services for microenterprises with the objective of solving their common problems and enhancing their abilities to run businesses, covering technical support and skills trainings/courses such as bookkeeping, marketing and production (Ledgerwood, 2000: 63; Trezza, 2006: 34-35). The provision of financial services only equates to a 'minimalist' approach, while an integrated approach means that all services are provided, and the debate on this issue is still on-going (Bennet *et al.*, 1996; Ledgerwood, 2000: 65). Basically, the aforementioned services cannot be separated, as these non-financial services are necessary in order to improve the capability of the clients to run their businesses, and then to be able to repay the loan. Considering the importance of these services, Trezza (2006: 35) suggests to have a partnership with other institutions, such as universities, training institutions, *etc*. However, in order to choose which services are suitable for the clients, MFIs should consider "MFI's objectives, the demands of the target market, the existence of other service providers, and an accurate calculation of the costs and the feasibility of delivering additional services" (Ledgerwood, 2000: 63). Thus, it is implied that there is no perfect model for all types of MFIs in all areas; it depends on the above aspects, and good services in one MFI may not be suitable for other MFIs.

To attract poor clients, the interest charged for microfinance should be lower than that of banks and other informal counterparts. However, greater cost to the customers seems inevitable when microfinance institutions are forced to reduce costs and improve transparency (Armendariz and Morduch, 2010: 202). However, in certain circumstances modification and flexibility can be arranged; Grameen allows easily rescheduled 'flexi loans' while SKS Microfinance in India offers easy instalments and interest-free 'emergency loans' (Armendariz and Morduch, 2010: 202-203). Similarly, Mannan (2007: 628) also criticises these high interest rates, particularly Grameen's rate which can reach 86% per year. On this high interest issue, Obaidullah (2008b: 11) states that the interest rates are higher for a number of reasons: (i) higher administrative and monitoring costs and risk; (ii) having high profits and valuable credit not just from the amount but from access, quick service and flexibility, meaning that the microenterprise could repay the loan if it is lower than its profit. However, he further argues that an interest-based system should not necessarily be the basic approach of financing (Obaidullah, 2008b: 11).

3.3. DEVELOPMENTS IN MICROFINANCE: MODELS, STRATEGIES AND POLICIES

The above section has discussed the operational of microfinance, then, further discussion on development, model and strategies is presented in this section.

3.3.1. Models of Microfinance

The operation of microfinance institutions could fall into one of the following categories:

(i) Joint-Liability Groups (JLG);

(ii) Self-Help Groups (SHG);

(iii) Village Banks - these are banks and are not group-based; they require collateral to provide financing, *e.g.* BRI, BPR, BPRS *etc.*

(iv) Credit Union - this is a form of cooperative operating as a non-bank financial institution; it provides financing and savings services only for its members.

(v) ROSCA (Rotating Savings and Credit Association) is a group of people who form an association, each member of which makes a regular payment, such as monthly or weekly, over a certain period of time (usually one year), of a specific amount to the group; the accumulated money is then distributed to one member on an alternate basis. This informal mode of saving is popular and encourages regular saving; however, it runs the risk of bankruptcy if the leaders are corrupt (Robinson, 2001: 236);

(vi) Pawning/pawnshops are semi-formal non-bank financial institutions providing credit at high interest rates in a quick and easy process to a wide range of customers, including the poor (Robinson, 2001: 50). The main characteristic of a pawnshop is that the customers provide full collateral in the form of personal property, for instance gold, jewelry, *etc.*

3.3.1 The Development of Microfinance

The experience shows that microfinance industries in some countries have been well developed and have achieved success, as indicated by good macro economic conditions, managed growth, deposit mobilisation and cost control (Ledgerwood, 1999: 3). The CGAP Report in 2012 shows an improvement in the volume of private equity transactions in microfinance (investment into MFIs) in 2011; which reached USD 292m, an increase from USD 205m in 2010, due to several large transactions, as well as expectations of a better regulatory environment in India, *etc* (Glisovic, *et al.*, 2012: 3).

In searching of the possible reasons behind the microfinance development, based on the success story of microfinance in Bangladesh, the identified key success points are (i) visionary leadership, (ii) supportive regulation environment, (iii) provision of resources by donor, (iv) high population with similar social and cultural background, and (v) the important role of PKSF (Palli Karma Shayak Foundation) as professional apex body to scale up the microfinance industry (Hulme and Moore, 2006; Zaman, 2004). These points may differ as compared to the success factors suggested by Ledgerwood (2000) due to a different viewpoint. Generally, Ledgerwood (2000: 3) argues that some of the reasons for the emergence of microfinance are:

(i) the guarantee of supporting income for the poor,

(ii) the ability to help promote financial sustainability,

(iii) the prospective of being assembled with local systems,

(iv) the promise to support the present official financial structure,

(v) the increasing numbers of microfinance institutions that achieve success both in financial sustainability and outreach to the poor,

(vi) the provision of better financial products based on innovations and experience that can overcome the problems of the past, such as the problem of limited collateral being solved by the “group-based and character-based approach”, and the problem of high transaction costs being resolved by shifting the cost to group level and enlarging the outreach, *etc*.

It should be noted, the future of microfinance is projected as promising; some of the promising features for 2010 - 2015 are as follows (Platteau and Slewertsen, 2010: 6-24):

(i) The growth of microfinance, which reached around 20%-30%/year of total loan portfolio, even more in some countries, will continue to grow and the institutions will be more independent;

(ii) Small enterprises will continue to exist and play an important role as providers of micro financing because they operate in a niche market and maintain close relationships with their clients, even though their power in the market will be minimal in terms of investment capacity, access to technology and maintaining human resources;

(iii) There has been a shift in microfinance development; it was led by the North, but will be continued by the development of microfinance in developing countries;

(iv) There is a trend of shifting ownership and promoters; previously, it was more of the NGO type, but there is now a mixture of NGOs, social investors and commercial institutions. In addition, the number of microfinance banks is increasing; therefore microfinance is more likely to be integrated in the mainstream financial market without necessarily losing its socially-oriented aspects;

(v) At the meso level, particularly in microfinance associations, there will be more challenges in maintaining their important role of supporting their members;

(vi) On the supply side, microfinance institutions will become stronger. However, there are two main trends, among others: competition among microfinance institutions is increasing, which brings advantages to clients in terms of price reductions; and there are organisational and governance challenges to what has become a growing industry;

(vii) On the demand side, the trends show that the clients, who are usually in a weak position, are now paying increasing attention to improving their product knowledge, consumer protection and improved publication of financial products.

In the Asian context, microfinance has been growing despite the fact that this growth falls outside the legal and regulatory framework, which mainly focuses on the banking sector (Sharma, 2009: 8). However, similar to other world development trends, commercial banking is showing increasing interest in entering the microfinance market in Asia as well (Sharma, 2009: 9).

3.3.2 The Issues in Microfinance: Problems and Challenges, Role of Government, Sustainability and Outreach

The main challenges to microfinance seem to have remained the same over the years. Based on CGAP's long experience in microfinance, Helms (2006: 142) points out that the interlinked problems in three layers, micro, meso and macro levels, can be summarised as three fundamental challenges:

(i) developing the quality of microfinance services to reach a large number of people (scale);

(ii) reaching poorer people and clients in remote areas (depth); and

(iii) reducing cost to both clients and MFIs (cost). In addition, five new issues are emerging: technology optimisation, improving money transfer and remittances, reaching farmers and remote rural clients, social performance measurement, and poor customers' protection (Helms, 2006).

In addition, Staschen and Nelson (2013: 72) highlight three primary challenges in financial inclusion which cover obstacles from three aspects include

(i) supply side (*eg*. high transaction cost, difficulty in accessing the clients' financial record, lack of capability in providing services to poor customers);

(ii) demand side (*eg*. lack of capability to access to financial services due to socioeconomic and cultural issues, lack of formal identification, low level of financial literacy);

(iii) inadequate regulatory framework particularly in protecting customers**.**

Generally, there is emerging agreement that governments have an important role in microfinance development by providing constructive policies and a conducive environment (Helms, 2006: 75; Staschen and Nelson, 2013; Zaman, 2004). In this regard, the CGAP (2006) has developed eleven key principles of microfinance based on a decade-long consultation with its 31 member countries; one of these principles is directly related to the role of government:

> "The job of the government is to enable financial services, not to provide them directly. Governments can almost never do a good job of lending, but they can set a supporting environment policy environment" (Helms, 2006: x).

Similarly, Staschen and Nelson (2013: 72) also emphasises that government could play an important rule as policy maker in order to promote financial inclusion, to protect customers and to maintain macroeconomic stability. In broader perspective, prudential regulation and supervision are important (Chavez and Gonzales-Vega, 1993: 2):

(i) to provide supportive macroeconomic environment in order to avoid banking crisis and maintain the integrity of the payment system;

(ii) to protect depositors against risks, losses and frauds;

(iii) to encourage efficient financial performance in a fair competitive market .

It is important to note that regulation must not ended in financial repression and must not decrease efficiency (Chavez and Gonzales-Vega, 1993: 3). However, regulation is required in some circumstances (Ledgerwood, 2000: 22):

(i) when the institution generates deposits from the public and depositors require the government to monitor the vigour of MFI;

(ii) when standards of good practices are strongly required; and

(iii) when the institution grows bigger and there is a possibility of financial failure affecting large numbers of stakeholders, creditors/depositors and owners.

One of the current issues of microfinance is the question of how the institutions can be financially sustained and to be subsidy-free. As it is a fact that, in reality, microfinance still tends to use subsidies from many sources including government, donor funds, charities, *etc*, directly or indirectly, in the form of staff training, 'soft loans' (very long-term loans with very low interest), *etc* (Armendariz and Morduch, 2010: 318, 322). The role of subsidies appears paradoxical, as micro-lenders want to take advantage of them but they also bear certain consequences. Therefore, Armendariz and Morduch (2010) suggest a properly-planned subsidy called "smart subsidy" (Armendariz and Morduch, 2010: 332), which is based on the premise that it can be carefully used with the intention to "subsidize start-up cost, not on going operation" and sustain tough budget limits; hence, the social and economic effects might be better achieved (Armendariz and Morduch, 2010: 333).

Other important microfinance issues are sustainability and outreach. In this regard, Zeller and Meyer (2002) discuss the triangle of components that are essential for successful micro financing: outreach, impact and financial sustainability. Those three interrelated components are essential for supporting and ensuring the survival of an MFIs. In particular to microfinance in Asia, it is reported that a large majority of microfinance institutions are unable to expand their outreach, mainly due to a lack of financial resources and subsequent inability to invest in developing an adequate level of systems and human resources capacity to manage significant growth (Sharma, 2009: 1).

Another problem in microfinance is the asymmetric information caused by their provision of micro financing to poor people about whom there is a lack of comprehensive and reliable financial information as an indication of their ability to repay (Ahmed, 2012: 18-19). To address this problem, Ahmed (2012) subsequently underlines the importance of providing social financial intermediation conducted by specialised microfinance institutions so that both parties, clients and institutions, can benefit.

A further common problem faced in microfinance related to human behaviour is moral hazard in the form of misuse of funds and credit risks (Ahmed, 2012: 19). For example, the moral hazard problem was observed in Grameen Bank, where there were incidences of verbal aggression and physical assaults, particularly against women clients due to the escalation of the credit programme and the implementation of social collateral (Rahman, 1999: 75). These cases were usually triggered by the women's involvement with the bank; this led to violence in the household, basically because the women refused to hand over the loans to the husband, as admitted by 70% of the 120 respondents (Rahman, 1999: 75). In addition, the credit risks might occur when money is transferred, which might increase the possibility of it being utilised for other purposes, thus possibly leading to non-repayment. In addition, most MFIs have not achieved a good level of economic viability due to lack of fund mobilisation and high financing costs (Ahmed, 2012: 19).

Based on the general experiences of MFIs, hence, to overcome the problems of moral hazard and credit risks, Ahmed (2002: 19) points out some common applied solutions practiced in the industry, which unfortunately do not completely address the problems, as follows:

(i) Mitigating credit risk by reducing the possibility of non-repayment of physical non-collateral financing. Credit risk could also be mitigated by applying group-based lending which involves peer pressure as social collateral to replace physical collateral;

(ii) Solving the moral hazard problem by ensuring that funds are used for the intended productive activities,

(iii) Maintaining economic viability by lowering administration and financing costs.

In addition to these ways of overcoming credit risks, Schreiner (2000) proposes the utilisation of credit scoring. This scoring system does not replace personal judgement; it is a useful complementary tool for credit valuation through the prediction of risks and the provision of information on how the characteristics of borrowers, loans and lenders might affect the risks (Schreiner, 2000).

Overall, to be an effective microfinance provider in building inclusive financial market, Ferrand (2013: 470-473) points out the importance of addressing the following aspects:

(i) developing retail capacity through creating specialist MFI, promoting incentive system for loan officers, developing financing channels and products/services;

(ii) establishing supportive infrastructure through provision of trainings, advertising, information system development and management consultancy, *etc*;

3.3.3 The Importance of Microfinance in Developing Microenterprises

There is currently a debate on the importance of microfinance in supporting microenterprises; while some believe it has positive impacts, others suggest that microfinance is not the most important tool for developing microenterprises as they need more than just funding. Thus, the findings of impact studies on microfinance could be positive and negative.

A positive impact is revealed in a report by the Social Fund in Egypt showing that micro credit in general has a positive impact on higher levels of non-farm income in rural areas; meanwhile, in metropolitan and urban areas, it has also improved household expenditure and reduced poverty (Abou-Ali, *et al.*, 2009: 34). Similarly, a survey conducted in 87 villages in Bangladesh during 1991-2002 to examine the effect of group-based credit for the poor on household consumption based on seasonal patterns found that the credit has helped to smooth consumption by financing new productive activities, particularly non-agricultural activities (Pitt and Khandker, 2002: 21). Further evidence provided by Latif *et.al* (2011: 164) on the positive impact of micro credit comes from findings from structured interviews with 200 respondents who obtained micro credit in Pakistan, 40% of whom opened small shops, investing in poultry, embroidery and livestock.

In terms of repayment, Sharma and Zeller (1997) state that repayment rates of group-based institutions (BRAC/Bangladesh Rural Advancement Committee, RDRS/Rangpur Dinajpur Rural Services and ASA/Association for Social Advancement) are higher than nationalised commercial banks, particularly in remote areas. These high repayment rates are significantly affected by diversity of assets and enterprise within groups (Sharma and Zeller, 1997: 1740).

On the other hand, some research has obtained contrary findings. Based on an analysis of debt among small farmers, Adam and Von Pische (1992) argue that loans to microenterprises are likely to end up as unpaid debts, the funds simply consumed without sustainable outcome, and the borrowers are not well off in the long run. (Adams and Pischke, 1992: 21-22) also strongly assert that:

> Debt is not an effective tool for helping the poorest people enhance their economic condition – be they operators of small farms or microenterprises, or poor women. In most cases lack of formal loans is not the most pressing problem faced by these individuals. It must also be recognised that providing financial services to poor people is expensive and building sustainable financial institutions to do this requires patience and a keen eye for cost and risks. Most formal financial institutions in low-income countries currently avoid providing these services for sound commercial reasons, and commercial sources of informal finance are able to offer loans only by charging relatively high interest rates.

In addition, based on the comparative analysis between two separate groups of microenterprises who obtained finance from formal and informal sectors in urban Egypt, the findings suggest that the growth of microenterprises, in terms of income growth, is affected neither by the access to finance nor by high level of credit cost, from both formal and informal institutions; it may reach a certain level but will then become stagnant (Nasr, 2002: 186). Furthermore, Nasr (2002) also uncovers the factors of religious principles in relation to borrowing behaviour; therefore microenterprises choose not to use formal financial services for religious reasons, i.e. regarding the meaning of debt. Another point is that Nasr (2002) found that "formal credit does not substitute informal credit"; some microenterprises use cross-financing, which means utilising funds from both credit sources. In addition, Nasr (2002: 187) states that most microenterprises in his sample demonstrate growth in 3-4 years after the establishment. Compared to conducive macro-economic conditions provided by public infrastructure, the role of microfinance was found to be less important in the case of Egypt (Nasr, 2002: 188). In addition, it is pointed out that the growth of microenterprises is mostly affected by internal personal motives rather than finance. Thus, financing decisions are affected mainly by the personal behaviour and encouragement of microenterprises (Nasr, 2002: 189).

In particular to impact on employment, a survey study in Philippines generates findings that MF programme has positively improved the number of enterprises and employment as compared to others which do not participated in the programme (Kondo, *et al.*, 2008: 62). This study also reveals the positive impact on assets, children education and health.

Perhaps one of the most important studies is a study by Hulme and Mosley (1996a) that was conducted in seven countries and compares borrowers' incomes with those of a control group. In particular to poverty alleviation, the findings suggest that microfinance had positive impact in improving the income level of the borrowers. However, the positive impact on income was higher among the non-poor borrower as compared to the poor living under the poverty line. In other words, the microfinance program was found to be more effective for non-poor rather than the poor (Hulme and Mosley, 1996: 109; Mosley and Hulme, 1998: 786). Mosley and Hulme (1998: 787) argue that the reasons behind this findings is the character of the poor who were more risk averse; small loans were utilised mostly for working capital and, in large cases, for consumption purposes, hence, the impact on income were lower than the higher income respondents. To improve the impact and sustainability of the programme, based on the empirical evidence, Hulme and Mosley (1998) suggest that the MFI should develop good financial performance, such as development of savings and insurance facilities, intensive collection of repayment and incentives to repay, complemented with flexible scheme of repayment and charging lower interest rate for small loans.

A number of studies have been conducted on the impact of Grameen Bank. Rahman (2010a: 70-73) uses the secondary data by Grameen Bank from 1999 to 2003 and finds that its contributions are as follows: 3% increase in household consumption level, 2% of borrowers move above poverty line, which is slow but steady progress, 0.25% GDP growth, which might not be significant at the macro level but has an effect in local rural economic development, an increase in employment and production in rural non-farm activities (Rahman, 2010: 70-73).

However, Mannan (2007: 627-629) argues that Grameen does not have the mechanism to break the 'vicious circle' of poverty; the hard-core poor in rural areas are not served, and too much emphasis has been placed on the women-only approach, which has led to further family problems.

A critical assessment of the role of microfinance in poverty reduction is provided by Chowdhury (2009), who argues that, while microfinance has been developed, there is uncertainty about its impact on poverty since the poor do not just need credit; more importantly, among other things, they need support in developing entrepreneurial skills, as success in managing a business mostly depends on these skills.

In particular to social impact of microfinance, sufficient information has been provided in the literature. Social impact may include impact on relationship with spouse/family members (Nader, 2008; Rahman, 1999); impact on food consumption (Pitt and Khandker, 2002); impact on food nutrition and health (Deloach and Lamanna, 2011; Nader, 2008); impact on children education (Maldonado and Gonzalez-Vega, 2008; Nader, 2008); impact on women empowerment and decision making power (Akpalu, *et al.*, 2012; Brett, 2006; Goetz and Gupta, 1996; Hashemi, *et al.*, 1996; Mayoux, 2003; Montgomery, *et al.*, 1996; Nader, 2008; Naved, 1994; Zaman, 2004).

3.4. ISLAMIC MICROFINANCE: AN INTRODUCTION

After discussing the details of microfinance as a concept and operational financial tool, this section aims to discuss the case for Islamic microfinance by providing a detailed discussion on various aspects.

3.4.1. Conceptual Framework of Islamic Microfinance

As in Islamic finance, the values and principles of Islamic microfinance can be located in the ontological sources of Islam, namely Qur'an and *hadiths*. These principles can be listed as follows (Obaidullah, 2008b: 14-17; Obaidullah and Khan, 2008c: 17):

(i) Emphasis on providing access to the poorest of the poor;

(ii) Credit appraisal is conducted carefully with empathy and aims to provide clients with the best services;

(iii) Changing non-productive assets into productive and income-generating ones, involving the wider community in the process;

(iv) Fulfilling basic needs at first and then investing the surplus in productive properties;

(v) Contributing directly in capacity-building and provision of technical assistance to the customers;

(vi) Provision of technical assistance in the form of training on how to set up a business, and conducting an impact assessment to monitor the business;

(vii) Transparency of bookkeeping and reporting, and freedom to use a portion of the funds to fulfil basic needs.

Considering that Islam prefers community-based activities (Qur'an, 5:2), Islamic principles shape the nature of microfinance institutions as they operate under a group-based approach and joint liability.

It can, therefore, be argued that the above characteristics seem to cover almost all aspects required by the poor. However, attention should be given to the implementation of the spirit of Islamic microfinance so that it is not just an empty theory; as the gap between the spirit and implementation is rather obvious.

The role of microfinance in fulfilling social and development requirements is essential. Asutay (2010: 29) argues that, as part of the whole financial system, IBF has a unique character and it should apply the Islamic values contained in the Islamic Moral Economy (IME). The intention of the IBF should be to achieve both economic and social objectives, and these social objectives cannot be separated from IBF due to its obligation to implement the IME, to achieve "human-centered economic development" (Asutay, 2010: 29). On the other hand, the criticism that IBF is operating in an environment similar to conventional banking and failing to realise its social responsibility cannot be ignored (Asutay, 2010: 25). However, as the objective function of microfinance - to act as a development tool through capacity-building - is aligned with Islamic values, Asutay (2010: 29) suggests that the most suitable method of implementing IME in IBF is by conducting social banking and Islamic microfinance (IMF). Therefore, IMF is considered as a fundamental part of IME and IBF due to its ability to implement the values of IME in reality, hence bringing the idea of development into existence.

In rationalising Islamic version of microfinance, it should be noted that the values and principles determine and essentialise the need to develop Islamic microfinance. In addition, conventional microfinance has been criticised because it is likely to charge its clients high interest rates; this is known as the debt-based approach, as they are dragged into debt (Asutay, 2010: 26). Islamic finance, hence, offers a moral approach through a profit and loss-sharing approach in the form of *musharakah* and *mudarabah* modes of financing (Asutay, 2010: 26) to prevent individual borrowers to be dragged into further debt. As IMF is based on asset-based approach as opposed to a debt-based approach, it is more appropriate for the needs of microenterprises, since their profits from their businesses can be hard to predict.

3.4.2. The Supply and Demand of Islamic Microfinance

Concerning the providers of Islamic microfinance, Obaidullah and Khan (2008c: 23) divide them into broader categories: micro, meso and macro levels. As regards to the micro level, it can be categorised as follows:

(i) informal (individuals such as friends, relatives, neighbours, moneylenders, savings collectors, pawnbrokers, traders, processors and input suppliers, and groups (ROSCAs);

(ii) member based-organisations,

(iii) NGOs;

(iv) formal institutions.

With regards to the rules governing microfinance, the operations of individuals in the informal sector should follow *Shari'ah* rules, which are: only the original amount of the loan should be repaid (*qard hasan*); loans should be fee-based (*ujrat*); and pawn brokering should be *Shari'ah*-compliant (*al-rahn*) (Obaidullah and Khan, 2008c: 23). There are some disadvantages of this sector, such as being very high-priced, inflexible, high-risk, less transparent, and at risk of failure because of corruption, mismanagement and environmental catastrophes (Obaidullah and Khan, 2008c: 24). While member-based organisations might include village banks, self-help groups (SHG), credit unions and finance cooperatives, Islamic NGOs might include *zakah*- and *sadaqah*- (charity) based organisations with deeper social objectives. Islamic banks fall under the category of formal institutions, having the most potential to provide an inclusive financial system.

The meso level institutions cover the 'basic financial infrastructure' including auditors, rating agencies, professional networks, trade associations, credit bureau, *etc.* (Obaidullah and Khan, 2008c: 41). The macro level refers to the regulatory and policy regime set up by the government, which might include issues related to macroeconomic stability and banking regulations in microfinance (Obaidullah and Khan, 2008c: 47). These three levels should have a strategic synergy in order to promote the development of Islamic microfinance, as it cannot be developed at just on one level.

As regards to the clients of Islamic microfinance, namely the demand side, they are similar to the conventional ones: they are poor people, although there is no clear threshold regarding the maximum amount of income they can obtain in order to be judged poor.

3.4.3. The Operation of Islamic Microfinance: Source of Funds, Products and Services

Like other financial institutions, IsMFIs should take into account the importance of accumulating funds to be utilised in their operations, such as providing credit and sustaining themselves in the long run. Wilson (2007: 2013) proposes that an alternative way of raising funds is through accumulation of *waqf* and *zakah* by non-banking microfinance institutions rather than financial institutions. These non-banking institutions are recommended to utilise the *wakalah* model, in which capital comes from donor funds and is managed in the manner of a cooperative organising its financial management

(Wilson, 2007: 213). In the Muslim world, generally, *waqf* has mainly been spent on providing benefits for needy people; hence, it is aligned with the purposes of microfinance (Asutay, 2010: 26). However, it should be noted that there are some criticisms of this institution, particularly in the aspects of sustainability and public intention, due to the absence of accountable and transparent management (Asutay, 2010: 26). Wilson (2007) also points out that utilising *zakah* as a source of microfinance has its problems, as the Qur'an provides specific regulations regarding the *zakah* function and the permissible recipients of *zakah*. However, Shari'ah scholars seems to have overcome this through ijtihad in favour of development needs of Muslim societies.

In addition, IsMFIs can raise funds from the savings and deposit mechanism such as *wadiah*, *qard hasan* dan *mudarabah*, in which the primary concern should be with the aspect of balancing significant expenditure and profit, and considering the characteristics of the above mechanisms (Asutay, 2010: 26).

As noted before, Islamic financing products include debt-based and equity-based products. Although debt is permissible, Islamic normative principles suggests that debt should be avoided; equity-based products are preferable in the Islamic view, although they are more complex than debt-based products, which are likely to have simpler calculations (Obaidullah, 2008b: 13). Hence, debt-based products could lead to addiction and lack of product diversification, as is currently happening with *murabahah*, the major financing product. On the other hand, partnership-based structures are inherently more robust, more ethical and more effective in responding for clients' needs (Obaidullah, 2008b). Learning from the Grameen model, the provision of group-based and mutual guarantees in Islamic microfinance is actually aligned with Islamic principles based on Qur'anic verse (5:2).

In terms of operational aspect, Islamic microfinance provides *Shari'ah*-compliant instruments for fund accumulation, financing, and risk management (Obaidullah and Khan, 2008c: 18-22). Table 3.1.summarises these instruments:

Table 3.1: *Shari'ah*-Compliant Instruments

***Shari'ah* Instrument**	**Forms**
Fund accumulation	a. Charity (*zakah*, *sadaqah*, *awkaf*, gift that include *hiba* and *tabarru*) b. deposits (*wadiah*, *qard hasan* and *mudarabah*), c. equity (*musharakah*)
Financing	b. profit and loss sharing (PLS) (*e.g. mudarabah*, *musyarakah*), c. sale based mode (*murabahah*), d. lease-based modes (*ijarah*), e. caring loans (*qarn hasan*).
Risk	a. guarantee (*kafalah*), applied in group financing, b. collateral (*daman*) for individual financing and micro-takaful.

Source: Obaidullah and Khan (2008: 18-22).

It seems that these instruments cover the required instruments in the field, which can replace what conventional microfinance is offering in the interest-free perspective. Specifically, the characteristics of the above financing instruments are presented in Table 3.2:

Table 3.2: Financing Instruments

Instrument	**Mechanism**	**Suitability**	**Risk to borrower**	**Risk to institution**	**Remarks**
Mudarabah	Trustee partnership with pre-agreed ratio of profit sharing, the institution provides capital and borrower is responsible for managing the fund in business.	Fixed assets purchased, working capital financing and project financing.	If loss, it has risk of un-rewarded work.	Full responsibility for capital loss.	It has complex operation with high operation, administrative and monitoring cost, requires transparent and accountable reporting. Ideal mode of financing but hardly practised.
Musyarakah	Joint venture/ partnership contract, both participate in management and capital.	Fixed assets purchased, working capital financing and project financing.	If loss, share will be according to equity participation.	If loss, share will be according to equity participation	It has complex operation with high operation, administrative and monitoring cost, requires transparent and accountable reporting. Ideal mode of financing but hardly practised.
Murabahah (bai mu'ajjal)	Sale agreement with specified profit margin, payment can be in instalments or lump sum.	Fixed assets and working capital	Borrower can use asset and own it at the end of period.	Institution has the asset ownership; hence it has risk and liabilities of assets.	More popular, simpler and easier to manage compared to *mudarabah/ musyarakah*.
Ijarah	Leasing physical assets, institution is the owner of assets during *ijarah* period.	All income generating assets, particularly fixed assets.	Leased assets are a trust, no costs if the asset is damaged beyond his control.	Institution has risk and liabilities of assets ownership.	Lower administration and monitoring cost and simple operation, could be adopted by conventional microfinance.
Qard Hasan	Loan with zero nominal return.	All purposes (consumption/ productive).	Very low	Very low	The purest financing with the main purpose being only charity and helping the poor.

Source: Combined from Obaidullah (2008b), Dusuki (2008) and (Dhumale and Sapcanin, 1999).

Among the financing instruments depicted in Table 3.1 and Table 3.2., *murabahah*, *mudarabah* and *qard hasan* seem to be the most practical and suitable schemes due to their easier operation and monitoring of equal instalments derived from the buy-resell model (Dhumale and Sapcanin, 1999) due to their efficiency in responding to the needs of the potential borrowers.

3.4.4. The Difference between Conventional and Islamic Microfinance

A comparison between Islamic microfinance and its conventional counterpart reveals similarities in terms of their focus on economic development and social objectives, aiming to achieve a better life for all people, providing additional income, promoting entrepreneurship, and encouraging risk-sharing in the belief that the poor should become involved in entrepreneurship activities (Obaidullah, 2008b: 10). In addition, both are expected to provide wider access to the poor and to act as sustainable institutions that can achieve a 'market based for profit approach', supported by an efficient system and transparent reporting, with the focus on capacity-building combined with the integration of microfinance and the official financial system (Obaidullah, 2008b: 9-10). Similarly, Dhumale and Sapcanin (1999) affirm that both types of microfinance support entrepreneurship and risk-taking through, for example, the provision of collateral-free loans, and they share the same belief that the poor should take part in such activities.

However, some differences exist. Firstly, Islam categorises the poor into two levels: the deeply poor who do not need loans but require a social safety net and charitable funds (*zakah*), and the moderately poor who would be better off were they to obtain credit to run microenterprises (Obaidullah, 2008b: 10-11). Secondly, to reiterate, Islamic microfinance is not a debt-based and interest-based approach; rather, it is based on a profit and loss-sharing approach, free of interest (*riba*) and uncertainty (*gharar*) (Obaidullah, 2008b: 11-12). Thirdly, Islamic teaching aims to empower the family rather than giving preference to the women-only approach, as practised by conventional microfinance (Obaidullah, 2008b: 12). Thus, it can be concluded that the above similarities and differences guide them in the same direction but they contain different values, meanings and instruments.

The main difference is that the Islamic approach emphasises and essentialises the provision of financing and non-financing services to improve microenterprises, transparency in its operation through social accountability, understanding and cooperation (Obaidullah, 2008b: 10).

In overall, however, specifically, the differences between the two financial instruments can be summarised as in Table 3.3. It can, therefore, be concluded that while the similarities and differences shape their operation by directing both in the same direction, they contain different values, meanings and instruments through which the operational aspects are developed.

Table 3.3: Differences between Conventional and Islamic Microfinance

Category	Conventional Microfinance	Islamic Microfinance
Category of poor	One category	Two levels: 1. deeply poor who do not need loan but social safety net and charitable fund (*zakah*), 2. moderately poor who will be better off if they obtain credit for running microenterprises
Basis of financing	Debt-based and interest-based approach	Profit and loss-sharing (PLS) approach, free of interest (*riba*) and uncertainty (*gharar*)
Approach/target of empowerment	The poor and women	The poorest and family
Sources of fund	External funds, savings of clients	External funds, savings of clients and Islamic charity funds.
Dealing with default	Group/centre pressure and threats	Group/centre/spouse guarantee, and Islamic ethics.
Social Development Programme	Secular	Religious (behaviour, ethics and social)

Source: Combined from Obaidullah (2008b: 11-12), Ahmed (2002: 41)

3.5. MODELS AND STRATEGIES IN ISLAMIC MICROFINANCE

Models of Islamic microfinance are varied and are likely be influenced by the local culture and environment. However, Islamic microfinance models can be divided into four categories (Obaidullah, 2008b: 6-8):

(i) The Grameen model adopted as a *Shari'ah*-compliant model by Islamic Bank Bangladesh Limited (IBBL). IBBL replicates the group-based approach, having five members in each group with joint liability as a replacement for collateral;

(ii) Village Bank, successfully adopted as *Shari'ah*-compliant institution by Jabal Al-Hoss, Syria. Village Bank works like the agency model, as it obtains capital and distributes it to individuals who are expected to repay on time in weekly instalments under peer pressure;

(iii) Credit Union, of which a *Shari'ah* modification is applied by Baitul Maal wat Tamwil (BMT) in Indonesia. Credit Union operates based on the membership who own and control the union, accumulate savings and provide credit to members; it is in the nature of a 'non-profit financial cooperative';

(iv) Self-Help Groups (SHGs) have ten to fifteen members with the same level of income who accumulate funds and distribute them as loans to other members.

Methods in Islamic microfinance might include the composite model of Islamic microfinance (Obaidullah, 2008b: 54), *wakalah* agency model, *mudarabah* agency model (Wilson, 2007), and SPV model (Dusuki, 2008).

First, the 'composite model' works through the following activities (Obaidullah, 2008b: 53-55):

(i) Donors create *Zakah* fund;

(ii) *Waqf* fund has a physical basis and cash is built up;

(iii) The poorest, who are economically inactive, will receive *zakah* funds as a safety net;

(iv) Skills training is delivered for the poorest using physical assets from *waqf*;

(v) Skills improvement will encourage the poorest to graduate from poverty and become economically active;

(vi) The participants form self-help groups with mutual guarantee;

(vii) Allocated funds are based on a combination of for-profit debt-based and equity-based modes;

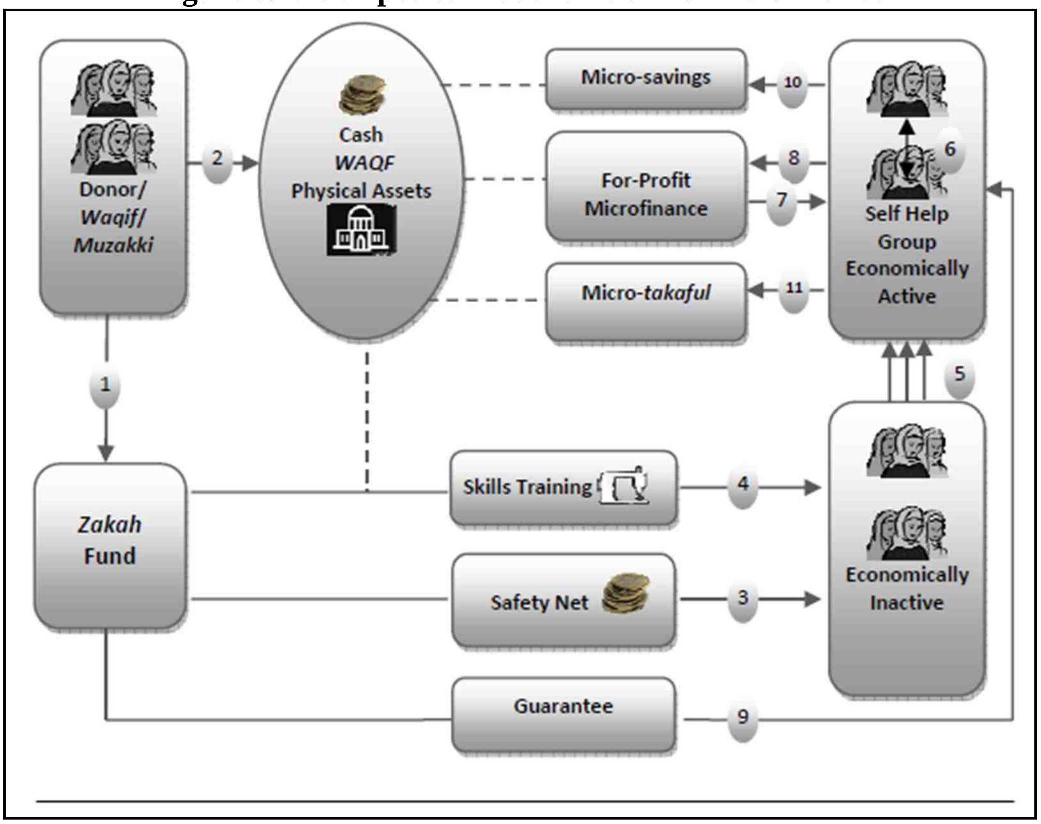
(viii) Loan repayment produces possibilities of higher loans in the future;

(ix) Zakah funds are used to guarantee against default;

(x) Saving is encouraged under micro-savings;

(xi) *Takaful* fund is encouraged to protect against risks and uncertainties.

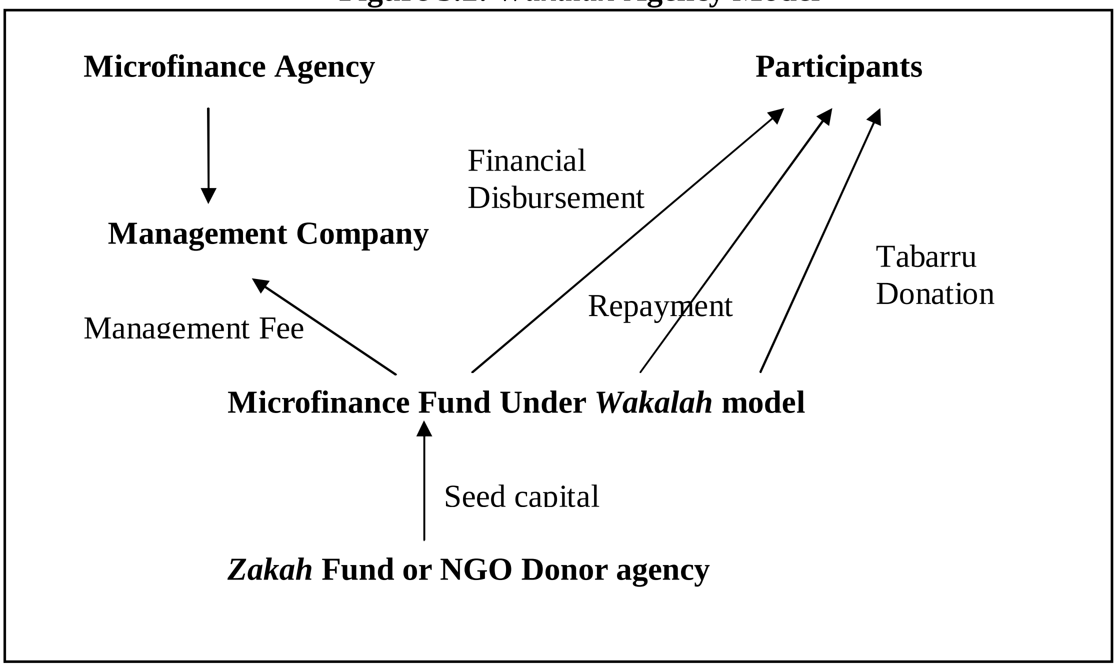
Figure 3.1: Composite Model of Islamic Microfinance



Source : Obaidullah (2000b: 54)

Wilson (2007: 210) proposes two further models. First, the *wakalah* model, as depicted in Figure 3.2, utilises funds from *zakah* and NGO donors, distributed to the poor in *qard hasan*; hence, *zakah* is promoted as a self-sustaining development tool for the needy, educating them to be independent. The management company acts as an agency and assesses eligible credit applications. For this duty a fixed fee, rather than a share of the *wakalah* fund, is set up for the management as a reward for conducting the operation. The participants can obtain fund disbursements, but with a rationing mechanism and prioritisation to prevent the bulk of the capital being taken out. In this case, it is similar to credit unions, but with qualified financial administration and protection for clients. This model is widely used in Islamic *takaful* insurance, as it features donations of *tabarru* (solidarity) funds as revenue accumulation to help other participants. Other revenues are gathered through management fee-based services (*jualah*).

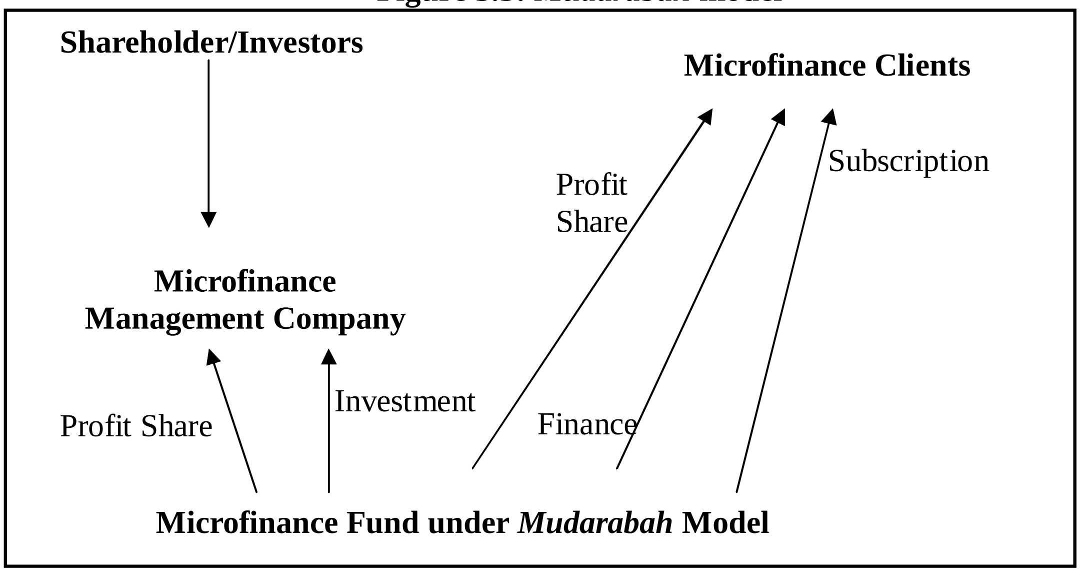
Figure 3.2: *Wakalah* Agency Model



Source: Wilson (2007: 204)

Second, the *mudarabah* model, as depicted in Figure 3.3, works differently from the *wakalah* model as it is based on a profit and loss-sharing contract (Wilson, 2007: 211). In this model, the company acts as financier (*Rabb al mal*), invests the funds in the clients (*mudharib*) and receives a predetermined ratio of profit share in return, which makes it similar to joint ventures. Hence, due to the fluctuation of actual profits, the amount of the share will fluctuate. If there is a loss, the bank concedes that it will not get the funds back and the clients run the risk of not obtaining the rewards for the work completed in running the business. *Zakah* funds cannot be used in this method because they are more commercial than social in nature. The problems in this method, as in the conventional method, are asymmetric information - due to difficulties in obtaining information about clients' liability - and moral hazard in the case of misuse of funds.

Figure 3.3: ***Mudarabah*** **model**



Source: Wilson (2007: 211)

Overall, Wilson (2007) underlines that microfinance services should be provided by specialised financial institutions rather than Islamic banks.

In contrast to Wilson's concept, Ahmed (2012) has recently proposed two models of Islamic microfinance organisation. First, Islamic banks could manage Islamic microfinance through the establishment of a microfinance division, which applies the same format of group-based financing and weekly repayments. This proposal is based on the argument that Islamic banks have more capable staff to manage financing, and a large number of branches/networking which might reduce administration costs; hence Islamic banks' operation of Islamic microfinance is likely to be more effective than that of Islamic MFIs (Ahmed, 2012: 25-26). Furthermore, the economic viability of Islamic banking is likely to be higher compared to Islamic MFIs in terms of available funds and lower operational costs due to its wider operation. Subsequently, micro financing and social services could be provided with more effective and efficient management.

Second, there is the potential to develop the provision of Islamic micro financing through traditional Islamic instruments such as *zakah, waqf, qard hasan* and *sadaqat* (Ahmed, 2012: 27-29). Currently, researchers have become increasingly interested in the implementation of this concept. Aligned with this concept, Zarka (2012) argues that microfinance should be provided by *waqf* institutions rather than Islamic banks. In his scheme, he suggests the establishment of a guarantor of liquidity and a guarantor of losses with the purpose of strengthening the security of funds; hence, this is expected to contribute to the improvement of credit standing (Zarka, 2012: 78-79).

Finally, Dusuki (2008) proposes the SPV model, which is depicted in Figure 3.4. This alternative model has the following features (Dusuki, 2008: 61):

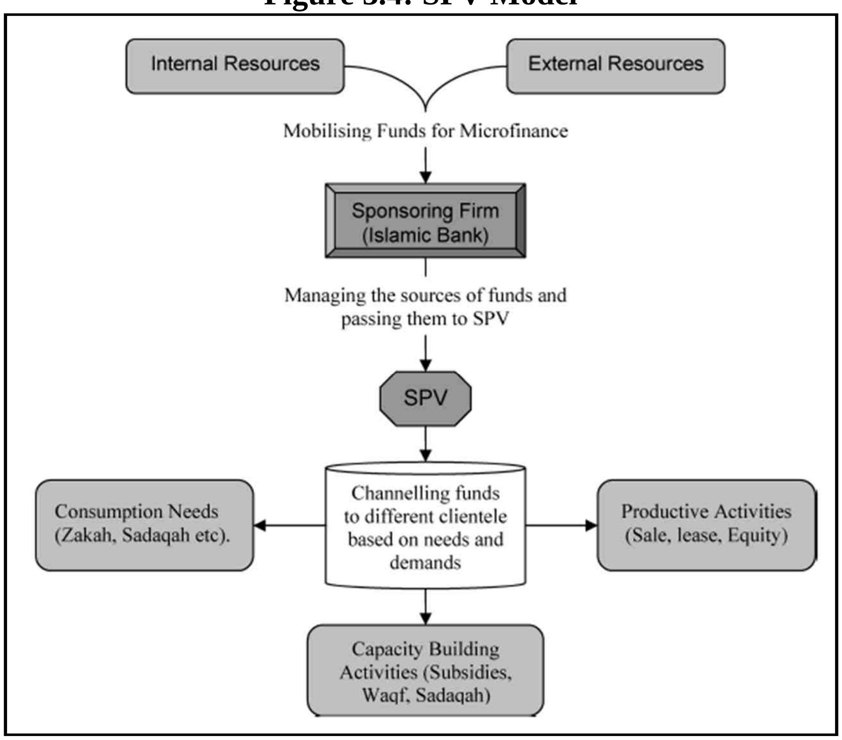
(i) a variety of funding sources with specific microfinance intentions are mobilised by Islamic Banks;

(ii) a bankruptcy-remote SPV is created;

(iii) certain amounts of funds are allocated and forwarded to SPV;

(iv) the funds are distributed based on client demand.

Figure 3.4: SPV Model



Source: Dusuki (2008: 62)

It can, therefore, be summarised from the above models that Islamic microfinance maintains the basic format of conventional microfinance in terms of weekly/monthly repayments and social development programmes. However, Islamic microfinance has more opportunities to use other external funds from charities (*zakah, waqfs*), the mode of financing is more varied to accommodate the different needs of the poor, and the approach in dealing with default is softer.

3.6. DEVELOPMENTS AND TRENDS IN ISLAMIC MICROFINANCE

Recently, Islamic microfinance has spread throughout the world, particularly in Muslim developing countries. Although the share of Islamic microfinance worldwide and in all Muslim countries is very small as compared to total microfinance outreach, there is a potential demand for microfinance in these countries, as 44% of the conventional worldwide microfinance clients are currently in Muslim countries (Karim *et al.*, 2008: 5).

The CGAP Focus Note 49/2008 suggests that Islamic microfinance has good potential for growth, since it has the ability to serve the potential demand: the people who currently avoid non-*Shari'ah*-compliant products offered by conventional microfinance (Karim *et al.*, 2008: 5-6). Based on a number of IFC market studies, the potentially strong demand for Islamic microfinance, in both the Muslim and non-Muslim markets, can be found in the West Bank, Gaza, Jordan, Algeria, Yemen and Syria (Karim *et al.*, 2008: 5). In addition, Karim, *et al* (2008) states that conventional microfinance's current clients are likely to switch to Islamic products, as found in Afghanistan, Indonesia, Syria and Yemen.

It should, therefore, be noted that there is also some movement in Islamic microfinance through the transformation of conventional MFIs into Islamic MFIs and a new policy of offering Islamic microfinance services in Islamic commercial banks (*e.g.* Yemen's Tadhamin Islamic Banks, Noor Islamic Bank and Emirates Post Holding in UEA, *etc.*).

Among others, the support to develop Islamic microfinance comes from the Islamic Solidarity Fund for Development (ISFD) at the IDB, which is concerned with promoting microfinance and poverty alleviation in its member countries under the Microfinance Support Program (MFSP) with USD 500 millions (Karim *et al.*, 2008: 5). Another encouraging development in Islamic microfinance is the growing number of Islamic commercial banks offering Islamic microfinance products in some regions, such as Indonesia, Yemen, UAE *etc.* (Karim *et al.*, 2008: 6). Hence, there is an optimism that Islamic microfinance will experience a high demand due to its compliance with *Shari'ah*; hence, it will achieve respectable growth (Ibrahim, 2012: 98), in particular under the circumstances of further Islamisation in most of the Muslim societies and Arab Spring countries.

In terms of outreach, the fastest growing region with IsMFIs is Asia, followed by the Middle East and North Africa (MENA) region which has grown beyond USD 1.175 billions (Ibrahim, 2012). Similarly, CGAP survey findings in 2007 also reveal that the supply of Islamic microfinance is highly concentrated in Indonesia, Bangladesh and Afghanistan, accounting for 80% of worldwide Islamic microfinance outreach (Karim *et al.*, 2008). The latest report stated that the total clients of IsMFIs worldwide are 1,28 million in 19 countries, mostly concentrated in Bangladesh, Sudan and Indonesia (El-Zoghbi and Tarazi, 2013: 6) The trends related to Islamic microfinance outreach are depicted in Table 3.4:

Table 3.4: Outreach of Islamic Microfinance by Country

Region	Included institutions	% Female (Avg.)	Total of clients (2008)	Total clients (2013)	Total Outstanding Loan Portfolio	Avg. Loan Balance
Afghanistan	4	22	53,011	26,000	10,347,29	162
Bahrain	1	n/a	323		96,565	299
Bangladesh	2	90	111,837	445,153	34,490,490	280
Indonesia	105	60	74,698	181,508	122,480,000	1,640
Jordan	1	80	1,481	15,000	1,619,909	1,094
Lebanon	1	50	26,000	70,000	22,500,000	865
Mali	1	12	2,812		273,298	97
Pakistan	1	40	6,069	30,000	746,904	123
West Bank and Gaza	1	100	132		145,485	1,102
Saudi Arabia	1	86	7,000	8,000	586,667	84
Somalia	1	n/a	50		35,200	704
Sudan	3	65	9,561	426,694	1,891,819	171
Syria	1	45	2,298	20,000	1,838,047	800
Yemen	3	58	7,031	30,000	840,240	146
Iraq				24,000		
Egypt				16,000		
Cameroon				10,000		
Palestine				6,000		
Srilanka				2,000		
TOTAL	**126**	**59**	**302,303**	**1,280,000**	**197,891,882**	**541**

Source: Karim (2008: 8), El-Zoghbi and Tarazi (2013: 7)

The following is an overview of Islamic microfinance development by focusing on regional development:

Bangladesh is the home of well-established Islamic MFIs, namely Islamic Bank Bangladesh, Social and Investment Bank Bangladesh, AL-Fallah and Resque. Based on CGAP survey findings in 2007, Bangladesh has the largest Islamic microfinance outreach, having 100,000 clients and two active institutions; this is aligned with the largest outreach of conventional microfinance which reaches almost 8 million borrowers of whom only 1% take up Islamic microfinance (Karim *et al.*, 2008: 7). The latest data shows large improvement as the number of clients reaches 445,000 (El-Zoghbi and Tarazi, 2013: 6).

Having the largest Muslim population, Indonesia might represent the greatest diversity of both conventional and Islamic microfinance; it has around 6,000 formal and 48,000 semi-formal registered microfinance units with a total of 3,2 million borrowers (Seibel, 2012: 148). The main players in Islamic microfinance in Indonesia are Islamic Commercial Banks (ICBs), followed by *Shari'ah* Rural Banks (BPRS) and Islamic Financial Cooperatives (BMT) (see: section 4.4. for detailed discussion on Islamic microfinance in Indonesia in Chapter 4). As depicted in Table 3.4, Indonesia is ranked second in terms of number of clients. However, this figure does not include the clients served by 4,500 Islamic cooperatives since the data are only based on statistics of Bank Indonesia which only cover data from *Shari'ah* Rural Banks (BPRS) (Karim *et al.*, 2008). It is estimated that the total number of Islamic cooperatives' borrowers is 80,000 (Karim *et al.*, 2008: 8). Hence, if one were to add the cooperative borrowers to the Indonesian outreach in Table 3.4, there would probably be a higher number of clients than in Bangladesh. The latest report in 2013 located Indonesia in the first ranking in terms of total outstanding portfolio with estimated value of USD347 million (El-Zoghbi and Tarazi, 2013: 6).

In Sudan, Islamic microfinance has been developed well, dominated by Sudan the Agriculture Bank; while only had few institutions with 9,500 clients in 2006, now it reaches more than 400,000 clients, becoming the second largest worldwide (El-Zoghbi and Tarazi, 2013: 7-8). There are two reasons of this fast development, which include: (i) the Sudan Central Bank has been actively involved in developing microfinance sector by establishing particular unit to serve microfinance market; (ii) the regulation require banks to provide financing to MSME development sector (El-Zoghbi and Tarazi, 2013: 7).

In Pakistan, Akhuwat could be considered successful Islamic MFIs, which applied a mosque-based model with strong brotherhood, offering *qard hasan* organised mainly by volunteers, without any funding from international donors or financial institutions (Obaidullah and Khan, 2008c: 27). In addition, the Centre for Women's Cooperative Development (CWCD) in Pakistan transformed its services from conventional microfinance to Islamic microfinance, and now provides benefits in the form of better recovery rates and increased sustainability, as well as moving closer to poverty alleviation objectives, *etc.* (Khaled, 2011: 26).

Microfinance provision in Southern India is dominated by minority funds. Nisar and Rahman (2012: 181) state that the funds (known as '*amana*' funds) have been increased successfully by improving their members' savings through small daily savings collections, without offering any return on the savings. The funds are channelled to members, and a fee is charged on the principal outstanding; this is different from the compound rates applied by other credit providers (Nisar and Rahman, 2012).

Muslim Aid (MA) in Sri Lanka has innovated and successfully implemented the combination of *salam* and *murabaha* financing in providing micro financing to farmers for paddy cultivation following the devastating tsunami and ethnic conflicts (Obaidullah and Mohamed-Saleem, 2012). This project works on a cooperative model basis, providing mutual benefits for both farmers and millers, since the final net profit obtained from selling paddy is distributed to farmers; hence it contributes to farmers' independence and empowerment (Obaidullah and Mohamed-Saleem, 2012).

As a different model, *Jabal al Hoss Sanadiq* (village banks) in Syria provides an excellent model for global Islamic microfinance through the application of *musharakah* owned and managed by the poor, *murabahah* with net profits shared among members, *etc.* (Obaidullah and Khan, 2008c: 26).

In Lebanon, the *Mu'assasat Bait Al-Mal*, a highly credible organisation with a good donor network, provides *qard hasan* based on volunteers managing the collection and disbursement of funds, while its sister organisation AL-Yusor offers profit and loss-sharing financing (Obaidullah and Khan, 2008c: 26). Overall, Lebanon is located in the second rank worldwide with USD132 million total Islamic microfinance outstanding portfolio (El-Zoghbi and Tarazi, 2013: 6)

In Iran, the government requires all the commercial banks to provide Islamic microfinance products (*qarzul-hasaneh* funds) to clients with urgent needs; they achieved a significant outreach of 3 million families in March 2008 (Karim *et al.*, 2008: 7; Mollah and Uddin, 2013).

Despite a lengthy period of crises and conflicts in the country, Islamic microfinance in Afghanistan has achieved a successful rapid development, encouraging enterprises' improvement and poverty alleviation (Sait, 2012: 170). The Islamic Investment and Finance Cooperatives (IIFCs), as credit unions set up by the World Council of Credit Unions (WOCCU) had an increased distribution in 2004 of nearly 8,000 items of working capital worth USD 7.4 million to micro and small business owners, increasing the number of members by 10% (WOCCU, 2012). In addition, FINCA's Village Banking in Afghanistan provides *qard hasan* based on 'solidarity' group guarantee financing with upfront fees, targeting the working poor (Obaidullah and Khan, 2008c: 30).

As an African experience, the Tanzania eco-Volunteerism (TeV), a market-driven honey project, provides community development programmes and Islamic micro financing through *qard-hasan*, *wadiah* and *takaful* for rural poor communities, and has been able to sustain and increase the scale of operation (Khaled, 2011: 26)

Al-Amal Microfinance Bank in Yemen, which has been offering various financial services since 2010, has had remarkable success in increasing the number of active borrowers and savers, and has achieved a national microfinance market of over 25% (Khaled, 2011: 27). This bank won the Islamic Microfinance Challenges 2010 organised by CGAP by proposing *ijarah* products channelled by Al-Amal Investment Fund to support their borrowers' enterprises (Al-Waeel, 2011; Khaled, 2011: 27). In addition, the

Hodeidah Microfinance Program in Yemen, which replicates the Grameen model in implementing group-based and graduated financing, offers *murabahah* financing (Obaidullah and Khan, 2008c: 26).

In Palestine, pioneered by Deprived Families Economic Empowerment (DEEP) funded by Islamic Development Bank and United Nation Development Program, Islamic microfinance products were introduced with the aim of providing financial and non-financial services to the poor (Obaidullah and Khan, 2008c: 55). Currently, the religious motivation to choose Islamic microfinance products has found to be the largest worldwide, as 60% of the MEs indicating a preference for *Shari'ah* compliant services (El-Zoghbi and Tarazi, 2013: 8).

Operating in former civil war areas, Azaouad Finances, a project initiated by GTZ (German Technical Cooperation) and KfW (German Financial Cooperation) in Northern Mali, Sub-Saharan Africa, could be considered the only Islamic MFI in the area that is well managed (Obaidullah and Khan, 2008c: 30).

In Australia, where 1.7% of the population is Muslim, Ahmad and Ahmad (2008) argue that there is a potential market for Islamic microfinance. Currently, the providers of Islamic microfinance are the Muslim Community Co-Operative (Australia) Limited (MCCA), Islamic Co-operative Finance Australia Limited and Iskan Finance Pty Limited. As the largest provider of Islamic microfinance in Australia, MCCA manages more than AUD 100 million/year of Islamic home finance and equipment assets (Ahmad and Ahmad, 2008: 11).

As the survey in this section indicates, IsMFIs have made important inroad in most of the Muslim countries contributing to the development of the local economies. Despite such positive developments, there are problems and challenges also faced by Islamic microfinance institutions, which are discussed in the following section.

3.7. PROBLEMS AND CHALLENGES FACED BY ISLAMIC MICROFINANCE

Following the above discussion on the development of Islamic microfinance, this section elaborates the issues and challenges of Islamic microfinance.

3.7.1 Problems and Challenges

Similar to its conventional counterpart, Islamic microfinance also faces problems and challenges in its operations. Obaidullah and Khan (2008c) discuss in detail the challenges of Islamic microfinance on three levels: micro, meso and macro levels. At the micro level, the challenges include the following (Obaidullah and Khan, 2008c: 30-34):

(i) The diversity of organisational structure (ranging from NGOs, Islamic cooperatives, societies, trusts, foundations, associations *etc*.) making it difficult to register for legal status;

(ii) *Shari'ah* compliance issues are raised as none of the Islamic MFIs have set up *Shari'ah* Supervisory Boards; there are also *fiqhi* issues due to the influence of local culture in the judgement of *Shari'ah*-compliant products; and clients' perceptions of financing products are diverse;

(iii) Lack of product diversification as most financing is based on *murabahah*;

(iv) Weak linkages with commercial banks (both Islamic and conventional) and capital markets and lack of interest in microfinance due to the absence of guarantee systems.

At the meso level, the challenges include the following (Obaidullah and Khan, 2008c: 42-43):

(i) Lack of electronic payment system to enable safe, efficient and reliable payments among Islamic MFIs or their conventional counterparts;

(ii) Lack of transparency of financial performance and information infrastructure;

(iii) Lack of education and training is likely to become the main challenge; hence, resource centres should be developed to deliver training programmes;

(iv) Lack of networking.

At the macro level, Obaidullah and Khan (2008c: 47) believe that the best role for the government in Islamic microfinance development is to build policies and regulations that might contribute to the growing number of competitive and diverse financial service providers. However, only three IDB member countries (Bangladesh, Jordan and Uganda) have developed the required microfinance strategies. An important part of the policy is to set up banking regulations and supervision that encourage microfinance providers to become feasible institutions; IDB requires two sets of laws, one for MFIs and one for Islamic Financial Institutions. It should be mentioned that only Pakistan currently satisfies this requirement (Obaidullah and Khan, 2008c: 48).

Similar to the above points, Ahmed (2002: 55-57), points out that, based on a survey in Bangladesh, the problems of Islamic MFIs are as follows:

(i) The Islamic mode of financing is not fully applied due to “lack of personnel, physical barriers, difficulty in accessing financial flows and other problems including lack of vehicles”;

(ii) Lack of funds because public deposits cannot be cached and there are other constraints on obtaining external funds, resulting in low benefits for employees; Islamic MFIs should consider seeking alternative funds from charities (*waqf*);

(iii) Lack of training in social development programmes, particularly in Islamic views.

Further, Ahmed (2012: 24) underlines that the problems of Islamic MFIs are quite similar to their conventional counterparts (see: section 3.3.3, especially the three fundamental problems presented by Ahmed), particularly credit risks and dubious economic viability due to high operational costs. Thus, they turn to the same solution: credit risks are resolved through group financing involving social collateral and weekly repayments; meanwhile economic viability problems are mitigated by obtaining funds from external resources. Although governments offer funds to support Islamic MFIs, the terms and conditions imposed to gain access to the funds do not suit the character of Islamic MFIs, such as fixed interest/return charges for the government funds (Ahmed, 2012: 24). The economic viability, which is mostly related to lack of funds, seems to be a major problem that has further implications, such as lowering the Islamic MFIs' ability to provide reasonable salaries for employees, attract high-quality staff, conduct supervision, and hire a reasonable number of field workers, which affects the ratio of borrowers to staff, *etc*.

In terms of operational level, Islamic MFIs also face moral hazard problems. However, as their products have Islamic characteristics, Islamic MFIs provide goods/assets instead of cash (such as *murabahah* financing), which could eliminate moral hazards, as goods/assets tend to be used for productive purposes as intended in financing applications (Ahmed, 2012: 24).

Focusing more specifically on operational measurement, Ibrahim (2012: 99) points out that the challenges might include higher transaction costs, higher operational costs, less product diversity as more than 70% financing in Islamic microfinance is *murabahah* based as indicated by the CGAP survey reports, lower return on assets (ROA) and high portfolio risk ratio. All these problems are likely to be rooted in the business model of charities and grants as fund sources. There is, hence, an urgent need to consider product diversification, shifting from the heavy application of *murabahah* financing to other products required by the clients, such as savings and housing products (Karim *et al*., 2008: 12).

It is argued that there are two fundamental reasons for the lack of PLS mode of financing, namely internal factors (lack of understanding and quality of human resources) and lack of regulatory support (Ascarya and Yumanita, 2006). In further discussing the effect of heavy use of *murabahah*, Sultan (2012: 52) argues that this is likely to contribute to debt creation, a situation that should be avoided in the Islamic perspective. Therefore, equity-based financing seems to be a better solution to this problem (Sultan, 2012). Two other noted problems are lack of product innovation and lack of product development.

In considering the above problems, scholars offer a number of propositions. Ghalib (2012) suggests reconsidering *ijara* (leasing) to enhance the opportunity of the poor to establish microenterprises (Ghalib, 2012). In addition, to be successful, Islamic microfinance providers must learn certain lessons from conventional microfinance in CGAP (discussed previously in section 2.7, Strategies in developing microenterprises).

They should basically seek to provide wider access to the poor, and be sustainable institutions that can achieve a 'market-based for-profit approach', supported by an efficient system and transparent reporting, with the focus on capacity-building, combined with integration between microfinance and the official financial system (Obaidullah, 2008b: 9-10). However, the Islamic approach emphasises some important operational aspects: provision of financing and non-financing services to improve microenterprises, transparency, understanding and cooperation (Obaidullah, 2008b: 10). Based on the findings of an Islamic microfinance survey by CGAP in 2007 covering 125 institutions in 19 Muslim countries, Karim *et al* (2008: 16-17) suggest two important points to improve the performance of Islamic microfinance, which could replicate the lessons learnt from conventional counterparts:

(i) improving operational efficiency by introducing innovations to reduce financing and administrative costs;

(ii) reducing risk management, not by imposing physical collateral but by imposing social collateral (*e.g.* peer pressure, discipline for collection).

With regard to providing better services to customers in relation to the issues mentioned above, researchers specialised in the field share the same notion that there should be improvements and innovation in the way Islamic microfinance is operating. Among others, the urgent need for social services is widely addressed. In this point, Ahmed (2002) states that Islamic microfinance should improve the provision of social development programmes for microenterprises and there is need for specialised institutions to perform this duty.

In particular, in response to the urgent need to provide both financial and social services with good management, Ibrahim (2012) proposes a dual model with a separate function of micro financing provision by a profit institution called 'NewCo', while another institution called 'Microfinance Foundation' carries out the function of research and development, technical expertise, governance and limited guarantee for 'NewCo'. This scheme aims to ensure the sustainability and profitability of Islamic microfinance and cater for the economic welfare of the customers (Ibrahim, 2012).

In addition, new strategies are offered by Dusuki including utilising SPVs (Special Purpose Vehicles) into IsMF as an alternative way of distributing funds to the poor (Dusuki, 2008). Moreover, he also argues that an effective way of reducing the cost of transaction and risk is by 'building human capacity through social intermediation' and implementing group-based approach (Dusuki, 2008: 62).

3.7.2 Outreach and Sustainability

Generally, it is agreed that there is a potential global demand for Islamic microfinance, particularly from those who cannot accept financing products that do not comply with Islamic values. However, currently 80% of Islamic microfinance clients are concentrated in Bangladesh, Indonesia and Pakistan, and the total outreach of global Islamic microfinance is very small, at around only 1% of the total microfinance outreach (Karim *et al.*, 2008: 7). The CGAP survey (2007) reports that the largest Islamic MFI in Bangladesh reaches only 100,000 active borrowers, which still is considered a small number compared to conventional counterparts that can reach 22 million active borrowers; Islamic microfinance in the Arab world faces the same situation (Khaled, 2011: 7). This raises a question: why has Islamic microfinance lagged behind in terms of its progress, performance, outreach and sustainability as compared to its conventional counterpart?

In an attempt to respond to this, CGAP Focus Note in 2008 reported that:

> Although there is ample evidence of demand for Islamic microfinance products, this demand can only be met if low income clients are convinced that the products offered are authentically Islamic. Critics of Islamic finance products suggest that the pricing of some products offered as *Sharia*-compliant too closely parallels (or even exceeds) the pricing of conventional products. For example, some institutions offering *Murabaha* seem to disguise interest as a cost markup or administration fee. (Karim *et al.*, 2008: 12)

It should be noted that the outreach of Islamic microfinance varies from region to region (see details in section 3.6), while the total outreach of Islamic microfinance in all Muslim countries is very small as compared to total national microfinance outreach, *e.g.* 3% in Syria and 2% in Indonesia, while the average outreach is only 2,400 clients per institution (Karim *et al.*, 2008: 7). This shows that Islamic microfinance still cannot provide financial services on a large scale (Karim *et al.*, 2008; Obaidullah and Khan, 2008c: 57). However, this also provides optimism that there is a room to grow for Islamic microfinance (El-Zoghbi and Tarazi, 2013).

In regard to the type of suppliers of Islamic MFIs, as can be seen in Table 3.5, the main players are NGOs, which was accounted for 42% of the total outreach, with just 14 NGOs as the CGAP respondents in the 2007 survey; they are followed by commercial banks (Karim *et al.*, 2008: 8). It should be noted that, in Indonesia, with 105 BPRS accounting for 25% of the total clients, the outstanding loan portfolio is large (62%) due to significantly higher average loan size, because BPRS focuses on providing financing for small and microenterprises (Karim *et al.*, 2008: 9). The Table 3.5 presents the outreach of Islamic microfinance worldwide based on institutions type.

Table 3.5: Outreach of Islamic Microfinance, by Institution Type

Institution Type	# of Institution	Total # of Clients		Total Outstanding Loan Portfolio (Islamic)		Avg. Loan Size (Islamic)
		#	% of Total	US$	Total	
Cooperative	1	6,671	2	926,251	<1	132
Village Bank (Syria)	1	2,298	1	1,838,047	<1	800
NGO	14	125,793	42	41,421,580	21	303
Rural Bank (Indonesia)	105	74,698	25	122,475,158	62	1,640
NBFI	3	4,293	1	1,893,207	<1	598
Commercial Bank	2	87,56	29	29,030,997	15	305
TOTAL	126	305,237	100	198,090,268	100	629

Source: Karim (2008: 9)

As regards to sustainability in Islamic microfinance, it has become a crucial issue globally. Among others, sustainability problems might arise from the source of funds and efficiency of Islamic MFIs' operations. Obaidullah and Khan (2008c: 15) argues that utilising *zakah* funds could raise the issue of sustainability; hence, Islamic MFIs are encouraged to utilise more *waqf* funds and other commercial sources from public funds and Islamic banking rather than *zakah* funds. Focusing on the Rural Development Scheme (RDS), a programme managed by IBBL Bangladesh, Parveen (2009: 17-18) points out that RDS has proved highly sustainable in serving the very poor people, in terms of financial sustainability, institutional viability, leadership, decentralisation, management style *etc*. However, it also encounters a high drop-out rate (Parveen, 2009: 16). Based on the experiences of providing financing to the agricultural sector, Elhiraika (2003) argues that risk and return considerations affect the banks in their operations. This mutual exclusiveness between being financially sustainable and providing large-scale financing to farmers put them in a problematic situation, as the banks who achieved financial sustainability did so by limiting financing access to farmers who had financial feasibility (Elhiraika, 2003: 17). Overall, it is a challenge for Islamic microfinance to remain sustainable and achieve a wider scale, regardless of the challenges experienced in daily operational reality.

3.7.3 Other Issues

There are some common issues in Islamic microfinance: financing for the economically active poor, high cost of financing, and the women-only approach (Obaidullah, 2008b: 10-12), as has been discussed in the previous section (3.4.4). The first issue relates to the utilisation of charity funds; while *waqf* funds can be utilised for microfinance for the economically active poor, it seems that *zakah* (charity) funds can only be distributed to destitute people as a social safety net to meet their basic needs (Obaidullah, 2008b: 10).

In addition, it should be reiterated that conventional microfinance tends to charge higher interest rates, based on the assumption that microenterprises have high returns, with the aim of covering higher administrative and monitoring costs and risk (Obaidullah, 2008b: 11). Based on a large ethnography study in Bolivia, Brett (2006: 13) finds that high interest rate could create repayment problem and hinder the micro business development. However, this assumption may not be true in all cases, and it should not form the basis for arguing for an interest-based approach; hence, Islam offers an alternative profit and loss-sharing approach.

3.8. ISLAMIC MICROFINANCE AND POVERTY ALLEVIATION

Provision of financial access to poor people will enable them to increase their income and economic wellbeing, develop assets and reduce weaknesses (Obaidullah, 2008b: 4) by empowering them with the objective of developing functioning and enabled individuals

(Sen, 2001: 177-178). The lack of financial access seems to be the main reason for their inability to become involved in development (Obaidullah, 2008b: 4).

IsMFIs might be able to alleviate poverty because they are not debt-based; hence, they will not drag their clients into an even worse situation. Islamic teaching also encourages the waiving of credit if clients are in deep trouble.

Islamic microfinance plays a significant role in promoting microenterprises, which can be an important source of poverty alleviation. A study on the IBF industry in Indonesia found that it has both a positive effect on small and microenterprises empowerment - based on financial measures, sales improvement, and accumulation of working capital - and an ability to improve the tough synergy with a national programme for development of small enterprises and microenterprises (Antonio, 2004). In addition, it is capable of filling the gap between poverty alleviation approach and commercially-based methods of microfinance (Antonio, 2004).

The performance of Islamic microfinance has been quite promising in relation to poverty alleviation. Obaidullah (2008a: 23) argues that the performance of RDS (Rural Development Scheme) of IBBL was better in terms of growth (12.5%), drop-out rate (5%), and operational efficiency compared to three conventional leading institutions in microfinance, namely Grameen Bank, ASA (Association for Social Advancement) and BRAC (Bangladesh Rural Advancement Committee). Charging a lower rate of return (10% with 2.5% rebate for on-time payments) than other microfinance institutions (16% to 22.5% interest) offers an advantage for the poor (Obaidullah, 2008a: 23-24). This type of microfinance also offers an active spiritual development programme with the purpose of improving members' awareness of social rights and responsibilities in order to forge better relationships with others (Obaidullah, 2008a: 19). Due to such natures and social and personal development oriented programmes, such programmes have not been offered by conventional microfinance.

Seibel and Agung (2005), however, present a different view, noting that Islamic microfinance in Indonesia has low assets compared to conventional banking due to the lack of regulatory and supervisory aspects in Islamic values. The two proposed options are: (i) to focus completely on Islamic commercial banks and the "establishment of branch networks with Islamic microfinance products"; and (ii) "to reassess the challenges and realistic opportunities for Islamic rural banks and cooperatives" (Seibel, 2005: 41). Although this finding might be true for this specific research area, it could not be generalised to all areas of this country. As Obaidullah maintains (2008a: 53-54), the BMT (*Baitul Maal wat Tamweel*/Islamic Cooperative) in Indonesia represents a success story in the linkage programme between a group of microenterprises, BMT and Islamic Banks. Given its ability to cooperate with the poor in the surrounding area, BMT seems to be the most suitable institution to serve the poor (Ascarya and Sanrego, 2007). A study in BMT Yogyakarta also discovers a good impact on micro traders in terms of increasing self-employment in the informal sector (Kholis, : 18) (for detailed discussion on the impact of Islamic MFI in Indonesia, see Chapter 4).

The impact of Islamic microfinance in relation to poverty alleviation can be discussed in economic and social spheres. In general, it is expected that provision of financial access to poor people will enable them to increase their incomes and economic wellbeing, develop assets, reduce weaknesses, and become involved in development (Obaidullah, 2008b: 4). The latest economic impact presented by an empirical study of IBBL's (Islamic Bank Bangladesh Limited) impact on rural poverty finds that loans had a considerable effect in improving household earnings, output of harvest and cattle, disbursement and employment (Rahman and Ahmad, 2010: 177-179). In particular, based on a field survey of 1,024 respondents, Rahman and Ahmad (2010: 177-178) finds that the family income increased by more than 33%, health expenditure increased by 50%, family employment increased from 1.91 to 2.1 working members, and all types of assets have also increased. Moreover, the impressive economic impact can be seen in Ahmed's (2002: 53) study of three IsMFIs in Bangladesh, as he finds an increasing amount of time spent on productive activities by beneficiaries and other family members, increased output from economic activity, particularly in improving the amount of goods/services, innovation of new products, and increasing assets and other properties.

Recently, a study by Shirazi (2012: 20) finds poor borrowers are most benefited as compared to the non-poor borrowers in terms of income growth (2% and 6%), as based on the data from Pakistan Poverty Alleviation Fund in 2005 covering 3,000 household. In addition, the most recent study on the economic impact of IsMFIs in Thailand suggests that IsMFIs has positively contributed to increase the customers' welfare (Naipom, 2013). In particular to the economic impact of micro financing, Naipom (2013: 190) argues that gender, annual household income, age, total land size, membership length and occupation contribute to the impact factors. These economic aspects might imply that Islamic microfinance has an advantage to offer, although it still has weaknesses to overcome.

With regards to the social impact of IsMFIs, it includes impact on children's education, healthcare, food and non-food consumption, family empowerment and religious impact. In particular in relation to the impact on children education, based on survey study, Noipom (2013: 250) finds that IsMFI in Thailand have indirect impact on children education, as the effect of income improvement which lead to the higher ability of the respondents to pay university tuition fees and to pay other expenses related to children education, such as school equipment (*eg.* computer), transports (*eg.* motorcycle) and stationeries. The impact could also be a direct impact when the customers borrow emergency loan to pay for tuition fees (Naipom, 2013: 250). It should be noted that the impact on children education show up to be the highest compared to other non-economic impact (Naipom, 2013: 187).

As for impact on healthcare, Noipom (2013: 251) suggests that Islamic micro financing have indirect impact on healthcare, as the household income increase, they have a better capability to pay for cost of mediation for serious illness which not covered by the government healthcare system and to pay for private doctor and medication for normal illness. Similarly, a study in IBBL Bangladesh by Rahman and Ahmad (2010: 180) indicates that the health awareness of the respondents increased in terms of a greater number of people consuming quality drinking water and using quality latrines for sanitation (17.91%). Besides, they also found that the clients also have positive opinions about the improvement of their skills and social and economic wellbeing.

Regarding the impact on food and non-food consumption, the provision of IsMF improved the food expenditures, which is the highest improvement as compared to other household expenditures (Rahman and Ahmad, 2010: 178). Similarly, a study in Thailand indicate that Islamic micro financing may have indirect impact on food and non-food consumption (*eg.* clothes, vacation, *etc.*) in the household level as the income increase enable them to spend more money for household consumption (Naipom, 2013: 250).

Distinct from the conventional microfinance which focus on women empowerment as part of social impact, Obaidullah (2008b: 12) asserts that the Islamic teaching emphasises on family approach, rather than women only approach. Given the good characteristics of women, such as being more honest, responsible, loyal, caring, and less resistant to social action, this approach benefits the microfinance institutions and the women's families. However, there may also be social tensions, misuse of funds by husbands, and lack of business skills, as Mayoux (2003: 31) finds that "Small increases in access to income may be at the cost of heavier workloads for women", which lead to increased stress and affecting their health. Hence, the Islamic approach prefers empowerment of the family, not just women (Obaidullah, 2008b: 12), whereby aims to overcome gender bias by definition.

Finally, as for religious impact, the provision of religious services could be found in many IsMFIs in different regions. Among others, the RDS (Rural Development Scheme) of IBBL offers an active spiritual development programme with the purpose of improving members' awareness of social rights and responsibilities in order to forge better relationships with others (Obaidullah, 2008a: 19), such a programme has not been provided by conventional microfinance. Therefore, Rahman and Ahmad (2010), who study the ethics and morality of the IBBL clients based on ten daily religious activities (prayers, recite *Holy Quran*, fasting *etc*) reveal that involvement with RDS resulted in increased clients' practising of Islam (Rahman and Ahmad, 2010: 176)

Overall, Ahmed (2002: 55) also found that beneficiaries of Islamic microfinance obtain not only financial advantages but also improvement of other aspects through social development programmes, such as improvement of Islamic knowledge, and improving relationships with spouses and other group members. Based on the survey evidence, he emphasises that Islamic MFIs "… benefit from the social capital derived from the Islamic values and principles… Islamic teachings make the entrepreneurs better debtors" (Ahmed, 2002: 58).

In overall, on the basis of the above studies, it can be inferred that Islamic microfinance has considerable social aspects, although it requires more attention. Hence, in order to have a wider impact, Dusuki (2008: 58) argues that microfinance should provide market-based services, creativity to innovate new programmes and product differentiation, efficient operation, and broader outreach, offering not only productive loans but also loans for consumption purposes to cover the cost of health, education and social responsibility.

3.9. CONCLUSION

Microfinance, which aims mainly to assist the poor to improve their socio-economic welfare, particularly by providing access to financing, has been operating for more than forty years since the failure of government-subsidised financing and development programmes. Currently, microfinance is growing at around 20%-30%/year in terms of loan distribution and is predicted to continue to grow strongly. It is, hence, generally recognised that microfinance plays an important role in economic development. However, they face certain challenges as well: the core challenges in the daily operations of MFIs range from improving the quality of services, achieving a wider and deeper outreach, and reducing operational costs.

Islamic microfinance, hence, is a relatively young industry, serving particularly to meet the demand of a specific market whose members cannot accept the conventional financing product due to their adherence to Islamic principles. Thus, IsMF should be considered contributing to financial development and also financial inclusion.

Models applied in Islamic microfinance include the innovated *Shari'ah*-compliant Grameen model, village banks, credit unions and self-help groups. Apart from the usual problems it shares with its conventional counterpart, Islamic microfinance has issues in terms of *Shari'ah*-compliant products. It is also criticised for charging higher returns than conventional microfinance.

Considering the aspirations of IME, ideally, equity-based financing should be more favourable in the market for the operations of IsMFIs. However, most of the IsMF suppliers still use debt-based products (*murabahah*) due to simplicity and similarity to conventional products.

Lastly, in regard to poverty alleviation and economic development, it seems that Islamic microfinance has played a significant role, although there is some skepticism regarding the limited government supervision and monitoring.

Chapter 4
POVERTY AND STRATEGIES FOR ALLEVIATING POVERTY IN INDONESIA (SPECIAL REFERENCE TO MICRO FINANCING)

4.1. INTRODUCTION

This chapter aims to explore poverty and poverty strategies for alleviating poverty in Indonesia, particularly through the micro financing perspective. Being a developing country with a large population, Indonesia has a long history of fighting against poverty. Considering that some of the possible solutions to the problem of poverty alleviation include capacity-building and individual empowerment, developing microenterprises is considered an important policy option, and special efforts have been made by the government to provide micro financing to support microenterprises' development. In this regard, institutionalisation in sustainable microfinance was initiated in 1970 by Bank Dagang Bali (BDB), followed by Bank Rakyat Indonesia's (BRI/Indonesian's People Bank, the first state-owned bank established in 1895) initiative which restructured Village Units (Micro financing Division) in 1984 to serve the micro and small enterprises in rural areas (Robinson, 2002: xxiv). These have become among the largest and best-known success stories of micro financing in the developing world (Seibel and Agung, 2005). Then, in the 90s, the Islamic microfinance institutions began their operations to provide micro financing, which has developed rapidly and stands out as the unique articulation of Islamic finance in everyday life in Indonesia.

This chapter, hence, aims to survey and present the Indonesian experience in microenterprises and microfinance by first exploring the existence of poverty in Indonesia, before discussing the regulation, issues and challenges of microenterprises; it then analyses the issues and challenges of microfinance, followed by an observation of poverty alleviation strategies, particularly from micro financing perspectives.

4.2. POVERTY IN INDONESIA

Indonesia is the world's largest archipelagic state, with more than 17,500 islands divided into 33 provinces, spread across a land area of 1,910,931.32 square kilometres; there are

104,000 km of coastline with 2,981,211 square kilometres forming an economic exclusive zone (Biro Pusat Statistik, 2011). Located in the South East Asian, this country has the world's fourth largest population with 237,641,326 in 2010, 56% of whom live on the main Island, Java (Biro Pusat Statistik, 2011: 12). It is believed that the population grew to 241 million in 2011 (Asian Development Bank, 2012). East Java is the second largest province after West Java, with a total population of 37,286,246 (15.77% of the total population of Indonesia in 2010).

Possessing a large population but without the corresponding wealth, Indonesia is facing an on-going socio-economic challenge, mainly in the form of poverty and unemployment. The Statistics Indonesia measure poverty based on people's ability to meet their basic needs; hence, people are considered 'poor' if they are economically unable to fulfil food and non-food basic needs, measured by consumption/expenditure per capita per month (Biro Pusat Statistik, 2012: 158). In March 2012, the poverty line applied is defined as IDR 267,408 (equal to around USD 30) which, particularly in East Java, is IDR 245,305 (Biro Pusat Statistik, 2012: 215). Thus, according to the statistics the number of people living in poverty was 29,13 millions, corresponding to 11.99% of the population, in March 2012; this was a decrease compared to the previous data of March 2011, when the figure was 30,02 millions (12.49%) (Biro Pusat Statistik, 2012: 214). While this decreasing trend might be regarded with some scepticism, these data are nevertheless similar to those of the Asian Development Bank (ADB), which reported that 18.1% of the population have been living on less than $ 1.25 (PPP) a day and 12.5% of population were living below the national poverty line in 2011. Such measures become meaningful in comparison to other relevant variables; for example, the annual population growth in 2011 was 1.6%, GDP growth was 6.5%, literacy rate according to 2008 data was 92.2% (which is considered very high, and 53.7% of the population was living in urban areas (in 2010). The ADB report also reveals that GDP growth has shown an increasing trend over the last three years, from 4.6% in 2009 to 6.2% in 2010 and 6.5% in 2011 (Asian Development Bank, 2012: 2). Overall, although the prevalence of a high level of poverty is a reality, it should be noted that considerable achievements were made during 1970 and 1980, when the poverty level was reduced from 60% to 20% (World Bank, 2001: 6)

According to the February 2012 dataset, the level of unemployment is 6.32% (7,61 millions) (Biro Pusat Statistik, 2012: 55). Unfortunately, due to the large population the quality of the labour market is relatively low, as it is dominated by people with primary education and below (49.40%); other educational levels include Senior High School % (23.68%), University (5.15%) and Diploma I/II/III/Academy (2.89%) (Biro Pusat Statistik, 2012: 137).

As regards human development in Indonesia, the UNDP ranks Indonesia 124th in terms of HDI in 2011 which, unfortunately, is lower than the rank in 2010 which was 108th; however, despite the adverse trend in the HDI ranking, it should be noted that the value increased from 0.600 in 2010 to 0.617 in 2011 (UNDP, 2010: 145; 2011: 124). This indicates that other countries in the world have developed their HDI values higher than Indonesia. Moreover, the UNDP report in 2009 ranked Indonesia 111th in the HPI (Human Poverty Index); this ranking was no longer provided in HDR 2010 and 2011 (UNDP, 2009: 177).

In responding to economic challenges, including poverty and human development, it should be noted that Indonesia, on the other hand, has a large number of microenterprises, which form a strong pillar of the national economy as they account for more than 98% of the total enterprises (see: Table 4.1). However, microenterprises experience challenges and barriers in their operations, particularly difficulties in financial access: "only 22% of micro and small enterprises had access to financing facilities from banks and other micro or non-bank financial institutions" (Ascarya and Yumanita, 2007: 1). As such a large number of microenterprises have problems with financial access, it is necessary to provide support to help them obtain financing and thus reduce poverty; as Seibel strongly argues, "Microfinance is no panacea; but it has certainly contributed to the reduction of poor from 60% in 1970 to 11.5% in 1996" (Robinson, 2002: xxvi; Seibel and Agung, 2005: 31). Moreover, taking into account that Indonesia is the world's most populous Muslim country, Islamic microfinance institutions could play an important role in serving this market. The next section discusses in more detail the issues and challenges of microenterprises and microfinance institutions in Indonesia.

4.3. MICROENTERPRISES IN INDONESIA

The government has been endeavouring to pay considerable attention to micro, small and medium-sized enterprises through Presidential Regulation Number 7/2005, Article 20, in which the Medium Term Development Plan for the period of 2004 – 2009 is set out; this is concerned with the policies and programmes for developing cooperatives and SMEs to achieve certain goals as follows: (i) productivity improvement and exports; (ii) expanding agribusinesses; (iii) increasing new science and technology-based enterprises; (iv) capacity development of underprivileged microenterprises in rural and underdeveloped areas; and (v) enlarging the number of good-quality cooperatives, including women's cooperatives (Sembiring, 2008).

At present, Micro, Small and Medium-sized enterprises are regulated by the Government Act no 20/2008. Article 7 of the Act, in particular, provides criteria of classification based on net assets and annual sales as follows:

(i) Microenterprises have net assets (excluding land and buildings) of less than IDR 50millions (USD 5,556) and total annual sales of less than IDR 300 millions (USD 33,334);

(ii) Small enterprises have net assets (excluding land and buildings) of IDR 50millions - IDR 500 millions (USD 5,556 – USD 55,556) and total annual sales of IDR 300millions to IDR 2.5 billions (USD 33,334 – USD 277,778);

(iii) Medium-sized enterprises have net assets (excluding land and buildings) of IDR 500 millions to IDR 10 billions (USD 55,556 – USD 1,111,111) and total annual sales of IDR 2.5 billions to IDR 50 billions (USD 277,778 - USD 5,555,556).

However, based on the field research findings and considering that this category is too broad and unable to reach the poor, proposed classification changes have been suggested to distinguish between super-micro and microenterprises in order to allow them to graduate to the higher level, as follows: (i) super-microenterprises are enterprises with assets of less than IDR 10 million and a credit limit of less than IDR 5 million; (ii) microenterprises have assets between IDR 10 and IDR 100 millions and a credit limit between IDR 5-50 million; (iii) small and medium-sized enterprises continue to use the classification provided in the Act (Ascarya and Sanrego, 2007).

In 2008, statistics showed that microenterprises accounted for 98% of the total number of enterprises, which is considered very high, contributing around 32% of the total GDP, and absorbing the highest number of employees (89.3% of the total labour force); however, their export value was the lowest (Table 4.1).

Table 4.1: The Profile of SMEs in Indonesia

Criteria	Number		GDP	Labour		Export
Micro	50,697,659	98,9%	1,505,308	83,647,771	89,3%	20,247
Small	520,221	1,1%	473,267	3,992,371	4,26%	44,148
Medium	39,657	0,08%	630,784	3,256,188	3,34%	119,363
Large	4,372	0,01%	2,087,121	2,776,214	2,96%	727,169
	51,261,909		4,696,480			910,927

Source: Statistics Indonesia (2008)

4.4. MICROFINANCE INSTITUTIONS IN INDONESIA

Overall, the main players in Islamic Microfinance in Indonesia consist of three layers (Obaidullah, 2008a):

(i) micro level, including BMT, BPRS, Kopontren, micro insurance etc.;

(ii) meso level which is represented by non-government organisations of BMT and BPRS such as PINBUK (Pusat Inkubasi Bisnis Usaha Kecil/The Centre of *Shari'ah* Cooperatives) and ASBISINDO (The Association of *Shari'ah* Banking in Indonesia), and

(iii) macro level, representing the government's role such as the Central Bank (Bank Indonesia), the Ministry of Finance, the Ministry of Cooperatives and SMEs.

In conclusion, this chapter argues that the types of microfinance institutions can be classified based on the following:

(i) Operations, including banks (*e.g.* BPR, BPRS, BRI Rural Unit) and non-banks (*e.g.* Saving and Loan Cooperative (Koperasi Simpan Pinjam/KSP), *Shari'ah* Cooperative (Koperasi Shari'ah), Rural Fund and Credit Institutions (Lembaga Dana Kredit Pedesaan/LDKP);

(ii) Owners, which could be government-owned institutions (*e.g.* Permodalan Nasional Madani (PNM), BRI) and the private sector (*e.g.* NGO (Non-Government Organisation), Self-Help Groups (Kelompok Swadaya Masyarakat/KSM), money lenders, ROSCA etc.);

(iii) Background values of operations, consisting of conventional (*e.g.* BPR, Cooperative, Credit Union etc) and Islamic (*e.g.* BPRS, *Shari'ah* Cooperative, BMT etc.)

4.4.1. Conventional Microfinance Institutions

The history of microfinance in Indonesia began in 1896, initiated in the form of Badan Kredit Desa (BKD/Credit Village Organisation), which Robinson describes as "the world's oldest commercial financial institution" (Robinson, 2002: xll). Another milestone for formal microfinance institutions was the establishment of Bank Dagang Bali (BDB) in 1970 as "…the world's oldest licensed, full-service commercial bank providing continuous, profitable microfinance services on a substantial scale…" (Robinson, 2002: xll). However, after more than 30 years of operations, this privately-owned bank was closed by Bank Indonesia in 2004 due to "… un-prudential practices and poor financial health, particularly capital adequacy ratios [which] fell below the minimum threshold of eight percent" ("Indonesia's Central Bank Shut Down Bank Dagang Bali," 2004). It should be noted that, during 1976, 80% of the population lived in rural areas (Robinson, 2002: 86); therefore, the government financing programme focused on improving the wellbeing of the rural community.

Considering the importance of plantations for the economy, and with the rice intensification programme its main objective, the government launched BIMAS (Bimbingan Masyarakat/Society Coaching) in 1970, providing small subsidised loans for rice farmers distributed through 3,500 BRI Village Units. Similar programmes were introduced in the 1970s-1980s, namely KIK (Kredit Investasi Kecil/Small Investment Loan Programme) and KMKP (Kredit Modal Kerja Permanen/Small Permanent Working Capital Loan), also accessible through BRI; these offered higher subsidised loans than BIMAS, providing up to IDR 15 million. The rice intensification programme was highly successful, but the credit programmes (BIMAS, KIK and KMKP) all failed to meet their objectives as they were inefficient, unsustainable, could not reach the targeted customers (poor farmers) and were beset with high arrears, resulting in discontinuation in 1985 (Robinson, 2002: xxv-xxx).

In view of such an adverse experience, in 1983 a pioneering microfinance instrument called 'New concept of rural-based finance on principle of commercial finance' was introduced in Indonesia, supported by the first major financial deregulation package in the same year, allowing banks to set their own interest rates on loans and deposits (Robinson, 2002: xxx). Thus, BRI was transformed from a channelling agent for government-subsidised loans to a profitable and sustainable financial intermediary, providing small loans and deposits to rural areas, and expanding into urban areas in 1989. This programme successfully achieved a break-even position in less than two years with a single loan product called KUPEDES (Kredit Usaha Pedesaan/Credit For Rural Businesses); it started to become profitable in 1986, and continued to grow without subsidies from 1987. When the harsh economic crisis hit Indonesia in 1997, BRI grew by only 4.9% in 1997 and fell by 13.7% in 1998; however, as compared to the banking industry in general, BRI Village Units remained stable and were able to expand, with a high repayment rate of 98% and profitability during 1997-1999 (Robinson, 2002: xix). Hence, as Robinson argues, there were lessons to be learnt "…on the importance of microfinance to low-income households and …extraordinary stability that sustainable microfinance institutions can maintain in a highly unstable environment" (Robinson, 2002: xlii). The key success of BRI lay in the understanding and fulfilment of the local market demand for financial services suitable for low-income households and enterprises (Robinson, 2002: xxx). The implementation of microfinance commercialisation has achieved some positive results, such as providing large-scale and sustainable microfinance, having a wider scope and ability to reach the poor, and avoiding a shift of market segment from poor to less poor and non-poor; however, it is argued that the

Ministry of Cooperatives and SMEs does not have the capacity to supervise cooperatives (Charitonenko and Afwan, 2003)

An important landmark appeared in 1988 when the Indonesian government launched a regulation called Pakto 88, which relaxed the regulations on setting up a bank with limited capital. Based on this regulation, the market banks changed to become the Rural Banks (BPR) (Robinson, 2002: 37). The Indonesian government also built up some microfinance institutions such as Bank Karya Produksi Desa (BPKD) in West Java, Badan Kredit Kecamatan (BKK) in Central Java, Kredit Usaha Rakyat Kecil (KURK) in East Java, Lumbung Pitih Nagari (LPN) in West Sumatera and Lembaga Perkreditan Desa (LPD) in Bali. As a continuation of Pakto 88, Pakjan was introduced in 1990 as a reform package; many subsidised credit programmes were discontinued, although credit was still provided to support food self-sufficiency and the development of cooperatives and small-scale enterprises (Robinson, 2002: 38). Then, aiming to strengthen the banking industry, including banking for low-income people, the government launched Government Act No. 7/1992 and Act No 10/1998. In particular, the former Act paved the way for the development of the Rural Banks (BPR), to provide microfinance services and to help poor people avoid being exploited by moneylenders (Robinson, 2002: 103).

4.4.2. Islamic Microfinance Institutions

This research focuses only on Islamic microfinance in Indonesia, which is nowadays provided by three main institutions: the microfinance division of Islamic Banks (Islamic Windows or *Shari'ah* Business Unit), the Islamic Rural Banks (BPRS), and the Islamic Financial Cooperatives (referred to as BMTs), which are not part of the formal financial sector. In terms of sustainability and robustness, these institutions have shown their ability to survive during the harsh financial crisis in 1997 and during later crises. This has been an outstanding achievement, since the large banks were struggling to survive and their survival depended on government assistance to overcome severe financial problems. Moreover, Sakti (2011) points out that the number of newly established BMTs was significantly higher during the economic crises in 1998, 2004 and 2009, which is an indication that micro and small enterprises have a good capacity to survive during crises;

this provides the motivation and rationale for the establishment of new microfinance providers, particularly in the form of BMT (Sakti, 2011: 7).

Concerning the provision of micro financing to the poor, it is necessary to acknowledge and examine both the demand side (the need of the poor) and the supply side (what financial institutions should do). Obaidullah (2008a: 45-47) points out that the poor need equal and open access to financing, and fair and safe financial products and services; very poor individuals seek social safety nets in the form of *zakah*, *shadaqa* and *qard hasan* for new MEs. He further asserts that the relevant financing products and the areas where they are needed are as follows: (i) *Murabahah* for working capital ME; (ii) *qard hasan* for non-profit ME; (iii) *mudharabah/musaqah/musyarakah* for profitable ME based on sharing reward and risk; and (iv) *murabahah* and *ijarah* for ME in growth.

On the supply side, microfinance-providing institutions at the micro level are classified as Non-Profit Organisations (NPOs), such as associations of individuals, credit unions, cooperatives, trusts and non-banking finance companies, or as for-profit organisations, such as venture capital companies, guarantee providers, leasing companies, banks and financial institutions (Obaidullah, 2008a: 46-47). It should be noted that the focus in this research is on BMT representing non-profit organisations, and BPRS as a representative of for-profit institutions. However, it should be noted that, in reality, BMTs operate as banks and have become for-profit organisations.

The general profile of the microfinance industry in Indonesia (in 2005) is depicted in Table 4.2, which covers both conventional and Islamic microfinance. However, the detailed data of BPRS are missing from the Table. Table 4.2 shows that, in terms of number of units, among others, the USP (saving and credit units) is the largest, while in terms of the number of loans, loans (in millions), number of clients and savings, BRI (local units) is still the largest.

Table 4.2: Microfinance in Indonesia

Microfinance Institutions	Number of Units	Number of Loans	Loans (Million Rp)	Number of Clients	Savings (Million Rp)
BPR	2,158	2,160,000	12,150	5,760,000	11,160
BPRS	92				
BKD	5,345	410,000	200	460,000	29
BRI Local Units	3,916	3,100,000	14,182	29,870,000	27,429
KSP (Saving and credit cooperative)	1,097	665,000	531	NA	85
USP (savings and credit Units)	35,218	NA	3,629	NA	1,157
LDKP (rural fund and credit institutions)	2,271	1,300,000	358	NA	334
Pawnshop	42	1,644	21	No savings	No savings
BMT	3,308	1,200,000	157	NA	209
BK3D (credit union)	1,022	235,087	396	207,147	272
LSM (non governmental organisation)	124	162,314	110	81,931	12
Total	54,593	9,234,045	31,734	36,379,078	40,687

Source: Bank Indonesia (2012) and ProFI (2005) cited by Hamada (2010)

Since this research focuses only on two types of Islamic microfinance institutions, namely BMT and BPRS, the following section discusses only these two types of institutions and provides a brief comparison between BMT and BPRS.

4.4.2.1. *Baitul Maal wat Tamwil* (BMT)

BMT is a microfinancial institution operated under the *Shari'ah* principles, which aims to provide micro financing to micro and small enterprises; there are many such enterprises in Indonesia but they have difficulty in accessing finance. As institutions under the Ministry of Cooperatives and SMEs, some of them come under the label of KJKS (Koperasi Jasa Keuangan Shari'ah/Shari'ah Financial Cooperative) rather than BMT. The initiative for establishing BMT is usually provided by educated persons or local community leaders, who are concerned with the development of local communities by providing financial access to the poor and to micro and small enterprises (Ascarya, *et al.*, 2007). As such, they are likely to be similar to self-help groups with minimal support from the government.

The character of BMT is unique as compared to BPRS, as BMT is 'a community-based financial institution' which helps SMEs through training and social development programmes; therefore, it is not just a financial institution - it is also a social enterprise for two reasons:

(i) BMT started as a cooperative; thus it has a cooperative nature with the advantage of providing a more flexible and faster financing approval process than banks;

(ii) BMT offers entrepreneurial skills and the promotion of Islamic values in a practical way (Sakai and Marijan, 2008).

The survey by Bank Indonesia (2011) also confirms that BMT is a community-based institution as, among the respondents, 62.72% of the BMTs (out of a total of 386 BMT respondents in three provinces of Java - West, Central and East Java) were established by community-initiated projects based on community organisations, Islamic boarding schools, mosques or professional associations; a further 12.11% were established by cooperatives, 12% by individual persons, and others by Islamic Banks (Sakti, 2011: 8). This indicates a high awareness in society of the development and empowerment of microenterprises through the development of Islamic microfinance institutions.

In the provision of micro financing, most BMTs require assets collateral; in some cases savings could also represent collateral whereby the customers are allowed to obtain financing after they have saved for a certain period. The maximum amount of financing for each customer is usually IDR 50 million (USD 5,500); hence, most of their customers are microenterprises. When the customers need further financing beyond the maximum amount, a syndication of financing is set up with other BMTs, which could also include Islamic commercial banks in the form of *channelling* and *executing*. These fee-based linkage programmes are common methods of establishing cooperation between BMTs and Islamic commercial banks; this is a mutually beneficial form of cooperation as the Islamic commercial banks are unlikely to be willing to offer financing of less than IDR 50 millions. It is part of the healthy culture of BMTs that the business relationship and cooperation among BMTs aims to ease liquidity exposure and inter-BMT financing, and to improve their overall performance in general. The advantage offered by BMTs is the minimum financing evaluation time, providing decisions (mostly approvals) within 1-5 days, which is very short as compared to commercial banks. After their heavy involvement in serving small retail businesses, BMTs are now expanding into financing industry (*e.g*. soft foods and handicrafts), agriculture (*e.g*. farming vegetables and rice plantations), services (transportation, particularly motorcycles) and commerce sectors. In terms of operations, the common profit share ratio between BMT and customers is 40:60. It should also be noted that the NPF (non-performing financing) is around 1% - 3% for the majority of BMTs, a rate required by Bank Indonesia (Ascarya *et al.*, 2007).

In terms of products, the most popular financing product offered by BMTs is *murabahah*. The Bank Indonesia (2011) survey findings show that 68.45% of the financing is *murabaha*. However, there is a balanced portfolio share between sale and purchase agreements (*murabaha*) and profit/loss sharing-oriented financing (*mudharaba*, *musyaraka*) in Central Java (Sakti, 2011: 9). The amount of financing provided to the customers varies in each institution, and is mainly between IDR 500,000 and IDR 1 million in West Java. However, it reached more than IDR 5 million in Central Java. Most financing is provided on an individual basis (96%) and the majority of the borrowers are small traders (63.7%), employees and farmers (Sakti, 2011: 10).

Other than the above financing products, BMTs also provide other services related to financing in order to achieve a higher impact (Sakai and Marijan, 2008). Similarly, (Ascarya *et al.*, 2007) also state that BMTs also offer training and consultancy to microenterprises, for which they receive support from government agencies and, to some extent, from other donor-NGOs.

The financial structure of BMT is dominated by members' savings (66.75%), followed by capital (18.7%) and funding from linkage programmes with Islamic banking or Islamic Windows (6.23%) (Sakti, 2011: 11).

It should be noted that the difficulty in attracting larger savings is caused by the limited service facilities offered by BMTs, such as the lack of ATM machines, and higher security based on protection from the Deposit Guarantee Agency, which then affects the financing capacity (Sakti, 2011: 11).

The organisational structure of BMT is similar to other cooperatives. The Annual Members' Meeting (stakeholders) occupies the highest position in the structure and acts as the main decision-maker in terms of general policy. The general manager is the person in charge of managing the BMT in its day-to-day operations; while managers (usually including marketing manager, accounting and administrative manager *etc.*) and members of staff provide direct services to members.

BMTs are linked to a number of institutions in terms of providing and also receiving organisational support, consultancy and support programmes for capacity-building. Some of these institutions are independent of BMTs and others have been established by BMTs. Such institutions include BMT associations, namely PINBUK, Inkopsyah, BMT Center, Microfin, ABSINDO, PUSKOPSYAH (Seibel and Agung, 2005: 27-30). Of these, PINBUK (Pusat Inkubasi Bisnis Usaha Kecil/The Centre of *Shari'ah* Cooperatives) was initiated by ICMI (Ikatan Cendekiawan Muslim Indonesia/The Association of Indonesian Muslim Scholars) and was established on 13 March 1995. Then, Inskopsyah (Induk Koperasi Shari'ah/The Association of Shari'ah Cooperatives) was established on the initiative of PINBUK. In addition, Microfin Indonesia was established on 30 November 2001, while BMT Center was established on 14 June 2005, initiated by Dompet Dhuafa (a charity organisation). Furthermore, ABSINDO (Asosiasi BMT Indonesia/The Association of BMTs in Indonesia) was established on 4 December 2005 during the National Congress of BMTs. PUSKOPSYAH (Pusat Koperasi Shari'ah/The Center of *Shari'ah* Cooperatives) is a BMT association in local areas, which acts as lender of last resort for BMTs, while the apex institutions that provide liquidity facilities for BMTs are PTs, Permodalan Nasional Madani (PNM) and Persero dan Permodalan BMT Ventura.

Unlike BPRS, which provides up-to-date data, there are no official, accurate data on the total number of BMTs in Indonesia in 2012. Previously, BMT link had predicted that the total number of BMTs would be around 3,200 in 2006 (Sakti, 2011: 2), a figure similar to the last official data released by PINBUK in 2005 (around 3,100 BMTs). Then, it reached 5,200 BMTs in 2010, serving more than 10 million customers, particularly in the form of micro and small enterprises (Sakti, 2011: 2). Based on the data from the Ministry of Cooperatives and SMEs (cited from Sakti 2011, 3), the total number of cooperatives is

187,598, of which 71,386 are credit unions and around 5,500 are BMTs. From the supporting organisations' perspective, the difficulty in tracing the exact number of BMTs is mostly due to the limited financial ability of PINBUK (and other similar organisations) to conduct a survey. Kholim (cited by Sakti, 2011) reports that the three provinces with the largest numbers of BMTs are West Java (637 BMTs), East Java (600 BMTs) and Central Java (447 BMTs).

The development trajectories of BMTs can be traced back to the efforts of the last 30 years, as depicted in Table 4.3. During the initial growth phase in 1990-1995, there were only 300 BMTs. The establishment of PINBUK in 1996 contributed to the rapid development of BMTs; they numbered 1,501 in 1997 and grew rapidly until 2001 when the figure reached 3,037; development then began to slow down and growth became stagnant. However, after 2005, it demonstrated a relatively good growth, reaching 5,500 in 2011 (Table 4.3).

Table 4.3: The Development of BMT

No	Phase	Period	Number of BMT
1	Initial growth	1990-1995	300
2	Rapid growth promoted by PINBUK	1996	700
		1997	1,501
		6/1998	2,470
3	Slowing-down of growth	2000	2,938
4	Stagnation and decline	2001	3,037
		2003	2,856
5	Growth	2005	3.101
		2006	3,200
		2010	5,200
		2011	5,500

Source: Seibel (2008), Pinbuk (2005), Sakti (2011)

It should be noted that, as civil societies or grassroots organisations, BMTs are large in number but small in terms of the assets they own. It should be noted that most of them are not members of any BMT association (*e.g.* PINBUK, Absindo, BMT Center, Inkopsyah and Microfin). Hence, there is a difficulty in tracking the exact number of BMTs, although the general assumption is that it has reached thousands. However, Eriesudewo (2007), the Director of BMT Center, identifies some of the reasons for the difficulty in determining the exact number of BMTs:

(i) Geographically, they are located in remote places, because the market segment of BMT is microenterprises which tend to be in areas where BMTs sometimes exist but are sometimes absent.

(ii) A number of BMTs have closed their operational offices.

(iii) Amateur BMTs, which are allowed to join Islamic microfinance associations, sometimes also join conventional microfinance businesses.

(iv) There are 'Fictitious BMTs' created by moneylenders.

Bank Indonesia, in its survey of 2011, also attempted to discover how many BMTs no longer operate or are permanently closed (Sakti, 2011: 7). This field information provides an insight into some of the challenges faced by the promoters of *Shari'ah* economic activism in Indonesia who are concerned with BMT development in order to formulate possible solutions to protect BMTs.

In sum, the latest official data provided by PINBUK in 2005 and by Bank Indonesia in relation to the total number of BMTs are depicted in Table 4.4, which classifies them in terms of their assets.

Table 4.4: Total BMT di Indonesia

No	Province	Asset > IDR.1 billion	Asset IDR.500 mi- 1 bi	Asset IDR.250-500 bi	Asset IDR. 50-250 bi	Asset < IDR. 50 bi	Total (unit)
1	Aceh	2	7	23	37	7	76
2	Sumatera Utara	1	8	53	87	7	156
3	Sumatera Barat	1	5	17	28	9	60
4	Riau	2	5	20	23	15	65
5	Jambi	1	1	2	5	3	12
6	Bengkulu	-	1	10	5	4	20
7	Sumatera Selatan	1	3	14	38	9	65
8	Lampung	3	1	14	19	7	44
9	Jakarta	5	36	53	55	16	165
10	Jawa Barat	7	23	290	293	24	637
11	Jawa Tengah	97	9	215	225	49	595
12	Yogyakarta	7	10	29	14	9	69
13	Jawa Timur	16	32	271	230	62	611
14	Bali	1	6	4	3	1	15
15	Kalimantan Barat	2	5	13	17	2	39
16	Kalimantan Tengah	-	5	4	3	2	14
17	Kalimantan Timur	2	9	7	4	2	24
18	Kalimantan Selatan	3	4	5	4	1	17

No	Province	Asset > IDR.1 billion	Asset IDR.500 mi- 1 bi	Asset IDR.250-500 bi	Asset IDR. 50-250 bi	Asset < IDR. 50 bi	Total (unit)
19	Sulawesi Utara & Gorontalo	-	1	21	31	9	62
20	Sulawesi Tengah	1	2	4	2	2	11
21	Sulawesi Tenggara	-	1	11	7	4	23
22	Sulawesi Selatan	10	51	71	83	29	244
23	Nusa Tenggara Barat	1	4	41	39	8	93
24	Nusa Tenggara Timur	-	1	2	4	1	8
25	Maluku & Maluku Utara	2	5	10	7	4	28
26	Papua & Irjabar	3	2	6	7	3	21
Total		**168**	**237**	**1.210**	**1.270**	**289**	**3.101**

Source: PINBUK, 2005.

Since this study focuses on East Java as a case-study, Table 4.5 provides a list of BMTs in East Java according to cities and regions. This does not imply that East Java has only 128 BMTs: it is just that the survey could only reach certain geographical districts to register BMTs.

Table 4.5: BMTs in East Java

Regency/Cities	Total
Kediri	13
Bojonegoro	12
Tulungagung	12
Tuban	11
Malang	9
Lamongan	8
Sidoarjo	8
Gresik	7
Ponorogo	7
Pasuruan	6
Sampang	5
Jombang	4
Lumajang	4
Mojokerto	4
Surabaya	4
Blitar	3
Bondowoso	3
Nganjuk	3
Jember	2
Bangkalan	1
Banyuwangi	1
Sumenep	1
Total	128

Source: Bank Indonesia (2012)

4.4.2.2. Bank Pembiayaan Rakyat *Shari'ah* (BPRS/Shari'ah Rural Banks)

The establishment of BPRS (sometimes translated as People's Credit Bank) was supported by Act No 7/1992 on Banking as revised by Act No 10/1998. It is defined as a bank conducting banking/business activities based on *Shari'ah* principles ("Banking Act No 10/1998 ", 1998: 1). Article One of this Act defines a *Shari'ah* principle as an agreement based on *Shari'ah* law between a bank and other parties in funding and/or financing business activities or other activities in accordance with *Shari'ah,* such as those financial instruments based on the profit-loss-sharing (PLS) principle (*mudharabah*), those based on equity financing capital through *musharakah* based on the selling principle (*murabaha*), or financing capital goods on the basis of a pure lease option (*ijarah*) or with option of removal of ownership of the leased items from the bank by another party (*ijara wa istisna*).

It should be noted that this micro banking operates in specific local areas (district/*kecamatan*) providing micro financing, savings and other related financial products to local communities under Bank Indonesia's supervision and regulation, as identified in Act No 10/1998, Article 29.

The history of BPRS can be traced back to previous forms of rural banks, such as Bank Desa (Village Bank), Lumbung Desa (Village Office), Bank Pasar (Market Bank), Bank Pegawai (Employees' Bank), Lumbung Pitih Nagari (LPN), Badan Kredit Desa (Village Credit Institutions), Badan Kredit Kecamatan (BKK/ District Credit Institutions), Kredit Usaha Rakyat Kecil (KURK/Small People Business Credit), Lembaga Perkreditan Kecamatan (LPK, District Credit Institution), Bank Karya Produksi Desa (BKPD/Production Village Bank) and or other equivalent institutions, which were given the status of Rural Banks (only if they meet the requirements of procedure adopted by the regulation) when the Banking Act No 7/1992 was legalised (Article 58).

By way of further regulation to enhance the growth of BPRS, the Central Bank has announced Bank Indonesia Regulation No. 6/17/2004 on the Establishment of BPRS, amended by Bank Indonesia Regulation no 8/25/2006. This latest regulation mainly consents to the expansion of office network, capital and the requirements of professional management ("Bank Indonesia Regulation No. 8/25/2006 concerning Amendment to Bank Indonesia Regulation umber 6/17/PBI/2004 concerning Sharia Rural Bank," 2006).

Unlike the conventional BPRs, which are mostly privately-owned and tend to be profit-oriented, BPRS holds two mandates: acting as a commercial institution and playing a social role. Hence, BPRS is more socially oriented than BPR, since they having a mission as supporting the community and in particular microentrepreneurs, strong links with Indonesian Muslim Mass movements (NU and Muhammadiyah) (Karim *et al.*, 2008: 9). However, this ‘social role’ may result in the slow growth of BPRS (Seibel and Agung, 2005: 35).

The general organisational structure of BPRS usually consists of stakeholders’ annual meetings as the apex, a *Shari’ah* Board who ensures the *Shari’ah* compliancy of the products/services, a Board of Directors, Directors and a Management Board supported by certain managers and members of staff.

Although the share of Islamic banking in general is considered low in Indonesia, at around only 4% of the total assets of the banking industry at the end of 2011 (Bank Indonesia, 2011: 9), the development of BPRS has been quite remarkable: after a promising start during the 1990s with the first 4 BPRS appearing in 1992, the number of BPRS continued to grow, reaching 155 BPRS with 389 branches in January 2012, as depicted in Table 4.6.

Table 4.6: The Growth of Islamic Banking in 1991-2012

Type of Islamic Bank	**‘91**	**‘92**	**‘99**	**‘00**	**‘01**	**‘02**	**‘03**	**‘04**	**‘05**	**‘06**	**‘07**	**’08**	**‘09**	**‘10**	**‘11**	**Jan 2012**
Commercial Bank	0	1	2	2	2	2	2	3	3	3	3	5	6	11	11	11
Brach Offices										349	401	581	711	1,215	1,401	1,435
CB units (UUS)	0	0	1	3	3	6	8	15	19	20	26	27	25	23	24	24
Branch Offices										183	196	241	287	262	336	378
Total CB Branch Offices	0	1	40	62	96	127	299	401	504							
Islamic Rural Banks	4	9	78	78	81	83	84	86	92	105	114	131	138	150	155	155
Brach offices										105	185	202	225	286	364	389
Total number of Banks	4	10	81	83	86	91	94	104	114							
Total number of offices	4	10	118	140	177	210	383	487	596	637	782	1,024	1,223	1,763	2,054	2,086

Source: Seibel (2005) and Bank Indonesia (2012)

Hence, during the 8 years from 2002 until January 2012, on average the number grew by 8% per annum. Seibel (2008: 93) argues that, despite the harsh economic crisis in 1997-

1998, BPRS still grew at no less than 4%, an achievement which should be appreciated despite the collapse of some commercial banks in Indonesia during this period.

To cater for the BPRS needs of affiliation and support, ASBISINDO (Asosiasi Bank *Shari'ah* Indonesia/The Association of Islamic Banking in Indonesia) was established in 1992 with the main objective of providing training for the management and staff of commercial banks and rural banks. Thus, since 2002, ASBISINDO has been open to a wider membership of Islamic commercial banks (Seibel and Agung, 2005: 36).

4.4.2.3. Comparison between BMT AND BPRS

Although both types of institutions provide the same financial services for the same market segment, they are different in nature, as summarised in Table 4.7:

Table 4.7: Summary of Comparison between BMT and BPRS

Aspect	BMT	BPRS
1. Nature of operation	• Cooperative and community based • Flexible and faster financing approval • Offers entrepreneurial skills and the promotion of Islamic values in a practical way	Bank
2. Regulation	• Cooperative Law no 25/1992 • Government Act No 1/2013 on Microfinance Institution (come into force in 2015)	Banking Law No 10/1998
3. Regulator	• Ministry of Cooperative and SME. • OJK (Otoritas Jasa Keuangan/Financial Services Authority)	Bank Indonesia
4. General Supervision	None, will be under the OJK in 2015	Bank Indonesia
5. Insurance	None	Bank Indonesia
6. Supervision of liquidity requirements	None, will be under the OJK in 2015	Bank Indonesia
7. Bankable	Low	High
8. Rating	Ministry of Cooperative and SMEs	Bank Indonesia
9. Association	PINBUK, Inkopsyah, Absindo, BMT Center, Microfin.	Asbisindo, Perbarindo,
10. Development in 2011	Total number: 5,500	Total numbers: 155 Total branches: 364

Source: Author's compilation

4.5. ISSUES AND CHALLENGES FOR MICROENTERPRISES

Despite the increasing number of microenterprises operating in Indonesia, microenterprises experience problems and challenges in their operations due to their limited resources. Based on Bank Indonesia's large-scale survey of 2005 with about 11,000 MSME respondents (micro, small and medium-sized enterprises), Ascarya and Sanrego (2007: 4-6) pointed out some problems faced by MSMEs: they found that 98.6% of them did not have legal business permits, which constrains them in the financing application process to banks; therefore most microenterprises have a lack of assets. On the other hand, MSMEs have certain advantages, such as having high loyalty to their business field, as 51% of the respondents have been running their businesses for more than 7 years, while 13.8% of the respondents have been running their businesses for more than 21 years. In addition, micro and small enterprises have the advantage of making high profits of between 10% and 50%, while the profit margins of medium-sized enterprises are less than 10% (Ascarya and Sanrego, 2007: 7). Therefore, micro and small enterprises are likely to have the capacity to repay loans without subsidies. In addition, most of the respondents reported having promising future business prospects, particularly in household services, trade, hotel and restaurants, and agricultural sectors (Ascarya and Sanrego, 2007: 11).

With regard to financing needs, in the same study most of the respondents (65%) stated that financing sources are required. However, due to certain constraints, not all of them are willing to apply for loans from banks; only 74% consider loans, of which only 54.1% actually apply for them. This is also related to the fact that microenterprises are reluctant to provide collateral, while SMEs are unwilling to pay high interest rates. Further, based on the research findings, micro and small enterprises admit that the financing provided by banks is not extended to them, resulting in low accessibility of financing, while the medium-sized enterprises stated otherwise. Moreover, regarding the position of the banks, it seems that one of the main constraints to providing financing to MSMEs is related to the unfeasibility of the businesses, which might include doubts about financial, marketing and human resources; this factor seems to be the reason for about 15.5% of the rejections (Ascarya and Sanrego, 2007: 8).

Despite the above findings on the importance of credit to the development of MSEs, McPherson and Rous (2007) reveal that the growth, measured by the increasing number of employees, of SMEs in East Java is not necessarily affected by access to credit. Rather, the growth is more related to business sector, initial size and age of business, number of workers, other characteristics of the business and surrounding local society (McPherson and Rous, 2007: 169). Therefore, they (2007) suggest that, rather than being used for credit provision, such funds would be more beneficial for the development of SMEs if they were to be invested in workers' training programmes and the improvement of national education systems.

From the government perspective, namely the Ministry of Cooperatives and SMEs, the most common issues and challenges to the growth of micro, small and medium-sized enterprises include the following: (i) lack of working capital; (ii) marketing difficulties; (iii) limited access to financial resources; (iv) lack of technological skills and management; (v) limited human resource capability, (vi) low productivity; (vii) limited access to productive resources, particularly capital, technology, information and markets; (viii) the still low quality of institutions and organisation of cooperatives; (ix) the performance of cooperatives has lagged behind other businesses and the image of cooperatives has not been good; and (x) absence of a conducive business climate (Sembiring, 2008: 3-4). These issues are commonly faced in everyday life by micro and small businesses; this provides the rationale for efficient and effective support from government and related institutions.

4.5.1. Government Strategies in Developing Microenterprises

Considering the challenges identified in the previous section through various stakeholders' perspectives, the government, particularly the Ministry of Cooperatives and SMEs, has initiated several strategies for the development of microenterprises through some empowerment programmes, particularly financial assistance programmes (Sembiring, 2008: 7), as follows:

(i) P3KUM (Productive Financing Programme for Cooperative and Micro Enterprises) aims to increase the capital structure of Saving and Loans Cooperatives (SLC), to provide broader financial access to small and microenterprises, to alleviate poverty, and to increase working opportunities by enhancing the economic capacity of micro and small enterprises. The funding distributed to this programme was IDR 284 billion during a 2-year period from 2006; it enabled 2,840 cooperatives to each obtain IDR 100 million.

(ii) Women's Prosperous and Healthy Family Programme (Perkassa Programme) aims to support women entrepreneurs through women's cooperatives. This programme, in particular, has the objectives of increasing the capital structure of Women's Savings and Loans Cooperatives, to open wider financial access for women-owned small and microenterprises, and to increase family wellbeing as part of poverty alleviation. During the two years after its establishment in 2006, the distributed fund reached IDR 45 billions.

(iii) The KUR **(**Credit for People's Business) was launched in 2007 with the aim of solving the collateral problem faced by micro and small enterprises, particularly those that are feasible but not bankable, in accessing credit from commercial banks. In 2008, six commercial banks had been assigned to apply this scheme, namely Bank Rakyat Indonesia, Bank Mandiri, Bank BNI, Bank Syariah Mandiri, Bank Tabungan Negara and Bank BUKOPIN. Some banks in the programme, except BRI, which does not have enough branches to reach SMEs, have built a linkage programme with microfinance institutions and cooperatives to distribute the fund. To secure this scheme, a credit insurance agency (Asuransi Kredit Indonesia/Askrindo) and credit guarantee agency (Perum Jaminan Kredit Indonesia/ Jamkrindo) have been assigned to manage credit guarantees, securing 70% of the risks, with the banks being responsible for the remaining risks. In return, these agencies received fees from the government. It is intended that a total of IDR 14.5 trillion will be distributed to SMEs. IDR 8.6 trillion was distributed to over 650 thousand SMEs in 2008; hence, each SME received around IDR 8-9 millions on average. The interest rate imposed is, however, quite high, at around 16% per year. It seems that SMEs are happy with this scheme, according to the Ministry.

In addition to the above-mentioned programmes, a new entrepreneur development programme was launched to promote new business by introducing an entrepreneurial spirit into schools (Sembiring, 2008: 9-11). This programme is being conducted in collaboration with formal education institutions and incubators, the government providing incentives for the institutions and awards for successful enterprises.

To complement the above programmes, the government has also launched two further programmes in relation to the development of cooperatives, and micro, small and medium-sized enterprises, as follows (Sembiring, 2008: 9-11):

(i) The RFMA-CMSME (Revolving Fund Management Agency for Cooperatives, Micro, Small and Medium Enterprises/LPDB-KUMKM) is a non-profit organisation set up to provide sustainable financial support for CMSMEs through provision of financing facility and management (*e.g.* loans, venture capital, credit guarantee, Initial Capital Partnership – Incubator and other financing to facilitate and strengthen the capital of CMSMEs) based on government funds and other sources (*e.g.* Public Grant, service income or from other institutions managed under a Professional Management System). Thus, it is expected that this programme will achieve the goal of enhancing people's economic welfare. As of August 2008, the revolving funds managed under this programme amounted to IDR 160 billions.

(ii) The SMEsCo Marketing Services Body (SMSB) or LLP-KUKM aims to focus on improving the access of SMEs and cooperatives to markets, opening wider markets for their products, strengthening networking, increasing the quality and skills of their human resources, partnership development, and raising higher funding resources and product development both in volume and quality through better design and packaging. In its operation, the popular name of SMEsCo Indonesia Company (SIC) is used and operated under the Financial Management Model for Public Services as set up in the Government Decree Number 23/2005. This non-profit and independent professional institution under the Ministry of Cooperatives and SMEs promotes the development of cooperatives and SMEs through the provision of trading house services, exhibition centres, permanent display showrooms (UKM Gallery), trading boards, education and management consultants, retail businesses, marketing incubation and office space. To support its operation, SIC owns and manages SMEsCo Promotion Centre (SPC) Building, a huge 17-storey building in Jakarta business district, as a one-stop shop for local and international buyers (Sembiring, 2008: 9-11).

Despite such effective programmes, however, it seems that, because Indonesia is a country with a large population spread across a very wide area, the outreach and sustainability of the programmes need to be improved as many cooperatives and SMEs are still lagging behind and some have even fallen into bankruptcy, particularly in rural and remote areas. In this regard, Ascarya and Sanrego (2007: 11) also state that only 14.1% of MSMEs have managed to obtain support/facilities from the government, particularly credit facilities, management training and workshops.

4.5.2. Non-Government Actions

In addition to the government strategies as identified above, communities are forming groups of micro and small enterprises aiming to support the business development of their members. Among others, both Tangan Diatas (TDA means 'hands on', a name inspired by the Prophet's *hadith* that hand over the hand (giving) is better than hand under the hand (receiving) and UNO Foundation can be mentioned as relatively well known institutions in the micro and small enterprises' community development. As self-help groups/organisations, they do not rely on government support; rather, they are more independent in funding and conducting activities, purely aiming to help their members to improve their businesses through networking.

4.6. ISSUES AND CHALLENGES FOR ISLAMIC MICROFINANCE INSTITUTIONS IN INDONESIA

Indonesia appears to have a unique feature in Islamic finance, as compared to GCC countries and Malaysia. In particular, the integration of social and economic development in its Islamic finance development should be considered a peculiar aspect of Indonesian Islamic finance (Asutay, 2012), as this has not been an essential component of future planning in Islamic banking and finance in GCC. While Malaysian governments have provided strong and unwavering support and incentives for the development of industry through their regulative and other institutions including education, it is considered that, despite such support, Islamic banking and finance in Malaysia has not directly contributed towards socio-economic development on the scale that might have been expected. On the other hand, despite having minimal support from the government, Asutay (2012) asserts that the trajectory of Indonesian Islamic finance development is marked by a growing number of Islamic microfinance institutions initiated by people at the grassroots/local community level, mainly from religious groups; this has shown a positive contribution to the development of micro and small enterprises through the provision of micro financing. Thus, in terms of industrial development, it seems that Indonesian 'bottom-up' Islamic finance institutionalisation has been more fruitful in terms of delivering outcome in relation to the expectations of Islamic moral economy (Asutay, 2012).

Generally, focusing on BMT and BPRS, Antonio (2008) argues that these institutions serve the poor through a better approach than other banks due to the simple administrative process and products' flexibility. However, these types of microfinance institutions face the problem of competing with Islamic commercial banks; as they have a smaller number of branches, it is hard for them to compete (Antonio, 2008).

4.6.1. Legal Issues of BMT

Despite the large numbers of BMTs and their role in providing micro financing services, the available infrastructure (particularly regulation and monitoring) has not been functioning optimally. It is likely that the main common problem of BMTs is lack of supervision, monitoring and regulation; hence, a majority of BMTs perform poorly and only around 20% of them are in relatively good health (Seibel, 2008: 95). In relation to regulation, Obaidullah (2008b: 57) also strongly asserts the following:

> It should be noted that Indonesian BMTs at the grassroots largely fall outside the financial regulatory mechanism since they operate as member-based cooperative organizations (similar to a *musharakah* structure) without governmental assistance or intervention. These organizations have been found to be less vulnerable to systemic risks that arise due to interdependence, as each BMT is an independently operating entity. As such, the system poses a serious challenge to the regulator – how to strike a balance between the need to strengthen the linkage

> between formal financial system and the BMTs while retaining the benefits of flexibility and independence

Therefore, BMTs are not categorised as part of the formal financial sector (Obaidullah, 2008b: 57). Similarly, Seibel and Agung (2005: 7) also categorise BMTs as part of the informal sector:

> The Islamic financial cooperatives in Indonesia are not part of the formal financial sector. They may be registered with the Ministry of Cooperative or be unregistered; accordingly, they may be placed in the semiformal and the informal financial sector, respectively".

BMTs have a complex legal base, as there are different legal bases for the different parts of the operations. These include the following (Sakai and Marijan, 2008: 2):

- Letter of the Minister of Home Affairs No. 538/PKK/IV/1997 issued on 14 April 1997, concerning the Legal Status of *Shari'ah* Financial Institutions;
- BMT membership is regulated by Law under KUHD (Kitab Undang-Undang Hukum Dagang/Trade Law Legislation);
- Arrangements for initial capital funds and members' saving are regulated by Law No. 25 1992 on Cooperatives;
- The *Baitul Maal* (House of Treasury) function is controlled by Law UU No. 38/1999 on Management of Zakat.

As a result of these complex legal bases, BMTs lack supervision and reporting. Previously, certain options were proposed to overcome these problems, including the following: (i) Bank Indonesia proposed to convert BMTs into BPRS so that they can be supervised by Bank Indonesia; (ii) Ministry of Cooperatives suggested incorporating BMTs as cooperatives by amending the Law No. 25/1992 on Cooperatives; (iii) Ministry of Finance recommended to create special regulations for micro financing, with BMTs falling under this regulation; and (iv) BMTs themselves searched for a law that would incorporate their dual functions as microfinance and social institutions (Sakai and Marijan, 2008: 2). From all these options, BMTs finally chose a cooperative structure as their legal form in 2010 (Sakai and Marijan, 2008: 3).

These issues have also been revealed in the findings of the Bank Indonesia survey (2011); although 84.77% of the respondents reported to have regular monitoring, 15.23% of them stated that there is no regular monitoring (Sakti, 2011: 18). However, the survey also shows that monitoring of BMTs is only conducted once a year (62%) and some even mentioned that they were monitored only occasionally (27.6% stated that monitoring is only conducted when the information on BMTs' condition is required for capital assistance purposes whether from the government or from other sources). Moreover, 11.72% of respondents stated that there is no assessment institution that certifies the financial health of BMTs and there is no uniformity of financial soundness indicators; therefore, certain indicators are applied as main parameters, such as NPF (26.21%), ROA (15.10%) and ROE (14.53%) (Sakti, 2011: 18).

Recently, a new act has been endorsed on 8 January 2013, namely Government Act No. 1/2013 on the Microfinance Institution, covered both conventional and Shari'ah MFI, with three main aims, include

(i) to facilitate financial access to the poor and low income society;

(ii) to provide economic empowerment and productivity towards the poor and low-income society;

(iii) to improve the income and welfare of the poor and low income society.

Under this act, the establishment of MFI must be approved by Otoritas Jasa Keuangan (OJK/Financial Services Authority) based on certain criteria, such as organizational structure, capital, ownership and feasibility (Republic of Indonesia, 2013: Article 9) which then coaching, regulation and supervision of MFIs conducted by OJK in coordination with Ministry of Cooperative and Ministry of Home Affair (Republic of Indonesia, 2013: Article 28). In particular to IsMFI, it is obligatory to set up a shari'ah board to provide advice and recommendation to the Board of Directors of MFIs and to conform with Islamic principle (Republic of Indonesia, 2013: Article 13). Article 19 of this act stated that to guarantee the safety of public savings, local government and/or MFI can establish deposit insurance agency (Republic of Indonesia, 2013). As regard to reporting, MFIs must provide financial report to OJK every 4 month (Republic of Indonesia, 2013: Article 40). It should be noted that BMT (and other equivalent MFI) can still maintain its operation up to one year after this act applies, which then BMT should obtain business license from OJK (Republic of Indonesia, 2013: Article 39). This act will come into force 2 years since its endorsement, in order to provide sufficient time in preparing infrastructure and human resources of OJK.

4.6.2. Other Problems and Issues of BMT

Besides the regulation and monitoring problems, the main obstacles faced by BMTs are capital (56.15%), human resources competence/quality (15.24%) and competition (12.83%); meanwhile, particularly in Central Java, 12% of BMTs stated that the government regulations are not conducive to BMT operations (Sakti, 2011: 16). Sakti (2011) also points out that the common factors hindering the development of BMTs are the limited knowledge of Indonesians on Islamic banking (32.11%), limited funding sources (18.69%), low income levels (12.37%), culture and low public savings preferences (10.26%), competition with similar microfinance institutions (8.95%) and low level of public trust in BMTs (5.79%); on the other hand, the main common factors that support the development of BMTs are affordable services for customers (28.73%), the religious community in areas surrounding BMTs (26.24%), easy procedures/requirements (22.38%), large number of micro and small enterprises (11.60%), high familial cultural in the community (5.80) and limited number of microfinance institutions in the areas surrounding BMTs (5.25%) (Sakti, 2011: 16-17)

In addition, some other contenders in the field suggest that sourcing capital is the most important constraint. For example, Ascarya *et al* (2007) point out that BMTs depend generally on a small group of member-investors to contribute a major portion of capital. In the microfinance field, as cited in (Hamidi, 2003: 80), Wahyu, the president of Asbisindo (Asosiasi Bank Syariah Indonesia/The Associated of *Shari'ah* Banking in Indonesia), strongly argues that this latent problem of limited funding sources requires urgent help from Islamic commercial banking and Islamic business units, which could then contribute to the development of micro and small enterprises by providing more allocated financing funds. It is supposed that there is a low level of trust from Islamic commercial banking, as stated by Bainurrahman (The President Director of BPRS Insan Karimah, reported by Hamidi (2003: 80) based on his experience of receiving no responses from Islamic commercial banks to his proposals/offers of partnership. However, Wahyu also admitted that it is not easy to facilitate cooperation between BPRS and Islamic commercial banking, as a gentlemen's agreement is necessary to ensure that both parties derive mutual benefit from the cooperation; this means that the funds distributed by commercial banks must be in safe and secure institutions, with a full guarantee that the funds will be repaid while, at the same time, BPRS (and the borrowers) also enjoy the benefits (Wahyu and Bainurrahman, as cited by Hamidi (2003: 80-81).

Moreover, BMTs have certain problems, such as "identifying opportunities and needs, planning and acquiring support information and resources, marketing and creating demand and constructing organisational frameworks" (Sakai and Marijan, 2008: 4). Another problem for BMTs relates to funding issues and loans without collateral that can lead to bankruptcy (*e.g*. BMT SMS Pacul Gowang).

Considering the above challenges and on the basis of an overall analysis of the potency and problems of BMTs in developing micro and small enterprises, Amalia (2008) formulates that the strength of BMTs is employees' integrity, profit-sharing (margin) and good services, while the weaknesses include networking development problems and lack of capital access, requirement of guarantor agency for savings and financing, and need for supporting regulations and supervision (Amalia, 2008: 11). Overall, this underlines the common agreement on the main BMT problems, namely supporting regulations and access to capital.

Another issue to consider is the great deviation in the sizes of BMTs in terms of assets, financing, number of branches and number of staff (Sakti, 2011), all of which are rather important for building a strong and healthy microfinance industry. For each of these, there is a standard that should be complied with. On the assets side, according to a survey conducted by Sakti (2011: 9), the minimum assets were reported as IDR 9 millions and the maximum assets were IDR 287 billions. According to Sakti's findings (2011: 14), the deviation also varied in funding and financing; BMTs in East Java offer the highest funding share (1.29%), while BMTs in West and Central Java offer 0.60% and 0.56% respectively; the margin of financing is highest in West Java (2.65%), followed by East Java (2.54%) and Central Java (1.95%) (Sakti, 2011: 9). Hence, East

Java offers the most favourable outcome for customers. The number of BMT staff members also varies. On average, BMTs have 12 members of staff; the minimum number is two but there is one BMT with 730 members of staff.

Concerning the issues of staff, the salaries offered by BMTs are far below the salaries of commercial banking officials, on average around IDR 1 million (for all levels) and around IDR 4-5 millions respectively; this also seems to be creating another issue related to welfare (Sakti, 2011: 16). However, despite such low salaries, the Bank Indonesia survey findings also show that there is a low level of staff turnover, which indicates a strong loyalty to BMTs (Sakti, 2011: 15); on the other hand, perhaps the difficulty of finding such professional jobs might discourage people from risking their current jobs despite the low salaries. A possible reason for the low level of salary, as stated by Sakti (2011: 5), may be the low educational level, as a majority of the BMT staff members are graduates of Junior and Senior High School (52.40%). Hence, this also raises the issue of the requirement for further training and higher funding being allocated for training, since the current funding allocated for training is very limited (on average IDR 3,5 millions/year) (Sakti, 2011: 15).

4.6.3. In Search of Possible Solutions

In searching for possible actions to overcome BMT problems, some recommendations and solutions are offered. Seibel (2008: 97) points out that BMTs have poor performance and a lack of reliable reporting, while a large majority is technically bankrupt; they have negligible outreach, low loan portfolios, and pose great risk to savings. Hence, he further asserts that the possible remedy is "total overhaul of the cooperative system". Without effective regulation and supervision the fresh funds distributed to cooperatives will lead to collapse (Seibel, 2008: 97).

In view of these challenges, therefore, Sakai and Maridjan (2008: 7-8) propose some recommendations to encourage BMTs, including the following:

- Focus on loans for micro and small enterprises (less than IDR 50 millions);
- BMTs should arrange regular business training sessions to improve social capital;
- To promote BMTs, Ministry of Coops should publish books and local guides;
- Ministry of Coops should provide training for community development;

- BMTs should use local knowledge and social capital to expand their businesses.
- In the short term, BMTs can be cooperative;
- In the long run, a specific law to address the unique character of BMTs (microfinance, business training and *zakat* management) should be established.

Similar to the above recommendations, in order to provide better services to MSMEs, Ascarya and Yumanita (2007: 18) also recommend that each type of financing institution focus on different market segments; therefore BMTs should focus on serving microenterprises and BPRS should focus on small enterprises, while the medium-sized enterprises are served by Islamic commercial banks.

If these recommendations and solutions for improvement of BMTs are put in place, it is highly likely that BMTs will become robust and sustainable financial institutions.

4.6.4. BMTs' Performance and Contribution

As stated before, BMTs are legally located within the jurisdiction of the Ministry of Cooperatives and SMEs. However, Bank Indonesia has shown an interest in BMT development, for which it has undertaken at least three large research surveys. First, in 2006, while searching for the best model for Islamic microfinance institutions, Bank Indonesia conducted a study to analyse Islamic microfinance institutions according to three categories of services: (i) financial services only; (ii) financial and technical assistance only; and (iii) financial, technical and spiritual treatment. The findings show that the institutions that provide financial, technical and spiritual treatment achieve the best performance compared to other group categories. Based on this finding, Bank Indonesia started to develop a microfinance model combining those three services (Masyita, *et al.*, 2011; Obaidullah, 2008a).

Bank Indonesia also conducted research in 2007 with 80 BMTs in West Java as respondents (Ascarya *et al.*, 2007). The findings from this research have raised a number of questions and issues. First, collateral for the provision of micro financing is required by a large number of BMTs (about 85%), and the majority of customers provide certificates of their assets (*e.g.* homes, cars and landowner certificates) as collateral. Hence, it seems that there is a heavy dependence on collateral, which seems to contradict the idea of trust in members and helping the poor. Second, bearing the names *baitul maal* (charity in the form of *zakah, sadaqah* and *waqf*) and *baitul tamwil* (financial services provider), BMTs should seek to balance their performance in conducting these dual functions. There is a criticism that the first function has failed or is being ignored, as the BMTs mostly concentrate on the second function. Besides, managers of BMTs have varied opinions on the effectiveness of the dual functions in terms of whether both functions should be carried out by one institution. However, the survey findings in 2011 provide evidence that 66.84% of BMTs reported that they already performed the social function (*baitul maal*) in the form of distributing funds to *Dompet Dhuafa* (a charity fund agency), to customers with business problems, to social funding applicants and to others (Sakti, 2011: 14). Fourth, according to the BMT managers' perspective, there is an overwhelming belief that BMTs play a significant and positive role in improving the quality of customers' lives. This suggests the need for independent research to examine the role and impact of BMTs from the customers' perspective.

The last research survey on BMTs, conducted by Bank Indonesia in 2011 and covering three large provinces in Java, namely East, Central and West Java, aims to map the potential and problems of BMTs in order to formulate a related policy recommendation, particularly for finding the best model of partnership and linkage between Islamic commercial banking and BMTs (Sakti, 2011). The findings suggest that, very similar to the previous research, a fundamental reform of governance, particularly in relation to regulation and supervision, is required. This survey also reveals that the BMTs in Central Java perform better than their counterparts in West and East Java. However, BMTs in East Java have a higher number of branches as compared to West and Central Java. The good performance by BMTs in Central Java could be explained by the fact that there are more BMTs with large assets in Central Java (Sakti, 2011: 9); furthermore, BMTs in Central Java have the highest number of employees with undergraduate education (44.26%) (Sakti, 2011: 15).

Sakai and Marijan (2008: 4) also reported the differences in performance among these three provinces. Among other provinces, Central Java is a leading centre of the BMT movement in Indonesia having 20%, while BMTs in East Java accounted for only 19%

of all BMTs in Indonesia (Sakai and Marijan, 2008: 4). The success of BMTs in Central Java as compared to East Java, according to Sakai and Marijan (2008: 4), can be explained by the following:

(i) Central Java has a culture of meeting; moreover, the large number of universities spread across this province produce a large number of unemployed university graduates who are interesting in managing social enterprises such as BMTs;

(ii) Central Java is the location for the establishment of one of the biggest Islamic organisations in Indonesia, namely *Muhammadiyah*;

(iii) East Java, with *Nahdatul Ulama* as the largest Islamic organisation, is fearful of bankruptcy, considering BMTs as rivals; hence, conventional banking is deemed adequate.

Some studies indicate a good performance by and prospects for BMTs. A study analysing the sustainability of BMTs in developing microenterprises using data envelopment analyses finds that the efficiency level of BMTs is relatively low; they operate below the optimal scale, and have managerial problems (Chokro and Ismail, 2008). Thus, Chokro and Ismail (2008:10) conclude that "Although the profitability efficiency of BMTs is relatively low, since generally BMTs have made a profit and social benefit, Islamic financing can be predicted to be sustainable – able to provide viable Islamic financing".

The research findings of Adnan *et al.* (2003: 32-33) show that the factors related to 47 samples of BMTs' best performance in five provinces in Java are "salary rate of management, education and management skill". This research also finds a negative correlation between performance and working hours and number of products, and raises the issue of improving management skills and managers' salaries. This study, which also measures BMT customer perceptions, finds that most customers are satisfied with BMTs in terms of incentive system, payment system, the adequacy of financing provided and services. Overall, BMTs play a positive role in helping the lower levels of society (Adnan, *et al.*, 2003)

Considering the contribution to BMT customers, Sakai (2008) argues that BMTs have developed financing services, despite the limited start-up capital, and are able to provide financial resources to microenterprises as an alternative to moneylenders. New economic opportunities are brighter for the poor community as BMTs facilitate their business (Sakai, 2008). In addition, Sakai (2008) also conducted a study over three consecutive years (2006, 2007, 2008) among women in Central Java on how BMT services enhance their microenterprises; the study finds that BMTs contribute to improving women's economic independence by providing them with access to financial services (Sakai, 2010). Sakai (2010) points out that, despite the lack of government support, BMTs have developed well with the support of Muslim economic activists. Hence, as indicated by empirical evidence, BMTs have the potential to develop provided they can overcome the observed operational problems and undergo "financial and legal reform". In this complex situation, some BMTs are well developed but some of them have faced failure and even bankruptcy. (Sakai and Marijan, 2008: 1) summarise their study and observations on BMTs as follows:

(i) They are managed by social entrepreneurs with a strong dedication to applying Islamic values in social justice;
(ii) They mostly offer three services: financing, *zakat* and social welfare programmes, and entrepreneurial training;
(iii) Despite lack of government support, BMT associations are active in creating self-regulation and standard operational procedures;
(iv) There is a lack of promotion, while the public generally perceive these organisations as charities, which creates problems with repayments;
(v) Since some BMTs also manage other businesses, any success or failure affects BMTs' performance.

In relation to performance, a study by Adnan *et al.* (2003) shows that the BMT managers' performances are affected by education, salary and product attributes (Adnan *et al.*, 2003: 13). They also highlight the characteristics of BMT customers as follows:

(i) Not all of them have low levels of education; they are a mixture of university graduates and graduates of lower education;

(ii) They are active in religious pursuits;

(iii) They are mostly small entrepreneurs (83%) and use financing mostly for productive purposes;

(iv) They are motivated to use BMT services because they are in line with Islamic values, help small businesses and offer an alternative choice of financial access.

Similar to other previous research on the popularity of *murabahah* as a financing product, Adnan *et al.* (2003: 27) also assert that *bai' bithaman ajil* (similar to *murabahah*) is the most common product utilised by the sector, because the mechanism and calculation applied is straightforward, followed by *mudharabah, musyarakah, murabahah* and *qordhul hasan.* Customer satisfaction seems to be adequate as 13% of the respondents were reported as very satisfied, 66% satisfied and 17% moderately satisfied. With regard to the future of BMTs, the respondents consider that BMTs have 'high potential' (50%) and 'potential' (50%). However, similar to other studies on BMTs, this research also reveals the BMTs face the main problem of lack of capital (63%), managerial problems, limited amount of infrastructure, inappropriate types of business organisation, difficulties in allocating the funds, and other problems. Concerning the social services provided to customers, the responses show that 87% of 47 BMTs provide such services (Adnan *et al.*, 2003: 17). This should be considered an addition to the social capital created by BMTs. Therefore, Adnan *et al.* (2003: 34) conclude that BMTs are institutions with the potential to provide financial services to the poor and offer a positive contribution to the national economy, which is evidenced by their resilience in surviving during the economic crisis in 1997. However, BMTs still need support and assistance, particularly on legal issues.

PINBUK, as the earliest BMT association, conducted a study in three provinces in Java (West Java, Central Java and East Java) in 1998 covering 24 BMTs and 30 Kopontren (The Cooperative Islamic Boarding School) (PINBUK, 1999: 78), which shows that there are three external factors influencing the success of BMTs in the 1990s:

(i) Muslims support the development of BMTs and Kopontren by utilising their services;

(ii) BMT and Kopontren achieve customer satisfaction by providing good products and services and good collection methods; and

(iii) They offer customers an easy procedure to obtain loans.

It should be noted that the problems faced by BMTs are mostly related to society's perceptions of BMT which emerge from their characteristics, including the following aspects (PINBUK, 1999: 78):

(i) Character of BMTs;

(ii) Social and religious role of BMTs;

(iii) 'No leading competitive' projects that could be financed by BMTs;

(iv) No guarantee for liquidity problem; and (v) most customers are in the retail sector, rather than in manufacturing businesses.

With particular regard to the impact of BMTs on the poor, the research findings concerning the poor customers of BMT MMU in East Java by Ajija and Adnan (2011) show that BMTs have a significant impact on improving household income by around 50%, from IDR 1,097,700 before financing to IDR 1,669,100 after financing. This resulted in poverty reduction, as measured by three indices including head count index (HC), which showed that the number of people below the poverty line fell from 0.52 to 0.30, poverty gap (PG) which measured the extent of poverty, falling from 0.24 to 0.11, and the Sen Index which calculated the harshness of poverty, falling from 0.187 to 0.079 (Ajija and Adnan, 2011: 75-77).

Another research survey of 100 members of the biggest Islamic Cooperative in Central Java, Kospin Jasa Syariah (Koperasi Simpan Pinjam/Credit Union *Shari'ah* Services) also reveals the effectiveness of the financing procedure and its impact on micro and small enterprises in improving income levels (Beik and Purnamasari, 2011: 8-9). In this research, the effectiveness of financing is measured based on the following steps: application, fund disbursement, repayment and the effect of financing. The customers reported high scores which indicate the easy procedure and quick funds disbursement, and, although the repayment period reported to be too short (less than 1.5 years), the impact is considered positive and effective (Beik and Purnamasari, 2011: 9). Moreover, the results also show that the amount of proposed financing is affected positively (76%) by the cost of financing and borrowers' education levels (Beik and Purnamasari, 2011: 13). Further analysis of the financing impact shows that the daily income level after financing is positively affected (81%) by daily business profit, monthly consumption and proposed financing application (Beik and Purnamasari, 2011: 13). The findings are likely to provide better information if the variable used in the model is the amount of approved financing, rather than the proposed financing, since there is a possibility that the proposed funds will not be the same as the approved financing. Besides, analysis shows that another impact of BMT financing is its ability to significantly improve the borrowers' average sales by IDR 1,427,769 and average monthly income by IDR 472,328 (Amalia, 2008: 7)

Similar to the above positive findings, Hamada (2010) argues that the impact can be varied, based on secondary data from 1,104 BPRs (people's credit banks/village banks) in Indonesia, and finds that bank loans received by those BPRs contribute to expanding the provision of credit to clients; this contribution is even larger when the loans are gathered through linkage programmes (Hamada, 2010). However, Takahashi *et al.* (2010) study on microfinance in Indonesia based on a survey of 100 participants reveals that there is no immediate impact on poverty alleviation through the provision of microcredit because, apart from sales of non-farm enterprises for the non-poor and schooling expenditures, the effect on household outcome is not significant (Takahashi, 2010). Also, although the policy of requiring collateral in order to provide loans has been eased, it benefits the non-poor rather than the poor, which means that the outreach may be questionable

Another issue is related to the potency of Islamic banking development in a particular geographic area. Ascarya (2007) conducted area mapping in East Java and Central Java and the findings show that, in East Java, Malang and Surabaya, among other cities, have the highest level of potency in *Shari'ah* banking development. This indicates that the potency of development varies by region, and it could be affected by factors that have yet to be researched in depth.

4.6.5. Issues in BPRS

Seibel (2008: 95) states that the problems facing BPRS include governance and management problems, inadequate internal control, lack of popular demand, an emphasis on the informal sector and a lack of skills in managing complex Islamic banking operations.

In contrast with the previous views on the positive contribution and future prospects of BMTs and Islamic microfinance in Indonesia in general, a pessimistic point of view is presented by Seibel and Agung (2005). They conducted a study on IsMFI in Indonesia, collecting secondary data from samples of BMTs and BPRS in West Java, and then deliberately locating certain problems such as IsMFI having low assets compared to conventional banking due to the lack of regulatory and supervisory aspects in Islamic values. The two proposed options are as follows: to focus completely on Islamic commercial banks and the "establishment of branch networks with IsMFI products"; and "to reassess the challenges and realistic opportunities for Islamic rural banks and cooperatives" (Seibel, 2005: 41) (see: discussion in section 9.3).

4.7. STRATEGIES FOR POVERTY ALLEVIATION IN INDONESIA: SPECIAL REFERENCE TO MICRO FINANCING THROUGH GOVERNMENT AGENCIES

Poverty alleviation has been legally addressed in the Government Act No. 25/2000 on Propenas 2000-2004 (Program Pembangunan Nasional/National Development Program). In order to achieve the economic development goal of accelerating economic recovery, seven groups of programmes were formulated (2000: II-8). The first programme is poverty alleviation and fulfilment of society's basic needs; the second programme is the development of micro, small and medium-sized enterprises and cooperatives (MSMEC) as the backbone of the people's economic system and expanding democratic participation in the development process, which consists of accelerating the debt settlement of MSMECs, creating an environment conducive to the development of MSMEC and increasing their financing access (2000: II-8).

In addressing poverty-related problems, particularly through micro financing, a number of programmes have been conducted by the government (Komite Penanggulangan Kemiskinan Republik Indonesia, 2002: 30-33):

(i) Inpres Desa Tertinggal (IDT/President Instruction on Underdeveloped Villages), legalised through Inpres (Presidential Instruction) No. 5/1993, provided a revolving fund of IDR 20 millions for working capital to people living in underdeveloped villages, as well as supporting infrastructures and mentors. The mentors consist of Sarjana Pendamping Purna Waktu (SP2W/Full-Time Bachelor Companions), Sarjana Penggerak Pembangunan Pedesaan (SP3/Bachelor of Rural Development Activators) and Sarjana Alumni Beasiswa Supersemar (Bachelor Supersemar Scholarship Alumni). Then, in 1999, IDT wsa refined into Perluasan Jaring Pengaman Sosial dan Pemberdayaan Masyarakat (JPS-PM/Expanding Social Safety Net and Community).

(ii) To strengthen IDT, particularly in terms of working capital and mentors, Program Prasarana Pendukung Desa Tertinggal (P3DT/Villages Infrastructure Program) was launched in 1995/1996 with the aim of providing basic infrastructure such as roads, bridges, boat moorings, clean water and bathing facilities, and toilets, which basically support local poor community empowerment.

(iii) Program Pengembangan Kecamatan (PPK/District Development Program) has been established as an additional programme to support IDT, particularly in the management of the programme at district level; hence, PPK will be able to increase integration of the development of productive activities and rural infrastructure development with wider coverage in order to serve the needs of rural communities.

(iv) For the particular alleviation of urban poverty, Program Penanggulangan Kemiskinan Perkotaan (P2KP/Urban Poverty Reduction Program) was established to accelerate efforts to reduce poverty through the provision of financing for the development of productive activities and the creation of new jobs, funding for the development of social and economic infrastructures, and capacity-building for poor individuals and families through partnerships which will enable the development of new businesses based on groups *etc*.

(v) The programme that specifically targeted families through Takesra (Tabungan Keluarga Sejahtera/Savings Family Welfare) and Kukesra (Kredit Usaha Keluarga Sejahtera /Family Welfare Business Loan) was established to support the poorest families, namely pre-prosperous family (Keluarga Pra-sejahtera) and prosperous family 1 (Keluarga Sejahtera I/KS-1), to move to the upper level. This programme is implemented in cooperation with BKKBN (Badan Kependudukan dan Keluarga Berencana Nasional/National Population and Family Planning Agency), Bank Negara Indonesia and PT Pos Indonesia.

(vi) Program Kesejahteraan Sosial (Social Welfare Program) is conducted through provision of social mentoring, motivation, consultation and skills training for groups of families, complemented with provision of goats or cows for breeding; any monies earned through these could then be used to build home industries such as production of crackers, sugar, coconut oil, weaving, knitting and fishing.

(vii) Pembinaan Peningkatan Pendapatan Petani dan Nelayan Kecil (P4K/Fostering Increased Revenue of Small Farmers and Fishermen) is a financing project targeting small farmers with incomes below the poverty line. In this programme, the sizes of loans are tailored to the needs of each group, with durations of 12, 15 and 18 months including, if necessary, an instalment payout grace period of between 3 and 6 months. A joint liability is applied in this financing, in which all the members of the groups are responsible for paying the whole amount of the financing. Those who successfully complete this programme then progress to a new project called Peningkatan Pendapatan Masyarakat Perdesaan (Improved Rural Community Income) targeting 800,000 poor families.

(viii) In 1989, Bank Indonesia launched a pilot project, Pengembangan Hubungan Bank dengan Kelompok Swadaya Masyarakat (PHBK/Bank Relationship Development with Self-Help Groups), which aims to provide appropriate financial services for Kelompok Simpan Pinjam (KSP/Savings Groups) and Kelompok Swadaya

Masyarakat (KSM/Self-Help Groups) comprising small farmers and informal microenterprises in rural areas.

(ix) KCK/TPSP KUD (Kredit Candak Kulak/Tempat Pelayanan Simpan Pinjam Koperasi Unit Desa or Care Savings and Loans in Cooperative Village Units) is a separate independent part of Cooperatives, conducting two main activities of collecting funds and providing loans in cooperation with Badan Kredit Desa (BKD/Village Credit Agency). This aims to ensure the security of fund management.

(x) Usaha Ekonomi Desa Simpan Pinjam (UED-SP/Economic Business Village Savings and Loans), a programme of the Ministry of Internal Affairs in cooperation with the Ministry of Cooperatives and SMEs and BRI, aims to provide productive financing to rural communities, particularly members of UED-SP, and receive savings.

(xi) Kelompok Usaha Bersama (KUBE/Joint Business Groups) are business groups formed by around 10 poor individuals, launched in 1990 as part of Program Kesejahteraan Sosial (PROKESOS/Social Welfare Program). Financing/grants from the Ministry of Social Welfare are available for KUBE.

(xii) Probably the most popular programme is Kredit Usaha Rakyat Kecil (KURK/Credit for Small Businesses) providing financing to micro, small and medium-sized enterprises that have feasible businesses; funding is provided in a quick and simple procedure with a maximum duration of 5 years. This programme is implemented in cooperation with some of the government-owned banks such as BRI, BNI, Bank Tabungan Negara *etc*.

Overall, the above initiatives offer a wide variety of financing programmes covering the same markets and products; hence, this might lead to ineffectiveness, inefficiencies and overlaps. To improve the effectiveness of the programmes, the government set up Lembaga Pengelola Dana dan Keuangan Pedesaan (LDKP/Institutions Funds Management and Rural Finance), which aims to integrate these various existing financing programmes and projects in order to accelerate financing to target communities in the most impoverished areas. In addition, the government also established a national body of Komite Penanggulangan Kemiskinan (KPK/Poverty Reduction Committee) through Presidential Decree/Keppres No. 24/2002 to coordinate and integrate all efforts in poverty reduction projects and programmes initiated by a number of Ministries.

Despite the government's good efforts to tackle poverty through various strategies, it has been criticised for the weakness of the programme's implementation. Seibel criticised this IDT programme on the grounds that it was more of a political objective than a professional programme developed for the poor. In addition, other problems can be observed: in some cases, the mentors/facilitators do not have sufficient experience of commercial or production activities; and some of the businesses developed through this funding have lacked profit potentiality (Seibel, as cited by (Robinson, 2002: 106).

KUBE (Kelompok Usaha Bersama/Joint Business Group), as a form of small business association, provides social and economic benefits to members. However, it is likely that target-setting is being implemented improperly so that only the poor can access this programme, while the poorest of the poor, who should be the priority, are left behind (Andariani, 2011). Moreover, it is recommended that KUBEs be based on a bottom-up rather than a top-down approach, since new KUBEs tend to be set up with the main intention of obtaining funds/grants; furthermore, provision of technical training should be improved, the funds should be managed properly to optimise the outcome, and mentoring should be conducted during the whole operation of the KUBE, not just in its initial establishment, to maintain the KUBE's sustainability (Bachtiar and Jamaludin, 2011: 121).

The latest government programme is the 'Green Economy Program', part of a sustainable development and poverty reduction plan, namely pro-growth, pro-job and pro-poor as three pillars of social economic development launched in 2005, to which pro-environment was added in 2007. This became the direction of fiscal policy in Indonesia which is expected to be implemented by all Ministries and local provinces and cities (Indonesia, 2012). Furthermore, this programme is focused on poverty alleviation, which is among the most crucial of Indonesia's national priorities (Bratasida, 2011). However, this programme has created some concerns, since there is a tendency for it to be no more than jargon, while national workers striking for improved welfare and the removal of outsourcing have become evidence of the failure to implement the programme as a pro-people policy, as stated by a Member of Parliament (Andhika, 2012).

To implement this pro-poor programme, an important poverty reduction programme is PNPM Mandiri (The National Program for Community Empowerment), launched by the government in 2007. This programme focuses mainly on the empowerment of communities in villages, in which block grants are distributed at the sub-district level (Kecamatan) and then further dispersed to the villages based on competition and importance for the poor community. After three years, an independent study on the implementation of this programme found that most funds are allocated to infrastructure, such as roads, bridges, irrigation systems, waterways, school-building and posyandu (weekly health visiting programme). Simpan Pinjam Perempuan (SPP/Women Savings and Loans), which achieved success in developing the recipients' new or old businesses, improved household financial capacity and reduced the influence of moneylenders (Syukri, *et al.*, 2011: x-xi). However, this research also revealed that there is no significant impact on the government system (participation, transparency and accountability), as set out as part of the mechanism to obtain grants, mainly due to the dominance of the elites and lack of initiative among the villagers (Syukri *et al.*, 2011: xiii). Generally, PNPM has been successful in reducing the number of poor people through new job opportunities, creation of new economic centres in new areas, and increasing the prices of plantation and sea commodities. However, Syukri *et al.* (2011: xiii-xiv) point out that "The PNPM was regarded as playing an insignificant role in reducing poverty". This is the result of the lack of awareness by the implementers of this programme in the field that this programme is a poverty reduction programme, which does not focus on poor people. This, unfortunately, indicates a fundamental weakness of this programme, as the implementers are the persons responsible for implementing it at the field level; hence, the government and related institutions must provide further training for the implementers so that they understand the importance of poverty reduction, the initial main aim of PNPM.

4.8. CONCLUSION

Indonesia, like other developing countries, experiences poverty. To alleviate the observed poverty, micro financing programmes are implemented. Overall, the microfinance institutions, both conventional and Islamic, have played an important role in opening up financing access for micro and small enterprises. However, the Islamic microfinance institutions, particularly BMTs, require institutional and operational reform, especially in aspects of governance and internal management of BMTs. In addition to supervision and regulation problems, Islamic microfinance in general also suffers from a lack of capital, low quality of human resources, low awareness of society about the existence of Islamic microfinance institutions, and minimal infrastructure to support the Islamic microfinance performance.

Chapter 5
RESEARCH METHODOLOGY AND FRAMEWORK

5.1. INTRODUCTION

The previous chapters have discussed theories and empirical research available on conventional and Islamic microfinance and their relation to the encouragement of micro and small enterprises in the existing body of knowledge. In operationalising the aims and research questions of this particular research as identified in Chapter 1, this chapter presents the research methodology and framework utilised in this research. To this end, this chapter is divided into seven sections: the introduction; the basic theory of methodology, particularly quantitative and qualitative types; the research design; the research strategy; the research method, which will cover data collection methods, sampling, data analysis, research questions and hypotheses, and the data analysis method; ethical issues; and, finally, the limitations and difficulties faced in conducting the research.

5.2. RESEARCH METHODOLOGY

Any piece of social research needs a particular research methodology framework through which it can be operationalised. Research methodology is defined as "a model, which entails theoretical principles as well as a framework that provides guidelines about how research is done in the context of a particular paradigm" (Sarantakos, 1994: 30). In a more functional sense, Sarantakos (1994: 30) stated that "a methodology translates the principles of a paradigm in research language and shows how the world can be explained, handled, approached or studied". More simply put, research methodology can be described as "how we will go about studying any phenomenon" (Silverman, 2001: 4). Therefore, the methodology should be properly identified and set up in accordance with the nature of the specific research questions as it "cannot be true or false, only more or less useful" for a particular research objective (Silverman, 2001: 4).

In social research, there are two main methodological frameworks: quantitative and qualitative. Bryman (2008) discusses the fundamental difference between quantitative and qualitative methodologies. Quantitative methodology is defined as "a genre which uses a special language…[similar] to the ways in which scientists talk when they investigate the natural order – variables, control and measurement" (Bryman, 1988: 12). He further explains that quantitative research emphasises evaluating, examining and explaining through "quantification in the data collection and analysis of data", which mostly involves deductive-oriented strategies. Therefore, epistemologically, quantitative methodology "views social reality as an external, objective reality" (Bryman, 2008: 22)

Qualitative research methodology, on the other hand, emphasises words rather than quantifiable data (Bryman, 2008); therefore, it is defined as "an approach to the study of the social world which seeks to describe and analyze the culture and behaviour of humans and their groups from the point of view of those being studied" (Bryman, 1988: 46). Thus, qualitative research is motivated by exploration; therefore, epistemologically, it considers social reality as a socially constructed process. It therefore emphasises the human aspect and how people see, perceive and understand social phenomena as they occur in situations. Being socially constructed, qualitative research is subjective by definition.

It should be noted that there is no good or bad methodology, or valid and invalid methodology, as the choice between quantitative and qualitative depends on the research aims and objectives, and what the researcher wants to discover (Silverman, 2001: 25). Considering the research aims, objective and research questions of this study, this research is framed to employ a qualitative research methodology, as it aims to gauge the perceptions of the participants in the field in relation to their experiences in perceiving and understanding a social reality, which is the impact of microfinance on their micro businesses as well as their development. This includes, for example, their perceptions of the impact of micro financing when comparing the reality before and after they received financing services from BMTs and BPRS.

5.3. RESEARCH STRATEGY

The research strategy is concerned with how the researcher relates the theory with the field or data. Social theory identifies two particular research strategies: deductive and inductive (Bryman, 2008: 11).

In the deductive approach, the research process starts from a particular theory and tests it through secondary data in order to obtain findings. Thus, deductive research moves from the general to the specific. Since the motivation in such an approach is explanation, examination and evaluation, deductive strategy is usually related to quantitative methods.

The inductive approach works in the opposite direction in relation to deductive strategy, as it moves from the specific to the general. In other words, inductive strategy begins by observing and understanding the social reality in action in the field by collecting data through observation. The establishing of a general pattern that governs the data may lead to theory-building, which is defined as grounded theory. Due to the nature of the process, the inductive approach is usually associated with qualitative methods.

This research initially employs an inductive strategy because there is no particular established theory in regard to the impact of Islamic microfinance in developing microenterprises that could be tested by the data collected. Secondly, in this study, the research process begins by collecting primary data through field research into people's perceptions of Islamic microfinance and the running of microenterprises. Thus, the cycle commences with data collection with the objective of determining the general pattern in the data set to derive some conclusions. In addition to inductive strategy, this research should also be considered within deductive research strategy framework; as the search findings helps to evaluate and test a particular theoretical framework, namely financial deepening and financial inclusion within financial development theoretic. Thus, inductively established findings later were used to test a particular theoretical framework, resulting in the employment of both the research strategies in this research whereby the strength of the research is enhanced.

5.4. RESEARCH DESIGN

A research design "provides a framework for the collection and analysis of data" (Bryman, 2008: 31), but also helps to frame the research. In essence, it is about how research questions turn into a research project, how to answer the research questions (Saunders, *et al.*, 2009: 136) and how data are collected and analysed. The research design should be properly formulated by adapting the most suitable technique in relation to the research objectives in order to achieve an accurate outcome.

Depending on the research methodology and strategy, there are a number of research designs:

First, *exploratory design* is utilised when there is not much information and knowledge available on a particular subject (Sekaran and Bougie, 2009: 103). Therefore, exploratory design is useful when a researcher wants “to clarify understanding of a problem” or “to ensure the precise nature of the problem” (Saunders *et al.*, 2009: 139). The common tools of data collection for this design include distributing questionnaires, interviewing, or conducting focus groups (Sekaran and Bougie, 2009: 105).

Descriptive design aims to “ascertain and be able to describe the characteristics of the variables” (Sekaran and Bougie, 2009: 105). Therefore, the research outcome will provide an accurate understanding of the characteristics, which then will offer inspiration for further research. In this type of design, quantitative data such as frequencies, means and standard deviations become essential (Sekaran and Bougie, 2009: 107), although qualitative descriptions of the social reality through different methods are often utilised.

Third, *explanatory design* is valuable for verifying causal relationships between variables (Saunders *et al.*, 2009: 140). Therefore, it mostly relates to qualitative research methodology and deductive strategy.

Fourth, *case-study design* “involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidences” (Robson, 2002: 178, as cited in (Saunders *et al.*, 2009: 145). A case-study aims to obtain an in-depth understanding of an object of interest, which could be a certain organisation, location, persons or events (Bryman and Bell, 2007: 62-63). Therefore, case-study refers to a detailed and intensive study in a specific community or organisation in a certain location (Bryman, 2008: 53). It should be noted that a case-study can involve a single case or more than one case, commonly labelled multiple case-study or comparative case-study (Jankowicz, 2000: 210). In a multiple case-study, the researcher compares the cases he/she is exploring (Bryman and Bell, 2007: 64). Country-based research can be considered an example of a case-study.

Fifth, *survey research* directly relates to field research and the framing of the research directly with the data collected from the field. Using questionnaires or structured interviews, conducted on “more than one case” or only at “a single point in time”, data can be quantitative or qualitative, with more than two variables being analysed to identify a “pattern of association” (Bryman, 2008: 46). This is a popular approach and is mostly used to collect quantitative data by using questionnaires for quantitative analysis based on descriptive and inferential statistics. The advantage of this strategy is the possibility it provides of generating findings (Saunders *et al.*, 2009: 144). It should be noted that the survey design is also constructed through interview analysis, leading to qualitative and exploratory research.

This research is framed as a combination of exploratory, descriptive, survey and multiple case-study approaches. It is ‘exploratory’, since it aims to explore a particular topic through particular subjects. It is a ‘case-study’, as it aims to locate the research questions in a particular country, Indonesia, and in a particular geographical part of Indonesia, namely East Java. Furthermore, it is a multiple case-study, as it explores the research questions in the context of two types of institution, namely BMTs and BPRS, which are different in nature. Moreover, this study is also a survey-based design, as it explores issues affecting a large group of people, namely microenterprises who have borrowed money from BMTs and BPRS, by distributing questionnaires and interviewing the officials of BMTs and BPRS.

5.5. RESEARCH METHOD

A research method is defined as “a technique for collecting data” and analysing data (Bryman, 2008: 31). Sarantakos (1994: 30) states that a method “refers to the tools or instruments employed by researchers to gather empirical evidence”. In a more comprehensive manner, Jankowicz (2000: 209) defines a research method as “a systematic and orderly approach taken towards the collection and analysis of data so that information can be obtained from those data". Thus, in simple terms, it is a specific tool or technique used to collect and analyse data.

Similar to methodology, methods cannot be true or false, but more or less useful "depending on their fit with the theories and methodologies being used and the hypothesis being tested and/or the research topic that is selected" (Silverman, 2001: 12).

5.5.1. Research Method: Data Collection

There are two main methods or approaches to collecting data: quantitative and qualitative. The quantitative method mostly relates to data collection through questionnaires, which use numerical data, while the qualitative approach refers to data collection that use non-numerical data, such as interviewing (Saunders *et al.*, 2009: 151). The qualitative method often combines observation, analysis of text and documents, interviews, recording and transcribing (Silverman, 2001: 11). Each method has its own strengths and weaknesses which must be considered as they will affect the research findings. Distributing questionnaires personally helps to build connections with respondents, and quick results can be obtained. However, it can be expensive when respondents are distributed across a large region (Sekaran and Bougie, 2009: 217). On the other hand, interviews can supply rich data while building close connections with respondents; if there is any doubt about the meaning of a question, it can be directly explained, thus enhancing the understanding of multifaceted issues. However, conducting face-to-face interviews with large numbers of respondents might lead to bias and would be expensive (Sekaran and Bougie, 2009: 217).

In order to decide which data collection method to use, the researcher should mainly consider the research methodology framework that is being employed (Sarantakos, 1994: 152) and the method's appropriateness to the research questions established at the beginning of the research (Bryman, 2008: 624)

Nowadays, due to the complexity of social phenomena, it is common to combine both approaches, resulting in 'triangulation'. Triangulation is a mixed method using two or more data collection and analysis methods to support the research outcome (Saunders *et* *al.*, 2009: 154). Similarly, Tashakkori and Teddlie (2009: 285) underline the word 'integration' and define it as "research in which the investigator collects and analyzes data, integrates the findings and draws inferences using both qualitative approaches or methods in a single study". Thus, the research might be categorised as mixed-method if it satisfies one or more conditions as follows: two types of research questions, two types of data collection, two types of data analysis (Tashakkori and Teddlie, 2009: 286). Generally, the goal of using this mixed-method approach is to achieve complementarity, completeness, development, expansion, confirmation, compensation and diversity.

Triangulation offers certain advantages: it provides more validity to the conclusion when the outcome provides mutual confirmation; it usually (but not always) offers generally consistent data; it tends to provide mutually reinforcing results (Bryman, 1988: 131-133). Also, the quality of data collected using this method might be more credible since the weakness inherent in using a single method might be reduced, although it requires more time and financial effort (Sekaran and Bougie, 2009: 216-217). However, it should be noted that this method is not fundamentally of better quality compared to using a mono-method approach (Bryman, 2008: 624). Hence, Bryman (2008: 264) suggests some important points to be considered when using this mixed-method approach: it must be competently designed and conducted; it must be appropriate to the research question; it must consider the need to spread limited research resources.

Due to the nature of the research questions in this research, triangulation is adopted, as they require both quantitative and qualitative data and knowing. In doing so, this research particularly applies inter-method triangulation in the sense of using a quantitative method through questionnaires and a qualitative method through semi-structured interviews. The use of triangulation is rationalised on the basis of the variability of the research questions, which requires the triangulation method to be applied in order to obtain the most reliable and valid results.

5.5.5.1. Quantitative data collection method: Questionnaires

In a survey study, the most common data collection method is the questionnaire (Saunders, *et al.*, 2007: 355), which has become a common and often-used data collection method. To capture the main primary data required to answer the research questions and considering the advantage they offer in terms of efficiency in time, energy and cost (Sekaran and Bougie, 2009: 185), questionnaires are considered an efficient method.

Sekaran and Bougie (2009: 197) define a questionnaire as "a preformulated written set of questions to which respondents record their answers, usually within rather closely defined alternatives". They can be personally administered or self-administered; postal or online questionnaires have also become popular.

For this research, the questionnaire is considered an efficient method of reaching out to microenterprises that have borrowed money from BMTs and BPRS, as their population size is quite large. In addition, considering the detailed nature of the questions posed, the questionnaire is considered more appropriate.

(i) Questionnaire design

The questions in the questionnaire were designed as a mixture of closed-ended and open-ended questions. In addition, four types of scales were used for close-ended questions: the dichotomous scale; category scale; Likert scale; and ratio scale (see Appendix A). The dichotomous scale is used for questions with Yes or No answers (Sekaran and Bougie, 2009: 149), *e.g*. question number 1 on whether or not the respondent borrowed money from BMT or BPRS, *etc*.

Category scale is applied for multiple items to obtain a single response (Sekaran and Bougie, 2009: 149), such as question number 3 about other sources of income, or number 4 about marital status, *etc.*

The Likert scale is used to capture the strength of the respondent's agreement with a statement (Sekaran and Bougie, 2009: 152). This study applied a variety of Likert scales due to the varying nature of the questions; this scale was applied for the following:

(i) Question number 18 about business problems: never, rarely, sometimes, often, and always;

(ii) Question number 25 about the level of agreement in relation to factors in the decision to borrow money from BMTs or BPRS: strongly disagree, disagree, neutral, agree, and strongly agree;

(iii) Question number 30 about the level of understanding of terms used in Islamic finance: poor, fair, good, very good, and excellent;

(iv) Question number 42 about the impact of the financing on assets, number 45 about the impact on business expenditures per month, and number 46 about the impact on household expenditures: major negative effect, minor negative effect, no effect, minor positive effect, and major positive effect;

(v) Question number 43 about the effect of the loan on economic activities, and number 50 about the social impact: negative effect, no effect, minor positive effect, moderate positive effect, and major positive effect.

The ratio scale is used for questions that can be answered in terms of number (Sekaran and Bougie, 2009: 145), such as question number 6 about age, number 17 about the value of assets, number 41 about sales/month, *etc.* Hence, the respondents' precise numerical answers are more accurate and are likely to provide more flexibility when grouping the data analysis.

The open questions are provided to capture other answers that are not covered in the provided options (*e.g.* question number 3 about other sources of income), or to specify the answers (*e.g.* question number 32 about the original intention of the loan - if it is for consumption the respondents are required to specify what type of consumption), or when the options are not provided (*e.g.* question number 20 to specify the name of the institution from which the respondent obtained financing).

As for the structure of the questionnaire, it is designed in four sections with 50 questions in total, including closed-ended questions and short-answer, open-ended questions especially when values are required as answers.

Section A of the questionnaire captures the information regarding the microenterprises' profiles, comprising 18 questions. The first question is a screening question asking whether the respondent borrowed money from BMT or BPRS for productive purposes in the enterprise. Other questions cover demographic information, followed by more specific information about the household size, area of business, age of business, business field, business location, assets, and problems experienced in running the business, ranging from never to always. The questions are adopted and modified from Hulme *et al.* (1996), Ahmed (2002), Ascarya and Sanrego (2007) and Adnan *et al.* (2003).

Section B covers the twenty-two questions specific to financing aspects, which include access to financing, factors in decision-making when choosing BMT or BPRS, times and duration of the financing, level of understanding of Islamic terms used in Islamic finance, the purpose of the loan, collateral, instalments, arrears *etc*. These questions are adopted and modified based on the previous research by Hulme *et al.* (1996) and Ascarya and Sanrego (2007).

Section C aims to capture the required information about the economic impact of borrowing, by comparing the situations before financing and after financing. It therefore includes average monthly sales and net income, impact on assets, impact on economic activities, impact on monthly business and household expenditures, and impact on employment. There are eight questions in this section which are adopted and modified from Ahmed (2002), Hulme *et al.* (1996), Rahman (2010), Ascarya and Sanrego (2007) and Karlan and Goldberg (2007)

Section D is specifically about the social impact of borrowing, including social services obtained from BMT and BPRS, social impact (relationships with spouse/family members and other group members), religious impact (knowledge and practical) and other impacts (children's education, nutrition, housing stock, family empowerment and women's decision-making). The questions in this section were adopted and modified from Ahmed (2002) and Karlan and Goldberg (2007).

The questionnaire is presented in the Appendix A.

(ii) Administration of the questionnaires

The questionnaires were personally administered to MEs who are customers of BMTs and BPRS in East Java, Indonesia. This method of administering was employed because the characteristics of the respondents as well as the character of the questions posed are very specific and detailed, such as personal financial information of the respondents (Saunders *et al.*, 2007: 357). Hence, this approach is considered helpful for building connections with the respondents, for providing clarification when there is difficulty in answering the questions, and to ensure that the questionnaires are completed; they can then be collected immediately (Sekaran and Bougie, 2009: 217). It should also be noted that personally administering the questionnaire proved to be expensive due to the large numbers of respondents being located in many cities/towns in East Java, Indonesia.

(iii) Pre-tests

Pre-tests of the questionnaire were conducted in a number of stages. The first stage was conducted through distribution of written questionnaires to some PhD students who were undertaking research into Islamic microfinance. Based on the suggestions collected during the first pre-test, the questionnaire was developed for the second pre-test. The second stage was conducted using online questionnaires to obtain more responses from students and non-students, both in Durham and in Indonesia. The third pre-test was distributed to actual participants in Indonesia to obtain responses from microenterprises, the targeted respondents. This provided an opportunity to develop the questionnaire and also gave initial validity to the process.

5.5.1.2. Qualitative data collection method: Semi-structured interviews

The literature generally indicates that there are two types of interview: unstructured interview and structured interview (Sekaran and Bougie, 2009). Unstructured interviews aim to capture broad preliminary issues that emerge; hence, no specific questions are set in advance beyond the issues to be discussed (Sekaran and Bougie, 2009: 186). On the other hand, when the researcher knows what information is required and accordingly prepares predetermined questions, it becomes a structured interview (Sekaran and Bougie, 2009: 188). It should be noted that researchers often implement a method in between unstructured and structured interviews, namely the semi-structured interview, in which "the content and sequence aren't fully specified in advance" (Jankowicz, 2000: 237). The advantage of semi-structured interviews is the flexibility of the order of the questions, which helps to direct all the questions to the interviewees, allowing opportunities to raise new questions from the answers provided by the interviewees, with the objective of exploring further (Jankowicz, 2000: 243). This is commonly used in case-study and survey designs; it is also suitable for researchers who are not sure what kind of responses they may receive from the interviewees (Jankowicz, 2000: 246).

Interviews can be used to substantiate the data gathered through questionnaires, but they can also be used as a single method of data collection. In this research, in order to expand the available data for analysis, face-to-face semi-structured interviews are used to gather qualitative data from Directors/Managers of BMTs and BPRS with the objective of validating the data from the questionnaires and also directly engaging with another set of interviewees in relation to their perception of the running of their organisations (see Appendix B). Face-to-face one-to-one interviews were chosen to explore and understand the issues, although this method may be expensive when it involves many interviewees spread over a large area (Sekaran and Bougie, 2009: 217). It should be noted that the interviewees and the respondents of the questionnaires in this study are from the same institutions.

Interview questions' design and process

The interview questions used in this study are designed as a mixture of open-ended and closed-ended questions (see: Appendix B). While the open-ended questions offer flexibility to the interviewees in responding, the closed-ended questions are those which the interviewees will probably be able to answer easily and quickly, although there is always an opportunity to provide comments. Among others, the main questions in the interview schedule used in this study relate to the research questions, including the potential and prospect of BMTs, BPRS and MEs, and the role of BMTs and BPRS in developing MEs, all of which use open-ended questions, and the financing and non-financing services provided to MEs, which use a mixture of open-ended and closed-ended questions, such as question number 13 on the collection of repayment, *etc.* The detailed interview questions are presented in the Appendix B.

In regard to the interview process during the field research between mid-August and mid-November 2011, the interviews with 22 Directors/Managers of BMTs and BPRS took place in the 12 BMTs' and 10 BPRS' offices in various cities/towns in East Java; each interview lasted between 1.5 hours and 2 hours. The interviewees sometimes suggested that the researcher meet the BMTs' and BPRS' staff members, who could provide more detailed information, such as marketing staff, administration staff, *etc*.

5.5.2. Sampling

Due to the large size of the population in this research, it is important to select a subset of the population to be included in the research, which is known as sampling. Sampling is defined as "the process of selecting the right individuals, objects or events as representatives for the entire population" (Sekaran and Bougie, 2009: 264). A proper sampling procedure should be adopted in order to obtain a sample representing the population. It is true and inevitable that certain persons will be included in the sample as a result of the researcher's personal judgement, the prospective availability of respondents, and the researcher's criteria (Bryman, 2008: 169).

5.5.2.1. Research population

The target population in this research can be divided into two groups. The first is microenterprises, the borrowers of Islamic MFIs, who must have received financing for productive purposes in order to improve their businesses. For this, the relevant regulation that defines microenterprise should be consulted, as this determines the population of this study. Based on the Government Act No. 20/2008, a 'microenterprise is a business with productive assets, excluding land and buildings, of less than IDR 50million and annual sales of less than IDR 300 million'. For Islamic microenterprises, the type of financing used can be any type offered by Islamic MFIs: *musharakah, mudharabah, murabahah, salam, istisna* or *qard hasan*.

The second group, as regards the interview schedule population, is the bankers or officials of Islamic MFIs, which might include BMT (including Islamic cooperatives), BPRS, PNM *Shari'ah*, Pawnshop *Shari'ah*, and venture capital *Shari'ah*. A semi-structured interview schedule is employed to obtain in-depth information from these respondents.

The following sections provide details of the sampling issues for this study:

5.5.2.2. Sample frame

The sampling frame is "a physical representation of all elements in the population from which the sample is drawn" (Sekaran and Bougie, 2009: 267). Ideally, the samples for this research should be microenterprises that are borrowers of Islamic MFIs and officials from all Islamic MFIs. However, it was impossible to reach all of them since there were limitations in terms of data, time and funding availability. Thus, the sample frame was set based on statistical data provided by Bank Indonesia, the Statistical Bureau and samples of Islamic MFIs. However, the complete list of BPRS in Indonesia and East Java could not be accessed from Bank Indonesia, in which the official data only show the total number of BPRS in each province. Based on the information from Bank Indonesia (East Java branch), there were 30 BPRS in East Java in 2011. The exact number of BMTs in East Java is unknown, and there are no valid and comprehensive data that can be accessed due to there being different associations of BMTs. Some BMT associations (PINBUK, Puskopsyah, Inkopsyah, Absindo, Al-Kamil, *etc*) do not have recent valid comprehensive data; they only have lists of members. For example, PINBUK estimates that, in general, there were around 200 BMTs in East Java in 2011, which is the region covered by this study. For example, the Bank Indonesia dataset (2011) gathered through a survey includes 120 active BMTs in East Java. A sampling strategy to deal with the regional population for this study is explained below.

Data on the number of customers and borrowers of samples of BPRS and BMTs are collected through the interviews with the Directors/Managers. Samples used in the fieldwork were a shortlist of borrowers provided by BPRS and BMTs, which also included some walk-in borrowers who were present at the offices of BMTs and BPRS to pay their instalments. Such individuals were also considered for this study with the objective of increasing the sample size.

5.5.2.3. Sampling method

Defining the most appropriate sampling method is the next important process in selecting the samples. The relevant literature indicates that there are two broad categories of sampling method: probability sampling and non-probability sampling (Sekaran and Bougie, 2009:267).

Probability sampling means that all members of the population have the same probability of being selected as a sample (Sekaran and Bougie, 2009: 268); this type is used when "the representativeness of the sample is importance in the interest of wider generalizability" (Sekaran and Bougie, 2009: 268). Non-probability sampling, on the other hand, does not give the entire population a predetermined chance of being selected as subjects, which means that the findings of the research cannot be generalised vigorously (Sekaran and Bougie, 2009: 276). This method is suitable for researchers with limited schedules, resources and finance.

There are two categories of non-probability sampling: convenience sampling and purposive sampling (Sekaran and Bougie, 2009: 268). Convenience sampling refers to "the collection of information from members of the population who are conveniently available to provide it" (Sekaran and Bougie, 2009: 276). Although this is the least reliable method compared to other sampling methods, it is suitable for exploratory research (Sekaran and Bougie, 2009: 278). Purposive sampling, on the other hand, is an approach where "the researcher purposely chooses subjects who, in their opinion, are thought to be relevant to the research topic" (Sarantakos, 1994: 138). In this approach, subjects are a specific group of people who have the required information.

Purposive sampling was employed as the interview method for interviewing the Directors/Managers of BMTs and BPRS. There is no exact number of samples required for qualitative research: it mostly involves continuing the sampling process until no new insights are obtained; thus, it depends on the "heterogeneity of the population" (Sekaran and Bougie, 2009: 298). In other words, based on the information requirements, in this case the impact of Islamic micro financing on developing microenterprises that are specifically owned by *Islamic* microfinance borrowers, non-probability sampling is employed. Due to the limitations described above, this research employs both convenience and purposive sampling as part of non-probability sampling. Purposive sampling is applied in selecting the Islamic MFIs; in this case the selected institutions are BMTs and BPRS. These two types are selected since they fulfil these criteria: (i) they are well-established institutions serving microenterprises, and will thus provide sufficient evidence to measure the impacts of Islamic micro financing; (ii) they represent different natures and characteristics - while BMTs are cooperative in nature, less regulated and member-based, BPRS are banks, well-regulated and monitored by Bank Indonesia.

In quantitative data collection, the questionnaire method, hence convenience sampling, is then applied to select the borrowers of selected BMTs and BPRS. The selected respondents are either walk-in borrowers, who come to the offices to repay their loans, or those drawn from the list of borrowers provided by BMTs and BPRS, who repay their loans via the institutions' collection services.

In relation to geographical delamination and sampling, it should be stated that the large population size and limited resources implied that it was impossible to undertake nationwide sampling. Therefore, this research purposively limits the sample scale to certain cities in East Java province, such as Malang regency, Malang city, Batu, Surabaya, Pasuruan, Pandaan, Bangil, Lumajang, Tulungagung, Probolinggo, Jombang, and Gresik. The reasons for choosing East Java as a case-study are as follows:

(i) East Java is the second most populous province in Indonesia (Biro Pusat Statistik, 2012: 78);

(ii) Based on Inkopsyah (Centre of *Shari'ah* Cooperative and BMT), there are 32 BMTs in East Java, which makes it the third largest in Indonesia in terms of the number of BMTs; the largest is West Java with 92 institutions, followed by Central Java with 75 institutions (Inkopsyah, 2012);

(iii) Based on Bank Indonesia's data (2011), there were 30 BPRS in East Java in 2011, which made it the second largest in Indonesia in terms of the number of BPRS (Bank Indonesia, 2011: 3);

(iv) The number of microenterprises in Indonesia was 50,697,659 (in 2008), around 23% of which are in East Java. Thus, it is considered the largest compared to other areas/provinces in terms of the number of microenterprises (Ministry of Cooperative and Micro Small Medium Enterprises, 2009: 24);

(v) The number of people working in microenterprises in Indonesia was 83,647,771 in 2009, and 20% of them are in East Java, which is the second largest in Indonesia in terms of microenterprise workforce (Ministry of Cooperative and Micro Small Medium Enterprises, 2009: 24);

(vi) The total number of borrowers in East Java is unknown;

(vii) In East Java, among other cities Malang and Surabaya have the highest level of potency in terms of *Shari'ah* banking development (Ascarya, 2007).

In addition to the above-mentioned reasons, there is a very limited amount of research on BMTs in East Java, as such available studies are mostly concentrated on Central Java and West Java. In addition, the research on BPRS in Indonesia is even more limited, while no comparative studies of BMTs and BPRS have yet been conducted.

5.5.2.4. Sample size

Determining a proper sample size is necessary in order to obtain a reliable and valid sample that is representative for data analysis. A sufficient sample size should fulfil two requirements: precision and confidence (Sekaran and Bougie, 2009: 288). Precision refers to "how close our estimate is to the true population characteristics" (Sekaran and Bougie, 2009: 287), while confidence indicates that the certainty level of researcher's estimation "…will really hold true for the population" (Sekaran and Bougie, 2009: 288). The larger the sample size, the greater the precision and confidence. However, a large sample will increase the cost of data collection.

Bryman (2008: 179) argues that there is no fixed size or number required for a sample, since it depends on a number of factors including time limitation, funding availability and the need for precision. He summarises that a large sample size is likely to provide more precision and fewer sampling errors. As a straightforward guidance, a comprehensive table on the sample size of a given population is prepared by Krejie and Morgan (1970, cited by (Sekaran and Bougie, 2009: 295-296). Based on the information presented in the table, for a population of one million or more, a sample size of 384 is required (Sekaran and Bougie, 2009: 296). On the other hand, Roscoe (1975, cited by (Sekaran and Bougie, 2009: 296) suggests that, for most research, the proper sample size is between 30 and 500. Thus, due to cost, time and other resource limitations, this research used the above guidance stated in Sekaran and Bougie (2009) to determine the sample size.

Regarding the sampling size for the interviews, the number of officials from institutions targeted for interview was 20 institutions, consisting of 10 BMTs and 10 BPRS. For the questionnaire, a target of 300 borrowers from both BMTs and BPRS were considered sufficient.

It should be noted that the final sample of BPRS and BMTs were based on the following criteria:

(i) A total of 10 BPRS were selected from 30 BPRS in East Java based on their willingness to be involved in the study as respondents;

(ii) A total of 12 BMTs were selected based on their willingness to be involved in the study and their financing products, which support the development of MEs.

As indicated in Table 5.1, 348 questionnaires were completed by 12 BMTs and 10 BPRS .(see: Table 6.8).

5.5.2.5. Data collection process

The field research took about three months from mid-August to mid-November 2011. As for the interviews, in the sample there are two groups of respondents: the officers of MFIs and the borrowers who use the funds to develop their microenterprises. The list of interview questions was sent to the institutions providing funds for productive purposes; then, when the respondents were ready, the interviews were conducted in their offices. For the data collection process using questionnaires, three part-time enumerators were employed to help respondents answer the questions. The respondents were selected from among the borrowers who had been using the funds for productive purposes for more than 6 months. Some respondents were approached as ‘walk-in’ customers, but most of them were approached at their businesses premises in traditional markets or at home; their contact details were obtained with the assistance of the Account Officers of BMTs and BPRS who normally visit the borrowers to collect the repayments.

Overall, it should be noted that the response rate from both types of respondents is considered to be sufficient. Initially, 13 BPRS were approached by sending interview questions by post, followed by direct contact via phone calls for confirmation. As a result, 10 of them were able to participate in the survey, which means the response rate in relation to the target reached 77%, although it took quite a long time to secure their consent. The response rate from BMTs was higher than that of BPRS, since only 1 of the 13 contacted BMTs could not participate, which resulted in a 92% response rate in relation to the target. Thus, in total the institutional response rate was 84.61%. BMT officers probably provided better responses and were more willing to be involved in the research and survey due to their nature as community-based organisations which served the members of the local community, while BPRS were more concerned about confidentiality issues. Table 5.1., thus, summarises the general characteristics of the sampled institutions based on the initial descriptive results.

Table 5.1a: General Characteristics of Respondents (Institutions)

No	Description	BPRS	BMT
1.	Number of institutions	10 institutions	12 institutions
2	Legal type	PT (Perseroan Terbatas/ Limited Corporation (Bank)	Cooperative
3	Association	Asbisindo	Absindo, Pinbuk, Dekopin, Puskopsyah, Puskopsyah Al-Kamil,
4	Number of branches	1-2 branches	Varied (1-2 branches, MMU has 44 branches and UGT has 138 branches)
5	Financing approach	Personal, group	Personal, group

Table 5.1b: General Characteristics of Respondents (Institutions)

No	Description	BPRS	BMT
6	Most popular financing	Murabahah	Murabahah
7	Average financing duration	18 months	16 months
8	Time for financing evaluation	3 days	3,5 days
9	Collection of repayment	Monthly	Montly, Weekly, daily
10	Collateral	Required	Required
11	Number of borrowers	Varied : 250 – 2600	Varied : 100-1000, MMU and UGT has more than 25,000 borrowers.
12	Maximum financing	Varied: IDR 50.000.000,- to IDR 200.000.000,-	Varied : max IDR 50.000.000,-
13	Minimum financing	Varied: IDR 500.000,- to IDR 3.000.000,-	Varied : IDR 100.000,- to IDR 500.000,-
14	Average financing	Varied: IDR 1.500.000,- to IDR 50.000.000,-	Varied: IDR 500.000,- to IDR30.000.000,-
15	Margin per year	Varied : 18% - 24% per year	Varied: 12%-20% per year
16	Number of staff	Varied: 14 to 80, average 24 staff.	Varied: 3-20 staff, MMU has 285 staff and UGT has 670 staff

The response rate from borrowers was also satisfying. Almost all the respondents approached were willing to answer the questionnaires. This is because they have direct and close relationships with the Account Officers; thus, when the enumerators approached them through the Account Officers, all of them were willing to participate. Table 5.2 depicts the general characteristics of the questionnaire respondents, namely the borrowers, based on the initial descriptive findings.

Table 5.2a: General Characteristics of Respondents (Borrowers)

No	Description	
1.	Microenterprises (productive assets other than land and building less than IDR 50.000.000,-)	81% respondents are microenterprises
2	Marital status	Married (91%)
3	Gender	Male (54%)
4	Age	Average : 42.41 years
5	Education	Mostly having less than Senior High School education (87%)
6	Religion education	Formal education (23%), Informal education (20%), Nothing (56.6%)
7	Business area	Urban (66%), Rural (34%)
8	Age of business	In average 13 years business age.

Table 5.2b: General Characteristics of Respondents (Borrowers)

No	Description	
9	Financing sources	BMT: % , BPRS: %
10	Number of financing	Average : 3.66 times
11	Original purposes	Working capital (93%)
12	Financing used	Working capital only (68.4%), Consumption and working capital (23.6%)
13	Repayment	Monthly (84.2%)
14	Decision maker in using the fund	Self (77.3%)
15	Arrear	No arrear (79.5%)
16	Sales before	IDR 8.500.000,-/per month
17	Sales after	IDR 10.000.000,- / per month
18	Income before	IDR 1.500.000,- / per month
19	Income after	IDR 2.250.000,- / per month

5.5.2.6. Reliability and Validity

In social research, to ensure the quality of the research three issues are raised: reliability, replication and validity (Bryman, 2008: 31-35). This implies that good research should be repeatable and consistent, meaning that when it is conducted in other areas or on other occasions, the measurements should still be reliable and repeatable to produce good outcomes. Replication refers to the capacity of the measurements or procedures to be replicated by other researchers (Bryman, 2008: 32).

In technical terms, reliability refers to "consistency of measures" (Bryman, 2008: 149), which can be measured using 'Cronbach's alpha'; this measurement is also valuable for ensuring internal consistency of the data (Bryman, 2008: 161). Moreover, the reliability of a scale indicates the extent to which it is free from random errors, for which indicators are used to test-retest reliability and internal consistency (Pallant, 2007: 6). First, test-retest reliability administers the survey to the same people at two different times and calculates the correlation between the two scores obtained. Accordingly, the higher the test-retest correlation, the higher the reliability. Since the survey measures enterprises' profiles which are quite stable, the test-retest will have a high correlation. The impact aspect will also be expected to be stable. Second, internal consistency is "the degree to which the items that make up the scale are all measuring the same underlying attribute", in other words, the extent to which the items "hang together". Similar to Bryman's suggestion, the internal consistency measured by Cronbach's coefficient alpha should be above 0.7 (Pallant, 2007: 95).

In order to measure the reliability of the data in this study, the Cronbach's alpha was measured and found to be 0.925 for all items in the questionnaires; thus, it is considered reliable as it was above 0.7. In particular regard to interview data, reliability was ensured by audio-taping the interviews and taking notes, which were utilised as a source of data for transcription and interview analysis using coding.

Validity relates to the 'integrity' of the research outcome (Bryman, 2008: 32; Bryman and Bell, 2007: 42). In other words, as Pallant (2007: 7) argues, validity refers to "the degree to which it measures what it is supposed to measure". Bryman (2008) discusses four aspects of validity: measurement validity, internal validity, external validity and ecological validity. In quantitative methods, measurement validity mostly relates to reliability of measurement (Bryman and Bell, 2007: 41).

Internal validity means that the conclusion derived has a 'causal relationship' between two or more variables (Bryman, 2008: 32). External validity is concerned "with the question of whether the results of the study can be generalized beyond the specific research context" (Bryman and Bell, 2007: 42). Ecological validity is about ensuring that the environment is neutral, as when respondents respond to questionnaires, the environment should enable them to react naturally without any inference.

Pallant (2007: 7) states that the validation of a scale involves the collection of evidence concerning its use, which technically includes: (i) content validity, which refers to "the adequacy with which a measure of scale has sampled from the intended universe or domain of content"; (ii) criterion validity, which is defined as "the relationship between scale scores and some specified measurable criterion"; (iii) construct validity, which is related to "testing a scale not against a single criterion but in terms of theoretically derived hypotheses concerning the nature of the underlying variables or construct" (Pallant, 2007: 7). It is measured by investigating its relationship with other constructs.

To ensure the validity of this study, the researcher relied on the empirical evidence developed in previous research and carefully chose the wording applied in the questions. It should be noted that no straightforward, simple calculation method is provided in the statistical software. Therefore, an attempt to ensure the measurement and content validity has been conducted by adopting variables and scales from previous related studies (see section 5.5.1.1, Chapters 3 and 4). The pre-tests, both in English and Bahasa Indonesia, were also beneficial in providing feedback on whether the wording applied in the questions was clear and not misleading; thus, based on the feedback, corrections were made. In addition, the part-time enumerators employed to distribute the questionnaires to MEs were trained in order to ensure that they fully understood the questions and the specific information being sought.

5.5.3. Research Method: Data Analysis Methods

Data analysis is the next important step after all the data have been collected. This process must be conducted carefully in order to obtain accurate outcomes. This research analyses quantitative data from questionnaires and qualitative data from interviews; hence, the corresponding data analysis methods should be identified.

5.5.4.1. Questionnaire data analysis

There is a particular process for analysing quantitative data from questionnaires. Sekaran and Bougie (2009) suggest the following steps as part of such a process: preparing data for analysis; getting a feel of the data; testing the goodness of the data; and hypothesis-testing.

First, before analysis, data must be coded and keyed into a database. In relation to this research, SPSS v.19 software was utilised in keying and analysing the data. Then, the data must be edited to deal with any problems such as blank responses and outlier responses. This process must be done appropriately to ensure that all the data are correct.

Second, getting a feel of the data can be carried out by checking the central tendency and dispersion of the variables to obtain brief information on the survey outcome (Sekaran and Bougie, 2009: 311). To this end, the researcher adopted a number of statistical methods such as frequency distribution, charts, mean (average), median (central item in a group), mode, standard deviation and cross-tabulation.

Third, testing the goodness or quality of the data refers to checking the validity and reliability, as discussed in section 5.5.2.6.

Finally, after conducting the above three processes, analysis can be conducted by testing the proposed hypotheses using the appropriate statistical testing. The purpose of hypotheses-testing is "to determine accurately if the null hypotheses can be rejected in favour of the alternate hypotheses … with a certain degree of confidence" (Sekaran and Bougie, 2009: 336). It should be noted that implicit and specific written hypotheses were not set up in this research, as the research questions guide the analysis.

Before the empirical statistical test is conducted, descriptive analysis is prepared to explore the data with the objective of describing the characteristics of the samples (Pallant, 2007: 53). This analysis is the process of summarising data into forms which are easier to be understood, as the basis for further inferential analysis (Tashakkori and Teddlie, 2009: 302). Descriptive analysis is useful for depicting data characteristics and checking whether there is any violation of assumptions (Pallant, 2007: 53). Pallant (2007) considers descriptive analysis as a preliminary analysis before further statistical tests are carried out; it provides important information including skewness of data distribution, frequency, percentage distribution, mean and median. Similarly, Saunders *et al.* (2007: 434) emphasise that descriptive statistics focus on the central tendency of the data and how the data have been spread, which could be presented in tables, charts or graphs. Thus, in this research, all variables have been tested using descriptive analysis in order to gain a general understanding of responses from the participants. The findings of the descriptive analysis are presented in Chapter 6.

In addition to descriptive analysis, various empirical analyses could be adopted depending on the type of data, and whether it is parametric or non-parametric, as each type has assumptions that must be fulfilled (Pallant, 2007). A parametric test is appropriate when the data have normal distribution, meaning they do not have positive or negative skewness (Pallant, 2007: 86). When the required assumptions are not met, a non-parametric test should be applied. In addition, non-parametric tests are often more suitable for surveys that have small samples and use ordinal scales. Therefore, it can be assumed that a non-parametric test is less stringent than a parametric test. However, this does not mean that the non-parametric tests are less powerful than parametric tests (Field, 2005: 521). This research adopts non-parametric testing due to the nature of the study, which is considered an exploration. In addition, it was established that data distribution is not normal mainly due to the fact that they were collected in a non-random sampling manner.

As part of the inference test, two types of statistical tests were applied in this research: testing or comparing the difference between groups (including Chi Square, Mann-Whitney-U Test, Kruskal Wallis and Wilcoxon-Signed Rank Test); and finding relationships between variables, such as Factor Analysis.

It should be noted that all the statistical tests are conducted using SPSS version 19 and all the findings of the inferential statistical analyses are presented in Chapter 7. The following particular inferential tests are utilised in this research:

Chi Square: The Chi Square test for independence is utilised to explore the relationship or association between two categorical variables which might contain two or more categories; it is based on a cross-tabulation table (Pallant, 2007: 214). The additional assumption imposed is that the minimum frequency in any cell in the table should be 5 or more; thus, in analysis where this assumption is violated, the researcher should consider using the Fisher Exact Test (Pallant, 2007: 215). To find the strength of the association between two variables, the common calculation of effect size in this test is the phi coefficient which ranges from 0 to 1, meaning that a higher value indicates a stronger association between two variables (Pallant, 2007: 217). Cohen's criteria, set up to determine the strength, are 0.10 for small effect, .30 for medium effect and .50 for large effect (Pallant, 2007: 217).

Mann Whitney U-test: This non-parametric test is utilised to test significant differences between two variables which have two groups. When the significant difference is found, the mean rank is used to describe the direction of the difference, which group has the higher direction (Pallant, 2007: 222). The effect size for this test is measured by dividing *z* value with square root number of cases (N) (Pallant, 2007: 223).

Kruskal-Wallis Test: Similar to the Mann-Whitney *U*-Test, this non-parametric test is also applied to test relationships (significant difference) between groups. However, this test can be applied when some continuous variables have more than two groups (Pallant, 2007: 226).

Wilcoxon Signed Rank Test: This non-parametric test is designed for repeated measures when the respondents provide information on two occasions. "Wilcoxon converts scores to ranks and compares them at the Time 1 and Time 2" (Pallant, 2007: 223). In this research, the respondents are required to provide information on the value of sales, income, expenditures, employment and assets before financing and after financing; thus this test is applied to discover whether there is an improvement after financing.

Factor Analysis: This analysis is conducted to test the relationship between variables by reducing a large amount of data into smaller sets of factors to make them more manageable (Pallant, 2007: 179) but also to create a new distribution according to the revealed preferences. Of the two main approaches, namely exploratory and confirmatory, this research employs the exploratory approach since it is exploratory in nature and there is no specific hypothesis to be confirmed. The principal component analysis (PCA) is applied in the factor analysis by assessing the suitability of data for analysis. The data in this research are considered suitable for factor analysis, since the sample size is greater than the minimum requirement of 300 cases (Pallant, 2007: 180). In addition, SPSS provides assessment to measure factorability of data based on Bartlett's test of sphericity (which should be significant at $p< .05$) and to measure sampling adequacy based on Kaiser-Meyer-Olkin (KMO) with the minimum value of 0.6 (Pallant, 2007: 180)

The next step is factor extraction to "determine the smallest number of factors that can be used to best represent the interrelations among the set of variables" by using the Kaiser criterion (in which only factors with eigenvalues of 1.0 or more are retained for further analysis), scree test and parallel analysis, followed by factor rotation and interpretation (Pallant, 2007: 181-182).

Spearman Rank Order Correlation: This bivariate non-parametric correlation test was applied to assess the relationship between dependent variable and independent variable in non-parametric. The findings of this test is the strength of relationship in the form of correlation coefficient which range between -1 and +1; in which +1 indicates a perfect positive relationship while -1 indicates perfect negative relationship (Field, 2009: 173)

Binary Logistic Regression: This technique is used to measure the predictor variables to predict the occurrence of economic and social-religious impact. In this study, the dependent variable used is dichotomous while the predictor variables are categorical and continuous variables (Field, 2009: 265). The important outcome of this test are beta coefficient, unique significant of each predictor in the model and odd ratio of Exp(B) (Field, 2009: 290).

5.5.4.2. Qualitative (interview) data analysis

Qualitative data, which are available in the form of words, usually constitute a large amount of data. There are three main steps in analysing interview data: data reduction, data display and drawing conclusions (Sekaran and Bougie, 2009: 370). In the data reduction process, data are selected, coded and categorised, particularly using coding which aims to extract important information from the data (Sekaran and Bougie, 2009: 372). Then, the data are displayed in a well-organised form, after which conclusions can be drawn (Sekaran and Bougie, 2009: 382).

As a large amount of data was gathered during the interviews, after data transcription of audio-recorded interviews this research applied codification to present the analysis in a simpler way. Coding was conducted after reading the transcription many times to gain an adequate understanding of the responses by locating the same themes and keywords. These codes were then reviewed to remove similar words. In addition, thematic analysis was applied in this research, which basically organised the transcription into tables which represent each theme to provide more organised, concise and meaningful information (Bryman, 2008).

The findings of the interview data analysis are presented in Chapter 7.

5.6. ETHICAL ISSUES

Ethical issues have been addressed in this study by following the required procedure set up by the Graduate Research Committee. First, all the required forms for ethical clearance were submitted to the SGIA Ethics Committee before the fieldwork; those are the Ethics and Data Protection Monitoring Form, Fieldwork Risk Assessment Form, Fieldwork Contact Details and Individual Fieldwork/Miscellaneous Travel Authorisation for Students. Then, after the assessment process had been done to ensure that there were no ethical issues ensuing from the fieldwork, the Committee issued an ethical clearance letter to approve the fieldwork (see: Appendix C).

5.7. LIMITATIONS AND DIFFICULTIES

Like any other research, during field research the researcher faced various challenges and problems, starting with identification of samples to data collection process in the field, including population identification, sampling process and actual data collection. In the population identification process, the researcher was unable to obtain a complete, valid and recent comprehensive list of BPRS and BMTs in East Java and their borrowers; thus, the non-probability sampling method is applied.

In the sampling process, the researcher faced challenges in terms of cost, time and cooperation from the respondents. This is a self-funding field study unsupported by any institutions. This limited the number of respondents that could be captured, as reaching a large number of respondents throughout East Java was impractical.

In terms of time allocated for the data collection process, the researcher only had around three months to collect data from questionnaires and the interviews in East Java, Indonesia, which is the researcher's home country. This should be considered a limitation, as within this limited period it was not possible to expand the number of respondents. It should be noted that the respondents to the questionnaires are the borrowers of BMTs and BPRS, and the interviewees are the Directors/Managers. Waiting for their approval to conduct interviews and research on their premises, and to gain access to the borrowers through them, proved to be time-consuming.

Cooperation with the target institutions was the most challenging problem faced. Some institutions delayed their response or refused to provide supporting data or provide published reports, although the data are available and should be accessible by the public. Here, issues of transparency of Islamic financial institutions arose. Also, most institutions did not provide enough lists of borrowers' data for the questionnaire survey due to confidentiality issues.

Furthermore, in the actual data collection process, some respondents tend to be reluctant to answer the questionnaires, particularly on the questions relating to the value of sales, income and expenditures. Thus, before the respondents answer the questionnaires, they are provided with sufficient information about the purpose of the research and assuring confidentiality of the information, which is done through personal approach,

Despite all the burdens and challenges, the collected data which were analysed in this research should be considered relatively satisfactory in terms of supporting the analysis; for this, gratitude should be extended to the institutions for their support, particularly BMTs which seemed to be more open and offered kinship.

Chapter 6
EXPLORING PROFILE, FINANCING PERFORMANCE AND SOCIO-ECONOMIC IMPACTS OF ISLAMIC MICROFINANCE ON INDONESIAN MICRO AND SMALL ENTERPRISES

6.1. INTRODUCTION

This chapter is the first of two empirical chapters presenting the initial descriptive results and inferential statistical analysis of the primary data collected through the questionnaire survey as detailed in the Research Methodology chapter. The descriptive analysis in this chapter initially focuses on presenting findings related to demographic variables, while the second part presents the perceptions of participants on the economic and social impact of financing from BMT and BPRS in some cities in East Java, Indonesia.

Then, as a continuation of the descriptive analysis, the next section presents further empirical analysis through inferential statistical methods with the data assembled through questionnaires distributed to microenterprises to gain a better understanding of issues, problems, financing performance and socio-economic impacts. Before conducting empirical analysis, the distribution nature of the data was checked through normality check procedures, and the findings showed that the data distribution is not normal. In addition, since the data collection by questionnaire method was purposive rather than random sampling as necessitated by the nature of the questionnaires and the requirement for suitable respondents, it was expected that the data should not be normal. In substantiating the 'non-normal distribution of the data', most of the data types employed in the questionnaires were also in discrete categories rather than in interval level scales. Based on these reasons, the data were considered non-normally distributed, and therefore, the non-parametric statistical tests applied in this research included the Chi-Square Test, MWU test, KW test, Wilcoxon Signed Rank Test, and Factor Analysis. These empirical tests are mainly conducted in order to analyse the significant relationships among variables and to compare the significant differences, if any, between several subgroups, for example areas of business, business fields, types of micro financing, education *etc.*.

The analysis in this chapter is based on 348 usable questionnaires and divided into the following subsections:

(i) Microenterprises profile in terms of demographics, financing performance, economic impact and social impact. The descriptive analysis is based on statistical methods such as frequency, percentage and mean/median.

(ii) major issues and problems of microenterprises in East Java, Indonesia, consisting of business problems, the level of understanding of Islamic terms used in financing products, the intentions of borrowing, the collateral provided to borrow money, and arrears issues;

(iii) microenterprises' perceptions of the financing and non-financing services provided by BMT and BPRS, and the dominant factors in reasons for choosing the BMT or BPRS;

(iv) the role of BMT and BPRS in economic development, including analysis of the economic impacts (impacts on assets, sales, net incomes, business expenditures, household expenditures and employment) and analysis of the socio-economic impacts including social, religious and other impacts.

6.2. PROFILE OF MICROENTERPRISES

This section describes the profile of microenterprises participating in this research through a demographic profile and a business profile to provide information on the basic characteristics of the respondents.

6.2.1 Demographic Profile

Table 6.1 provides demographic characteristics of the 348 respondents, although not all variables have the same total responses due to missing values in some of the questions. The details are as follows:

Marital status: Most of the respondents (almost 92 %) are married, while only a very small percentage is divorced or separated. This may indicate that the majority of the respondents have shared financial responsibility with their spouses to manage their families.

Table 6.1: Distribution of Demographic Profile

Variables	Description	Freq.	Valid Percent	Mean	Mode	SD
Marital status	Single	11	3.2	2.03	2	0.343
	Married	318	91.6			
	Widowed	14	4.0			
	Divorced/separated	4	1.2			
	Total	347	100			
Gender	Male	189	54.3	1.46	1	0.499
	Female	159	45.7			
	Total	348	100			
Age group	Below 20	0	0	42.41	40	9.917
	21-30	50	14.4			
	31-40	124	35.7			
	41-50	107	30.8			
	51-60	53	15.3			
	61-70	12	3.5			
	Above 71	1	0.3			
	Total	347	100			
	Minimum	21				
	Maximum	72				
Last completed education	Not completed Primary School	24	6.9	3.47	4	1.590
	Primary school	79	22.8			
	Junior High or equivalent	78	22.5			
	Senior High or equivalent	122	35.2			
	Diploma I/II	4	1.2			
	Diploma III	3	0.9			
	Diploma IV/Bachelor (S1)	35	10.1			
	Master	2	0.6			
	PhD/Doctor	0	0			
	Total	347	100			
Religion	Islam	348	100	1	1	0.000
	Total	348	100			
Religion education	Formal	80	23.1	2.34	3	0.829
	Informal	70	20.2			
	None	197	56.8			
	Total	347	100			
Religious activities	Yes	290	83.3	1.17	1	0.373
	No	58	16.7			
	Total	348	100			

Gender: The number of male and female respondents is almost equal, accounting for 54.3% and 45.7% respectively. This can perhaps be explained by the particular culture prevailing in Indonesia in terms of equal opportunity in managing businesses, resulting in women being active participants in economic life.

Age: About one third (36%) of the respondents were in the age group of 31-40, which is a mature productive age. This is followed by about 30% in the 41-50 age group, while only one person was over 71 years of age. Overall, the mean age of the sample was about 42 years, which implies that the respondents represent a dynamic and relatively young generation that also represents the entire population, as the age distribution in Indonesia indicates a rather young population.

Last completed education: As can be seen in Table 6.1, a majority of the respondents (almost 87% in total) had educational backgrounds of Senior High School and below, while the rest had university backgrounds. Specifically, 35% of the respondents graduated from Senior High School, thus having 9 years of education that has provided them with sufficient basic knowledge to manage a microenterprise. In addition, this might imply that people whose completed educational level is lower than Senior High School seem to be more independent in terms of seeking jobs as they are likely to create their own businesses or continue their family businesses, while the university graduates seem to favour being employees in companies or government institutions.

Religion: Not surprisingly, all the respondents were Muslims, which might be a sign that Islamic Microfinance Institutions are focusing their services on Muslims and are not interested in the potential non-Muslim market; hence, the institutions are not attractive to non-Muslims. It should also be noted that the majority religion in Indonesia, at about 85%, is Islam, and therefore such a result in this study should not be surprising.

Religious education: More than half (57%) of the respondents did not have religious education, while the other had either formal or informal religious education, at 23% and 20% respectively.

Active in religious activity: Although more than 50% do not have religious education, as depicted in Table 6.1, 84% of the respondents are active in religious activity, at both personal and community levels. Hence, religious education is not the only factor determining religious activism, as the findings evidence.

6.2.2 Business Profile

The detailed characteristics of business profile are described in this section. The purpose of the section is to provide insightful background information before continuing the discussion on the socio-economic impacts. Table 6.2 shows other sources of income for both male and female participants among the respondents' family members.

Table 6.2: Profile of Microenterprises

Variables	Description	Freq.	Valid Percent	Mean	Median	SD
Microenterprise as the main source of income	Yes	308	88.8	1	1	0.316
	No	39	11.2			
	Total	347	100			
Other than income from microenterprises (other job/ source of income)	Civil Servant/ Government Officials (including Army and Police)	6	1.7	8.12	9	2.193
	Employee in Private company	27	7.8			
	Employee in Gov. Owned Co.	1	0.3			
	Teacher/Lecturer	3				
	Professional (Accountant, Medical Practitioner, *etc*)	0	0			
	Retired	2	0.6			
	Students	0	0			
	Housewife	71	20.5			
	None	209	60.2			
	Other	28	8.1			
	Total	347	100			

Income source: The findings indicate that 88.8% of the respondents relied on their business as the main source of income, while only about 11% had another source of income.

Other job/source of income: About 60% of the respondents did not have other sources of income and 20% were housewives. These findings indicate that those who are self-employed and housewives have more time to commit to managing their businesses compared to the other 20% of the respondents who worked as private or government employees and teachers. The findings demonstrate that none of the respondents work as professionals and none of them are students, which might indicate that the salary of a professional individual is quite reasonable and such a person may therefore not need additional income from running their own business.

Table 6.3 presents the household size or number of family members of the participants including males, females and total number of family members. In regard to the distribution of household size, male and female dependents were initially divided in terms of family size and the results for all the respondents were reported as follows:

Table 6.3: Family Members

Variables	Description	Frequency	Valid Percent	Mean	SD
Male family members (number of family members under respondent's responsibility, including respondent).	0	12	23.4	2.01	1.061
	1	103	29.6		
	2	143	41.1		
	3	60	17.2		
	4	24	6.9		
	5	3	0.9		
	6	2	0.6		
	7	1	0.3		
	Total	348	100		
Female family members (number of family members under respondent's responsibility, including respondent).	0	4	1.1	2.04	1.026
	1	114	32.8		
	2	132	37.9		
	3	70	20.1		
	4	20	5.7		
	5	6	1.7		
	6	2	0.6		
	Total	348	100		
Participants' family members (combines male and female participants)	0	0	0	4.04	1.452
	1	8	2.3		
	2	37	10.6		
	3	79	22.7		
	4	106	30.5		
	5	70	20.1		
	6	31	8.9		
	7	11	3.2		
	8	1	0.3		
	9	5	1.4		
	Total	348	100		

Male: More than 41% of the respondents were responsible for managing two male family members. In other words, more than 73% of the respondents only had responsibility for two male family members or fewer. The maximum number of male family members was seven, as reported by only one respondent.

Female: A similar situation also pertains to female family members: 37.9% of the respondents had two female family members, and more than 72% of the respondents had two female family members or fewer. However, the maximum number of female members in a family was six, which was lower than the maximum number of male members.

Total: In total, about 30% of the respondents were responsible for four family members; in other words, around 65% of the respondents had four family members or fewer, which is considered a small family. Only 5% of the respondents were considered to have large families, containing seven or more members.

Table 6.4 shows the business profile of the respondents, including area of business, age, field, owner and location.

The area of business: As the results in Table 6.4 depict, 67% of the businesses were located in urban areas, while the remaining 33% were reported to be in rural locations.

Age of enterprises: The age of the business can be a good indicator of sustainability, particularly in the development process. This study, therefore, attempted to examine the sustainability of the business in terms of 'age'. The results in Table 6.4 demonstrate that more than 29% of the respondents had managed their businesses for 11 to 20 years. In general, it can be seen that 45% of the businesses have been in operation for more than 11 years, and two respondents have even been managing businesses for more than 50 years. As indicated by the mean value, the respondents have successfully managed businesses for around 13 years, which is reasonably long-term for the microenterprises scale, indicating the sustainability of the businesses. The results also show that only a small percentage (4.6%) had recently established their businesses, implying a period of less than one year.

Table 6.4: Area, Age, Field, Owner and Location of Business

Variables	Description	Frequency	Valid Percent	Mean	Median	Standard Deviation
The area of business	Rural	116	33.3			
	Urban	232	66.7	2	2	0.472
	Total	348	100			
Age of enterprise	Below 12 months	16	4.6			
	1- 2 years	16	4.6			
	2 - 3 years	12	3.5			
	3 - 4 years	13	3.7			
	4 - 5 years	38	11.0			
	5 - 6 years	20	5.8			
	6 - 7 years	16	4.6			
	7- 8 years	13	3.7			
	8 - 9 years	5	1.4	12.84	-	10.07
	9 - 10 years	34	9.8			
	11-20 years	102	29.4			
	21-30 years	39	11.2			
	31-40 years	19	5.5			
	41-50 years	2	0.6			
	Above 50 years	2	0.6			
	Total	347	100			
	Minimum	4 month				
	Maximum	60 years				
Business field operated and supported by loan	Trade/shops/retail	212	60.9	2.26		
	Manufacturing/craftsman	25	7.2			
	Services	35	10.1			
	Transportation	4	1.1		1	1.861
	Agriculture services/ Forestry/stock breeder	27	7.8			
	Food production	45	12.9			
	Total	348	100			
The main manager and owner of the business	Self	312	89.7	1.12		
	Spouse	31	8.9			
	Other family member	4	1.1		1	0.383
	Business partner	1	0.3			
	Total	348	100			
Place of business location	Fully Mobile	47	13.5	3.01		
	Home	136	39.2			
	Home shop	53	15.3			
	Industrial estate	1	0.3			
	Traditional market	104	30.0		2	1.564
	Mall/supermarket	0	0			
	Agricultural land	5	1.4			
	Other	1	0.3			
	Total	347	100			

Business field which was operated and supported by loans: The results reported in Table 6.4 show that trade/shops/retail seems to be the most popular business field established and operated through loans, as more than 60% of the respondents fall into this category. This may be because of the simplicity of establishing and running this business field; it is easier to start up, as it can be operated from home with a small amount of equity. This category was followed by food production (13%), while transportation was not a popular business field among the respondents (1.2%) due to the requirements for a high amount of capital to buy vehicles. However, since the majority of the businesses are located in urban areas, it is not surprising that most of them are retail- and trade-oriented.

The main manager and owner of the business: As the results show, 90% of the respondents were the main managers and owners of the businesses, while only 0.3% were owned by business partners. This can be interpreted as respondents preferring independency in terms of decision-making in running their businesses.

Place of business location: The results in Table 6.4 also indicate that home was the preferred place of business for 40% of the respondents. This is reasonable, because 'home' is the place where they can easily start their businesses without having the obligation to find other places and commit to additional costs such as rent; this is evidenced by the very low preference for industrial estates at only 0.3%, which can be explained by the high rents charged.

6.2.3 Types and Value of Assets

The following Table 6.5 presents types and values of land and buildings. The details are as follows:

Land/Agricultural: As the findings reveal, more than half of the respondents (54.1%) had no land, whether for general or agricultural use; this may mean that they could not afford to buy land, which is expensive in East Java. However, 22.7% of the respondents occupy land worth between IDR 51 millions[1] and IDR 250 millions, while 0.6% own land of a

[1] The exchange rate is about GBP1=IDR15,000 or USD1=IDR10,000

very high value, between IDR 1.1 billions and IDR 5 billions. On average, the land value owned is IDR 106 millions, which might be categorised as a moderate standard of living.

Buildings/home: As can be seen from Table 6.5, more than 70% of the respondents have their own houses, mostly with a value of IDR 51 millions to IDR 250 millions (42.1%) followed by a value of below ID 50 millions (20.2%). This may indicate that their income was sufficient to purchase a house. However, the results also show that 27.7% of the respondents did not own their own houses. The average value of the respondents' houses was IDR 110 millions, which also represents an average value house.

It should be noted that, due to the difficulty faced by the respondents in splitting the value of land and buildings, the total amount of land and buildings is presented in order to provide further information.

Table 6.5: Value of Land and Building

Variables	Description	Freq.	Valid Percent	Mean	Standard Deviation
Land/ Agri cultural	Zero	188	54.1	106,000,000	327,300,000
	Below IDR 50 millions	45	13.0		
	IDR 51 millions - IDR 250 millions	79	22.7		
	IDR 251 millions - IDR 500 millions	25	7.2		
	IDR 501 millions - IDR 750 million	4	1.1		
	IDR 751 millions - IDR 1 billions	4	1.1		
	IDR 1,1 billions – IDR 5 billions	2	0.6		
	Total	347	100		
Buildings	Zero	96	27.7	110,000,000	151,800,000
	Below IDR 50 millions	70	20.2		
	IDR 51 millions - IDR 250 millions	146	42.1		
	IDR 251 millions - IDR 500 millions	28	8.1		
	IDR 501 millions - IDR 750 million	3	0.9		
	IDR 751 millions - IDR 1 billions	4	1.2		
	Total	347	100		
Total land and buildings	Zero	49	14.1	216,200,000	404,455,000
	Below IDR 50 millions	41	11.8		
	IDR 51 millions - IDR 250 millions	173	49.9		
	IDR 251 millions - IDR 500 millions	58	16.7		
	IDR 501 millions - IDR 750 million	16	4.6		
	IDR 751 millions - IDR 1 billions	5	1.4		
	IDR 1,1 billions – IDR 5 billions	4	1.2		
	IDR 5,1 billions – IDR 10 billions	1	0.3		
	Total	347	100		

Total land and buildings: The findings confirm that almost half of the respondents (49.9.1%) hold total land and buildings worth between IDR 51 and 250 millions, followed by 16.7% of the respondents who own assets worth between IDR 251 and IDR 750 millions. This may suggest that the majority of the respondents had a good standard of living and could not be considered poor. Unfortunately, it also shows that some of the respondents (14.1%) do not have land and buildings. A possible explanation may be that those respondents are still living in their parents' home or are renting houses. The average value of total land and buildings was IDR 215,630,000, which may be considered a moderate standard of living.

Table 6.6 presents further details of other types of assets, including private cars/motorcycles, cattle, productive assets, electric goods, jewellery and savings. The table also presents the overall total assets, including land and buildings.

Private cars/motorcycles: The result shows that private cars/motorcycles are important assets to support the business operations, and 78% of the respondents had cars/motorcycles with a value of less than IDR 50 millions. This is followed by 8.6% of the respondents who owned cars/motorcycles worth between IDR 51 millions and IDR 250 millions. As can be seen from the average value of cars/motorcycles of IDR 27,317,982, the respondents had sufficient transportation tools, as the above value is equal to two good-quality motorcycles or one low-quality car.

Cattle: Cattle are not a common asset, particularly for people living in urban areas; thus 82.4% of the respondents had no cattle. Besides, the average value of cattle was very low, at just IDR 1,805,172, which is equal to the value of two goats. The findings indicate that only 17% of the respondents have cattle, with a value of below IDR 50 millions.

Productive assets (machinery, cars etc.): This category is also considered as an asset based on the classification in the Government Act No. 20/2008. Therefore, around 81% of the respondents were grouped as microenterprises, while around 17% were small enterprises. Based on these findings, it can be assumed that most of the customers of BMT/BPRS were microenterprises. Besides, the average value of productive assets was

IDR 49,658,645, which was less than IDR 50 millions, and can thus be classified as microenterprises.

The value of other assets as presented in Table 6.6 is as follows:

Table 6.6: Value of Private Vehicles, Cattle, Productive Assets, Electrical Goods, Jewellery and Savings

Variables	Description	Freq.	Valid Percent	Mean	Standard Deviation
Private cars/ Motorcycles	Zero	42	12.1	27,317,982	72,533,921
	Below IDR 50 millions	272	78.4		
	IDR 51 millions - IDR 250 millions	30	8.6		
	IDR 251 millions - IDR 500 millions	2	0.6		
	IDR 501 millions - IDR 750 million	0	0.0		
	IDR 751 millions - IDR 1 billions	1	0.3		
	Total	347	100		
Cattle	Zero	286	82.4	1,805,172	11,855,248
	Below IDR 50 millions	60	17.3		
	IDR 51 millions - IDR 250 millions	1	0.3		
	IDR 251 millions - IDR 500 millions	0	0		
	IDR 501 millions - IDR 750 million	0	0		
	Total	347	100		
Productive assets (machinery, cars *etc*)	Zero	74	21.3	49,658,645	148,900,000
	Below IDR 50 millions (micro)	212	60.9		
	IDR 51 - IDR 500 millions (small)	58	16.7		
	IDR 501- IDR 10 billions (medium)	3	0.9		
	Above IDR 10 billions	0	0		
	Total	347	100		
Electrical goods	Zero	16	4.6	5,327,377	10,023,670
	Below IDR 50 millions	327	94.2		
	IDR 50 millions - IDR 250 millions	4	1.2		
	Total	347	100		
Jewellery (gold)	Zero	184	53.0	4,041,354	11,651,279
	Below IDR 50 millions	159	45.8		
	IDR 51 millions - IDR 250 millions	4	1.2		
	IDR 251 millions - IDR 500 millions	0	0		
	Total	347	100		
Savings	Zero	179	51.6	5,654,951	31,013,261
	Below IDR 50 millions	162	46.7		
	IDR 51 millions - IDR 250 millions	5	1.4		
	IDR 251 millions - IDR 500 millions	1	0.3		
	Total	347	100		
Total Assets	Zero	0	0	310,000,000	579,038,000
	Below IDR 50 millions	65	18.7		
	IDR 51 millions - IDR 250 millions	154	44.4		
	IDR 251 millions - IDR 500 millions	70	20.2		
	IDR 501 millions - IDR 750 million	33	9.5		
	IDR 751 millions - IDR 1 billions	9	2.6		
	IDR 1,1 billions – IDR 5 billions	16	4.6		
	Total	347	100		

Electrical goods: The findings suggest that this was the most popular asset, owned by 94.2% the respondents. As can be seen from Table 6.6, a small percentage of the respondents (1.2%) even have electrical goods worth more than IDR 50 millions, which is considered to be a very high value of electrical goods. With an average value of IDR 5,327,377, this may suggest that the respondents had sufficient electrical goods on their premises, which might generally consist of televisions, audio tapes/radios and video players. This may also indicate that electrical goods were included as daily basic necessities by the respondents.

Jewellery (gold): Jewellery seems to be an alternative investment for around 47% of the respondents, mainly with values below IDR 50 million (45.8%). This may be because the value of jewellery is highly likely to increase in the near future and can be sold quickly and easily. The finding also shows that the rest of the respondents did not have jewellery (53%).

Savings: The finding in Table 6.6 reveals that around 52% of respondents do not have cash/bank savings. In addition, the average value of savings was just IDR 5,654,931, which is considered low. This may be due to the high usage of funds for business, or it might imply that there is no cash excess to be saved. However, 0.3% of the respondents saved between IDR 251 millions and IDR 500 millions, which is considered a very large amount.

Total assets: Table 6.6 shows that the majority of the respondents (44.4%) had total assets of between IDR 51 millions and IDR 250 millions, and they can thus be classified as middle-class society. However, it could be argued that the 18.7% of respondents who have total assets of less than IDR 50 millions are poor. The average value of total assets at IDR 310,000,000 may indicate that the respondents have a good standard of living or at least are not living in poverty.

6.2.4 Operational Business Problems

Table 6.7 presents the reported problems experienced by microenterprises in running their businesses. In general, the respondents faced no problems in running their businesses, which is rather uncommon. The details are as follows:

Production: Almost 70% of the respondents declared that they 'never' had production problems, while 0.6% 'always' faced these problems.

Table 6.7: Problems in Running Business

Variables	Description	Frequency	Valid Percent	Mean	Median
Production (e.g. difficulty in getting raw materials, limited equipment *etc*)	Never	243	69.8	1.47	1
	Rarely	52	14.9		
	Sometimes	47	13.5		
	Often	6	1.7		
	Always	0	0		
	Total	348	100		
Finance (e.g. limited working capital, lack of financial access to get loans *etc*)	Never	113	32.5	2.20	1
	Rarely	92	26.4		
	Sometimes	106	30.5		
	Often	35	10.1		
	Always	2	0.6		
	Total	348	100		
Bookkeeping (e.g. difficulty in managing financial records *etc.*)	Never	324	93.1	1.11	1
	Rarely	11	3.2		
	Sometimes	11	3.2		
	Often	2	0.6		
	Always	0	0		
	Total	348	100		
Management (e.g. difficulty in managing the employees, *etc.*)	Never	324	93.1	1.12	1
	Rarely	11	3.2		
	Sometimes	9	2.6		
	Often	4	1.1		
	Always	0	0		
	Total	348	100		
Marketing (e.g. Difficulty in selling the product, finding new market *etc.*)	Never	217	62.4	1.61	1
	Rarely	61	17.5		
	Sometimes	60	17.2		
	Often	10	2.9		
	Always	0	0		
	Total	348	100		

Finance: Finance problems seem to be the most common problems, compared to other difficulties, as more than 40% of the respondents asserted that they ‘sometimes’ and ‘often’ had these problems.

Bookkeeping: More than 93% of the respondents stated that these problems ‘never’ occurred in their businesses. In contrast, only 0.6% reported that they often faced bookkeeping problems. This might imply that the respondents assumed that they were undertaking proper bookkeeping that was sufficient for them to retain control over their businesses.

Management: Similarly to the findings in regard to bookkeeping problems, 93% of the respondents were confident that they ‘never’ had management problems. Only 1.1% of the respondents reported that they ‘often’ had management problems. This might be related to the nature of family businesses where most of the workers are family members and are thus easier to manage.

Marketing: Similarly to the above statements, a number of respondents (62%) stated that they ‘never’ had marketing problems. Table 6.7 shows that only a very small number of respondents (2.9%) reported that they ‘often’ had these problems.

6.3. RESULTS IN RELATION TO FINANCING

After presenting and detailing the profile of the participants, this section aims to present the initial descriptive findings in relation to financing aspects and issues.

6.3.1 Access to BMT/BPRS

This section presents the findings on the respondents’ access to financing sources in terms of microfinance, be it conventional or Islamic, formal or informal. Table 6.8 below displays the findings of the study on access to BMT/BPRS. Between the two types of institutions, the number of the respondents who stated that they had access to BMT was slightly higher than those who had access to BPRS, at around 51% and 49% respectively. The respondents came from 22 BMT/BPRS in 12 cities/towns in East Java. The number of respondents from each institution ranged between 8 and 20. This varied because of the availability of access provided by the institutions to the respondents.

Table 6.8: Access to BMT/BPRS

Variables	Description	Freq.	Valid Percent	Median
Type of IsMFIs from whom respondents have borrowed money	BMT	179	51.4	1
	BPRS	169	48.6	
	Total	348	100	
Name of institution	BMT MMU, Pasuruan	16	4.6	
	BMT UGT Sidogiri	30	8.6	
	BMT Al-Ikhlas, Malang	9	5.7	
	BMT SWM, Malang	15	4.0	
	BMT A Yani, Malang	8	2.3	
	BMT ABM, Malang,	14	4.0	
	BMT Pahlawan, Tulungagung	20	5.7	
	BMT Amanah Ummah, Surabaya	15	4.3	
	BMT As-Salam, Probolinggo	20	5.7	
	BMT Sabilillah, Malang	15	4.3	
	BMT Al-Ikhlas, Lumajang	20	5.7	
	BMT As-Sakinah, Malang	0	0	
	BPRS Al-Hidayah, Pandaan	15	4.3	
	BPRS Jabal Tsur, Pandaan	7	2.0	
	BPRS Ummu/Untung Suropati, Bangil	15	4.3	
	BPRS Lantabur, Jombang	20	5.8	
	BPRS Bhakti Haji Bululawang	20	5.7	
	BPRS Bumi Rinjani Junrejo	20	5.7	
	BPRS Bumi Rinjani Batu	20	5.7	
	BPRS Karya Mugi Sentosa, Surabaya	20	6.0	
	BPRS Bumi Rinjani Kepanjen	15	4.3	
	BPRS Amanah Sejahtera, Gresik	14	4.0	
	Total	348	100	

6.3.2 Access to Other Microfinance Sources

In addition to the question of access to BMT/BPRS, which is the main concern of this research, information about access to other microfinance sources is presented in Table 6.9. Generally, a majority of the respondents did not use the services provided by the sources identified in Table 6.9. However, among other types of financing sources listed in the table, the most common source of financing was families/relatives/friends, followed by BRI micro banking and cooperative/credit unions. The details are as follows:

Families/relatives/friends: As depicted in Table 6.9, it seems that the most preferred sources of financing involved an informal approach rather than official institutional sources. The findings suggest that almost 40% of the respondents used this alternative. This might also imply that respondents had close relationships with immediate family, other relatives and friends, as is quite common in Javanese culture.

Table 6.9: Access to Financing other than BMT/BPRS

Variables	Description	Frequency	Valid Percent	Mean	Median
Families/relatives/friends	Used	133	38.7	1.69	2
	Not used	211	61.3		
	Total	344	100		
Moneylenders/landlords (Big Men)	Used	9	2.6	1.97	2
	Not used	337	97.4		
	Total	346	100		
ROSCA	Used	34	9.8	1.90	2
	Not used	312	90.2		
	Total	346	100		
Pawnshop (conventional)	Used	26	7.5	1.92	2
	Not used	320	92.5		
	Total	346	100		
Pawnshop (Islamic)	Used	6	1.7	1.98	2
	Not used	340	98.3		
	Total	346	100		
Cooperative/Credit Union	Used	49	14.3	1.86	2
	Not used	293	85.7		
	Total	342	100		
Permodalan Nasional Madani	Used	2	0.6	1.99	2
	Not used	344	99.4		
	Total	346	100		
Venture Capital	Used	0	0	2	2
	Not used	346	100		
	Total	346	100		
Rural Bank (BPR)	Used	22	6.4	1.94	2
	Not used	323	93.6		
	Total	345	100		
BRI Microbanking (Indonesian People's Bank)	Used	73	21.0	1.79	2
	Not used	275	79.0		
	Total	348	100		
Islamic banks (e.g.BNI Shariah, BCA Shariah et	Used	4	1.2	1.99	2
	Not used	342	98.8		
	Total	346	100		
Conventional banks (*eg.* BRI, BNI, BCA *etc*)	Used	45	13.0	1.87	2
	Not used	301	87.0		
	Total	346	100		

Moneylenders/landlords (Big Men): In the past, these alternative financing sources were quite common, since they provided quick access, albeit at very high interest rates. However, the findings show that only 2.6% of the respondents reported using them. This may mean that the respondents now have more awareness of the risks of borrowing money from moneylenders, even though the moneylenders still exist, albeit with less power.

ROSCA: Despite the popularity of ROSCA in Javanese culture, the results suggest that only 9.8% of the respondents used it as a source of financing.

Conventional pawnshop: Conventional pawnshops still offer an alternative source of financing, and 7.5% of the respondents informed the researcher that they used them.

Islamic pawnshop: Compared to conventional pawnshops, Islamic pawnshops were less popular than their conventional counterparts, as only 1.7% of the respondents used them. This is understandable, since Islamic pawnshops are new and their presence and availability is limited to certain areas.

Cooperative/Credit Union: Cooperatives and credit unions were popular alternative financing sources amongst their members, as 14% of the respondents reported using them.

Permodalan Nasional Madani: This institution, which was established by the government in 1999 to provide financing access to microenterprises, is widespread in most villages in Indonesia, particularly in Java. However, the findings show that only 0.6% of the respondents used its services.

Venture Capital: This is the most uncommon financing source for microenterprises, as the results show that none of the respondents used it.

Rural Bank (BPR): This is a competitor of BPRS, but it uses a conventional system; only 6.4% of the respondents used its services. Therefore, based on these findings, it can be argued that BPR is not a 'real' competitor of BPRS.

BRI Microbanking (Indonesian People's Bank): This old government-owned bank is very popular among microenterprises and seems to be the most successful institution offering the most affordable and supportive source of financing for microenterprises. As can be seen from Table 6.9, BRI is still a popular and accessible institution, as 21% of the respondents reported using its services.

Islamic banks: Although BMT/BPRS claim that Islamic banks are the toughest competitors, since they now also offer *Shari'ah* microfinancing, the findings show that these banks were not popular among the respondents, since only 1.2% of respondents used these services.

Conventional banks (e.g. BRI, BNI, BCA etc): Being interested in the potential of the microfinance market, conventional banks offer microfinance services. Compared to Islamic banks, conventional banks are more accessible, as the result shows that 13% of the respondents used them as a source of financing.

6.3.3 Factors in Decision-Making to Borrow Money from BMT/BPRS

Table 6.10 presents information on the factors affecting decision-making in borrowing money from BMT/BPRS. The top three factors were simple procedure, location and flexible collateral, since more than 92% of the respondents answer 'agree' and strongly 'agree' in regard to these factors. However, the least common factors were advertisements and socialisation by particular parties. This might imply that more marketing efforts and socialisation in all media, printed and audio-visual, are required to attract more customers. The details are as follows:

Shariah-compliancy: The findings in Table 6.10 demonstrate that more than 70% of the respondents 'agree' that this factor might persuade them to use the services of BMT/BPRS. However, this factor was less common than other more technical factors with direct benefits for respondents, such as simple procedure and flexible collateral. It might be argued that the respondents were more concerned with the personal and practical benefits than practising the values of Islam in the economic sphere.

The procedure to obtain funds is not complicated: Similarly to the findings for two other factors - cheaper cost and flexible collateral - the results show that this was the most popular factor, as 83% of the respondents answered 'agree'.

Cost-related financing product is cheaper: The findings show that around 67% of the respondents 'agree' that this factor affected their decisions.

Flexible and easy collateral: Collateral is an important factor amongst respondents as the results show that around 83% of the respondents 'agree'.

Located in various places and easy to reach: The respondents preferred to go to places that were easy to reach. Thus, Table 6.10 shows that a large majority of respondents (81%) 'agree' that this factor is important.

Table 6.10a: Factors in Decision-Making to Borrow Money from BMT/BPRS

Variables	Description	Frequency	Valid Percent	Mean	Median
Shariah-compliant (e.g.. prohibition of *riba* (interest), profit- and loss-sharing system *etc*)	Strongly disagree	0	0	3.91	4
	Disagree	10	2.9		
	Neutral	53	15.2		
	Agree	244	70.1		
	Strongly agree	41	11.8		
	Total	348	100		
The procedure to obtain funds is not complicated.	Strongly disagree	0	0	4.02	4
	Disagree	10	2.9		
	Neutral	11	3.2		
	Agree	288	83.0		
	Strongly agree	38	11.0		
	Total	347	100		
Cost-related financing product is cheaper.	Strongly disagree	0	0	3.78	4
	Disagree	14	4.0		
	Neutral	73	21.0		
	Agree	253	67.7		
	Strongly agree	25	7.2		
	Total	347	100		
Flexible and easy collateral	Strongly disagree	0	0	3.97	4
	Disagree	5	1.4		
	Neutral	28	8.1		
	Agree	287	82.7		
	Strongly agree	27	7.8		
	Total	347	100		
Located in various places and easy to reach.	Strongly disagree	0	0	4.02	4
	Disagree	11	3.2		
	Neutral	12	3.5		
	Agree	283	81.6		
	Strongly agree	41	11.8		
	Total	347	100		

Influence from particular people: Only 31% of the respondents ‘agree’ that this factor affects their decisions. Around 40% the respondents stated that they ‘disagree’. This may indicate that the respondents are independent in their decision-making process.

Advertisements in printed or electronic media: There are few advertisements for BMT/BPRS in the media; consequently the findings show that around 60% of the respondents ‘disagree’ that this factor influences their decision-making.

Table 6.10b: Factors in Decision-Making to Borrow Money from BMT/BPRS

Variables	Description	Frequency	Valid Percent	Mean	Median
Influence from particular people (Parents, friends, colleagues)	Strongly disagree	6	1.7	2.93	2
	Disagree	137	39.5		
	Neutral	87	25.1		
	Agree	108	31.1		
	Strongly agree	9	2.6		
	Total	347	100		
Advertisements in printed or electronic media (TV, radio).	Strongly disagree	5	1.4	2.39	2
	Disagree	207	59.8		
	Neutral	128	37.0		
	Agree	6	1.7		
	Strongly agree	0	0		
	Total	346	100		
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc*)	Strongly disagree	4	1.2	2.47	2
	Disagree	199	57.3		
	Neutral	125	36.0		
	Agree	16	4.6		
	Strongly agree	3	0.9		
	Total	347	100		
Provision of social services (training, consultancy *etc*)	Strongly disagree	4	1.2	2.50	2
	Disagree	194	56.2		
	Neutral	121	35.1		
	Agree	24	7.0		
	Strongly agree	2	0.6		
	Total	345	100		
Good service (staff able to explain banking products clearly and handle complaints quickly).	Strongly disagree	1	0.3	4.15	4
	Disagree	10	2.9		
	Neutral	16	4.6		
	Agree	228	65.7		
	Strongly agree	92	26.5		
	Total	347	100		

Socialisation from particular party: It seems that *ulema* and experts in Islamic Economics/Banking *etc.* did not have a significant influence on the decision-making of respondents, since Table 6.9 demonstrates that more than half of the respondents (58.5% in total) 'disagree' that this factor affects their decision-making, while only 5.5%(in total) of the participants agreed to their impact.

Provision of social services: Due to the limited social services such as training and consultancy provided to their customers, the findings show that 56% of the respondents answered 'disagree'.

Good service: The ability of staff to explain banking products clearly and handle complaints quickly is important; thus, around 66% of the respondents answered 'agree'.

6.3.4 Financing Experience and Performance

This section briefly describes the financing performance of the respondents including approaching method (Table 6.11), duration of membership or length of time as a borrower (Table 6.12), last loan receipt, duration of loan payment and type of financing (Table 6.13), level of understanding of terms used in Islamic finance (Table 6.14), total amount borrowed (Table 6.15), last loan received (Table 6.16), and arrears (Table 6.17).

As can be seen from Table 6.11, almost all of the respondents (97.7%) had not become members of a group in order to obtain financing. It should be explained that the financing channels used by BMT/BPRS strongly emphasised individual-based financing rather than group-based financing because it was easier to handle an individual than a group. The result also shows that all the respondents who were members of groups stated that they consulted other group members, particularly on how to use the funds. This may indicate strong relationships amongst members of groups, which may have resulted from the strong role played by groups and good support from BMT/BPRS.

The duration of membership or length of time as clients of BMT/BPRS is presented in Table 6.12. On average, there was a similarity between the duration of membership (4.1 years) and length of time as borrowers (3.65 years). This might be explained by the fact that respondents applied to be members when they needed to borrow money from

BMT/BPRS. The gap between the average value of those two periods resulted from the BMT's requirement that customers first become members and then save money before being allowed to borrow money from BMT.

Table 6.11: Financing Channel

Variables	Description	Frequency	Valid Percent	Mean	Median	SD
Member of the group in order to get loan	Yes	8	2.3	1.98	2	0.151
	No	338	97.7			
	Total	346	100			
Consult other group members on how to use the funds	Yes	8	100		1	0.457
	No	0	0			
	Total	8	100			

The duration of membership/time spent as clients is presented in Table 6.12 as follows:

Table 6.12a: Duration of Time as Member/Client

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Duration of time as members/ clients of BMT/BPRS	Below 12 months	60	17.3	4.12 years	3.19 years
	1- 2 years	53	15.3		
	2 – 3 years	57	16.5		
	3 – 4 years	54	15.6		
	4 – 5 years	46	13.3		
	5 – 6 years	15	4.3		
	6 – 7 years	16	4.6		
	7- 8 years	13	3.8		
	8 – 9 years	3	0.9		
	9 – 10 years	6	1.7		
	10 – 11 years	6	1.7		
	11 -12 years	3	0.9		
	12 – 13 years	4	1.2		
	13 – 14 years	6	1.7		
	14 – 15 years	4	1.2		
	Total	346	100		
	Minimum	2 months			
	Maximum	15 years			

Duration of membership/time spent as clients of BMT/BPRS: Based on the findings in Table 6.12a, a large majority of the respondents (around 78%) had been members/clients of BMT/BPRS for less than 5 years, and 17.5% of the respondents had been members/clients for less than one year. The remaining respondents seem to be loyal members/clients who had been members for more than 5 years, while 6% of the respondents had even been members for more than 10 years. Based on these findings, it might be argued that BMT/BPRS were able not only to attract new members but also to retain old members. The minimum duration of membership was 2 months, while the maximum duration was 15 years.

Length of time spent as borrowers of BMT/BPRS: Similarly to the above findings, around 24% of the respondents had been borrowers for less than one year; in total, almost 84% of the respondents had been borrowers for less than 5 years. It might be argued that they became members when they needed to borrow money from BMT/BPRS.

Table 6.12b: Duration of Time as Member/Client

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Duration of time as borrowers BMT/BPRS	Below 12 months	81	23.4	3.61 years	3.02
	1- 2 years	62	17.8		
	2 - 3 years	56	16.2		
	3 - 4 years	53	15.3		
	4 - 5 years	34	9.8		
	5 - 6 years	11	3.2		
	6 - 7 years	15	4.3		
	7- 8 years	8	2.3		
	8 - 9 years	4	1.2		
	9 – 10 years	7	2.0		
	10 – 11 years	2	0.6		
	11 -12 years	3	0.9		
	12 – 13 years	2	0.6		
	13 – 14 years	4	1.2		
	14 – 15 years	4	1.2		
	Total	346	100		
	Minimum	2 months			
	Maximum	15 years			

Table 6.13 provides further information on total repeat financing, the last loan received and the types of loan.

Number of times respondents have borrowed money from Islamic BMT /BPRS: Based on the findings, there was quite a high rate of repeat borrowing, as 84.2% of the respondents had borrowed money between 1 and 5 times. 1.1% of the respondents had even borrowed

Table 6.13: Last Loan Receipt, Duration of Loan Repayment, Type of Financing

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Number of loans taken from BMT /BPRS	1-5	293	84.2	3.66	2.985
	6-10	46	13.2		
	11-15	3	1.4		
	Above 15	4	1.1		
	Total	348	100		
	Minimum	1			
	Maximum	20			
Time since respondent received the last loan	Less than 3 months	164	47.3	5.69	5.560
	4-6 months	67	19.3		
	7-9 months	49	14.1		
	10-12 months	41	11.8		
	13 – 15 months	6	1.7		
	16-18 months	6	1.7		
	19-21 months	7	2.0		
	22-24 months	3	.9		
	25-27 months	1	.3		
	28 -30 months	1	.3		
	More than 31 months	2	.6		
	Total	347	100		
	Minimum	0 month			
	Maximum	36 month			
The duration of loan repayment	Less than 3 months	30	8.6	14.04	8.023
	4-6 months	38	10.9		
	7-9 months	3	0.9		
	10-12 months	161	46.3		
	13 – 15 months	1	0.3		
	16-18 months	35	10.1		
	19-21 months	2	0.6		
	22-24 months	63	18.1		
	25-28 months	0	0		
	29 -30 months	1	0.3		
	More than 31 months	14	4.0		
	Total	348	100		
	Minimum	1			
	Maximum	36			
The types of loan from Islamic Microfinance (respondents may choose more than one option)	*Musharakah*	20	5.5		
	Mudharabah	56	15.4		
	Bai' bitsaman ajil	62	17.1		
	Murabahah	148	40.8		
	Ijarah	0	0		
	Salam	1	0.3		
	Qard Hasan	76	20.9		
	Total	363	100		

more than 15 times. This may indicate strong loyalty and a high need for financing amongst respondents. The minimum number of instances of borrowing was one, while the maximum was 20.

Last loan received by respondents: As can be seen in Table 6.13, 47.3% of the respondents had received their last loans only very recently, less than 3 months ago, which means that the funds had been used for only a short time when the respondents participated in this survey. However, around 1% of the respondents had been using them for more than 2 years.

The duration of loan repayment: The findings show that the most common duration of loan repayment was 10-12 months, as around 46% of the respondents' loan durations were in this category. Long-term loans for more than 2 years were taken out by only around 4.3% of the respondents.

The types of loan from Islamic Microfinance: In line with the general popularity of this mode of financing in Indonesia, the results show that the most common mode of financing was *murabahah* (40.8%), while the most uncommon were *ijarah* (0%) and *salam* (0.3%). Despite the evident popularity of *qard hasan*, it must be noted that the term *qard hasan* used here was not fully compliant *qard hasan.*

Table 6.14 shows the level of understanding of terms used in Islamic financing among the respondents. Ideally, one might expect the respondents to have sufficient understanding of the accounts they hold. In addition, the BMT/BPRS claimed that they provided sufficient explanations of the specific accounts to their customers when they signed the contracts for financing agreements and assumed that the customers understood the terms. However, the findings suggest that the respondents' understanding was poor in general. Therefore, it may be argued that, in the respondents' perceptions, having sufficient understanding of the financing mode is less important than obtaining the funds. This finding should encourage *shariah* microfinance institutions and other related institutions to plan more practical actions to educate their customers.

Table 6.14: Level of Understanding of Terms Used in Islamic Finance

Variables	Description	Frequency	Valid Percent	Mean	Median
Riba	Poor	105	30.3	2.01	2
	Fair	145	41.8		
	Good	87	25.1		
	Very good	9	2.6		
	Excellent	1	0.3		
	Total	347	100		
Musharakah	Poor	296	85.3	1.19	1
	Fair	37	10.7		
	Good	12	3.5		
	Very good	2	0.6		
	Excellent	0	0		
	Total	347	100		
Mudharabah	Poor	289	84.0	1.19	1
	Fair	44	12.8		
	Good	11	3.2		
	Very good	0	0		
	Excellent	0	0		
	Total	344	100		
Bai' bitsaman ajil	Poor	313	90.7	1.13	1
	Fair	22	6.4		
	Good	8	2.3		
	Very good	2	0.6		
	Excellent	0	0		
	Total	345	100		
Murabahah	Poor	295	85.3	1.20	1
	Fair	36	10.4		
	Good	13	3.8		
	Very good	2	0.6		
	Excellent	0	0		
	Total	346	100		
Ijarah	Poor	312	89.9	1.14	1
	Fair	24	6.9		
	Good	9	2.6		
	Very good	2	0.6		
	Excellent	0	0		
	Total	347	100		
Salam	Poor	315	90.8	1.12	1
	Fair	24	6.9		
	Good	6	1.7		
	Very good	2	0.6		
	Excellent	0	0		
	Total	347	100		
Qard Hasan	Poor	316	90.8	1.14	1
	Fair	21	6.0		
	Good	7	2.0		
	Very good	4	1.1		
	Excellent	0	0		
	Total	348	100		

Riba: Generally, compared to other terms in this question, this is the best-known term among Muslims. However, as can be seen from Table 6.14, only 25% of the respondents claimed to have a ‘good’ understanding. In addition, the results show that the majority of the respondents claimed to have a ‘fair’ understanding (41%) or a ‘poor’ understanding (30.3%).

Musharakah: The findings suggest that a majority of the respondents (85%) claimed to have a ‘poor’ understanding of this term, while 10.7% of the respondents said they had a ‘fair’ understanding.

Mudharabah: Similarly to the above findings, 84% of the respondents have a ‘poor’ understanding of this term, followed by 12.8% of the respondents who declared they have a ‘fair’ understanding.

Bai’ bitsaman ajil: This term is rarely used in BMT/BPRS; therefore the findings show that 90.7% of the respondents confessed to having a ‘poor’ understanding.

Murabahah: Although a majority of the respondents used this mode of financing, unfortunately the results show that 85% of the respondents did not understand this term.

Ijarah: Table 6.14 demonstrates that around 90% of the respondents had a ‘poor’ understanding of this term.

Salam: As can be seen from the results, similar to other findings on levels of understanding, 90% of the respondents declared that they have a ‘poor’ understanding, followed by 6.9% of the respondents with a ‘fair’ understanding.

Qard Hasan: Similarly to the above statements, the findings show that 90% of the respondents have a ‘poor’ understanding. A small amount of respondents (6%) stated that they have a ‘fair’ understanding.

With regards to the total amount of money the respondents have borrowed, both fully repaid and outstanding, the findings are presented in Table 6.15. The findings outline that more than half of the respondents (54%) obtain small amounts of financing of less than IDR 10 millions, particularly between IDR 4 – 5 millions (8.4%). This is in line with the basic character of microfinance which focuses on small financing although a small number of respondents (4.3%) received large amounts of financing of more than IDR 100 millions, generally as a result of multiple repeat financing. On average, the respondents obtained financing of IDR 28,976,789, which may be considered a moderate amount of financing.

Table 6.15: Total Amount Borrowed

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
The total amount of money the respondents have borrowed (fully paid and outstanding)	Below IDR 1 million	19	5.5	29,002,800	68,802,379
	IDR 1 – 2 millions	26	7.5		
	IDR 2 – 3 milions	20	5.8		
	IDR 3 - 4 millions	18	5.2		
	IDR 4 - 5 millions	29	8.4		
	IDR 5 – 6 millions	17	4.9		
	IDR 6 - 7 millions	9	2.6		
	IDR 7 -8 millions	14	4.0		
	IDR 8 – 9 millions	8	2.3		
	IDR 9 -10 billions	27	7.8		
	IDR 10 -20 millions	63	18.2		
	IDR 20 -30 millions	31	9.0		
	IDR 30 – 40 millions	9	2.6		
	IDR 40 -50 millions	20	5.8		
	IDR 50 -60 millions	3	0.9		
	IDR 60-70 millions	4	1.2		
	IDR 70-80 millions	5	1.4		
	IDR 80 – 90 millions	0	0		
	IDR 90–100 millions	9	2.6		
	Above IDR 100 mil.	15	4.3		
	Total	346	100		

Table 6.16 presents purpose of loan, collateral, instalments and decision-maker of the business.

The original intended purpose of the loan: As can be seen from Table 6.16, 93.7% of the respondents declared that obtaining working capital was the original intended purpose of the loan. Only 1.1% of the respondents used the loans for consumption purposes, particularly with the intention to finance education expenditures and to purchase washing machines.

Table 6.16: Purpose of Loan, Collateral, Instalments and Decision-Makers

Variables	Description	Freq.	Valid Percent	Mean	Median	SD
The original intended purpose of the loan	Working capital	326	93.7		1	.30395
	Fixed capital	18	5.2			
	Consumption	4	1.1			
	Total	348	100	1.07		
Collateral has been provided to borrow funds (the respondents may choose more than one option)	Assets (home/building, land) certificate	92	24.5			
	Cars certificate	24	6.4			
	Motorcycles certificate	174	46.4			
	Group reference	1	0.2			
	No collateral	81	21.6			
	Other (fridge, shop certificate, savings)	3	0.8			
	Total	375	100			
Total collateral higher than the total amount borrowed	Yes	264	90.4		1	
	No	28	9.6			
	Total	292	100	1.1		
Instalments	Daily	30	8.6	3.61	4	.946
	Weekly	23	6.6			
	Quarterly	1	3			
	Monthly	293	84.2			
	Other	1	0.3			
	Total	348	100			
The actual use of loan	Working capital only	238	68.4		1	1.738
	Fixed capital only	14	4.0			
	Consumption only	1	0.3			
	Both fixed and working capital	11	3.2			
	Consumption and working capital	82	23.6			
	Consumption and fixed capital	2	0.6			
	Total	348	100			
Decision-maker on how to use the funds	Self	269	77.3	1.40	1	.773
	Spouse	23	6.6			
	Together (self and spouse)	53	15.2			
	Other household member	3	0.9			
	Business Partner	0	0			
	Total	348	100			

Collateral has been provided in order to borrow funds from the BMT/BPRS: Based on the findings, motorcycle certificates seem to be the most common assets owned, as around 47% of the respondents preferred to use them as collateral. This was followed by home or building certificates at 24.5%. Non-asset collateral, or group reference, was used by only one person as most of the respondents were not members of groups.

Total collateral provided: The results show that a large majority of the respondents (90%) declared that they provided a higher amount of collateral to borrow money than the total amount borrowed.

Instalments: The findings in Table 6.16 show that monthly instalment was the general mode of repayment among the respondents (84%), followed by 6.6% of the respondents who pay weekly.

The actual use of loans: Despite the findings for the previous variable that the original purpose of loans was to provide working capital, as stated by 94%, in this result only around 68% of the respondents use the funds as working capital in reality. In other words, 26% of the respondents took advantage of the funds for other purposes, particularly for consumption. Besides, around 24% of the respondents used the fund for consumption and working capital. This may indicate that there is a demand for consumption purposes which is not provided by BMT/BPRS.

Making decisions on how to use the funds: The results demonstrate that the respondents were highly likely to be independent in deciding on how to use the funds, since around 78% of the respondents nominated ‘self’ as the decision-maker. This is followed by joint decision-making with spouse (15.3%). Only a very small percentage (0.9%) of the respondents declared that decisions were made by other household members.

In further discussing the financial issues, Table 6.17 provides information on arrears in financing, with the intention of obtaining information on whether the respondents have arrears in their businesses and the reasons for the arrears.

Arrears in the respondents' instalments: As can be seen from Table 6.17, the financing performance of the respondents seems to be good, as almost 80% of the respondents did not have arrears.

Reasons for the arrears: Based on the findings in Table 6.17, the main reason for arrears was business failure (58%), followed by urgent consumption needs (35%). It should be noted that none of the arrears was caused by natural disasters. Thus, it can be argued that repayment problems were mainly a result of business problems.

If the respondent is a group borrower, what did other members do when the respondent had arrears?: As shown in the findings in Table 6.16, although the respondents were members of groups, when there were problems with repayment the majority of the groups' members did not provide support. In addition, the groups did not apply group pressure. Therefore, in this case there is an indication that groups do not play a significant role in assisting their members.

Table 6.17: Arrears

Variables	Description	Frequency	Valid Percent	Mean	Median	SD
Arrears in the respondents' instalments	Yes	71	20.4	1.80	2	.404
	No	276	79.6			
	Total	347	100			
Reasons for the arrears	The business was not successful (business failure)	48	57.8	-	-	-
	Natural disaster	0	0			
	Consumption requirements	6	7.2			
	Distress /urgent consumption	29	34.9			
	Total	83	100			
If respondent is a group borrower, what did other members do when respondent had arrears?	Help pay (with money)	2	25	-	-	-
	Giving peer and group pressure	0	0			
	Ask spouse/other household members	2	25			
	Do nothing	4	50			
	Total	8	100			

6.4. REPORTING THE PERCEPTIONS ON ECONOMIC IMPACT

This section briefly presents the economic impacts of BMT/BPRS financing on microenterprises in terms of both business and personal aspects. This includes impact on sales and net income (Table 6.18), impact on business and household expenditures (Table 6.19, Table 6.20, Table 6.21 and Table 6.22), impact on assets (Table 6.23), impact on economic activities (Table 6.24), and impact on employment (Table 6.25).

6.4.1 Impact on Sales and Net Income

Table 6.18 shows the economic impact on sales and net income. The Government Act No. 20/2008, Article 6, declares that classification of micro, small, medium and large enterprises is based on annual sales under the following categories: below IDR 300 millions, between IDR 300 millions and IDR 2.5 billions, between IDR 2.5 billions and IDR 50 billions, and above IDR 50 billions. Therefore, the classifications applied in the following tables are based on such legal definition, with minor modifications due to very wide range applied in the Act to capture more detailed insights into the categories.

Table 6.18: Impact on Value of Annual Sales

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Sales before loan (annual)	Zero	12	3.4	333,860,000	1,990,690,000
	Below IDR 300 m.	273	78.4		
	IDR 301 million - IDR 1b	49	14.1		
	IDR 1,1 - 2,5 billions	10	2.9		
	IDR 2,6 – IDR 5 billions	1	0.3		
	IDR 5,1 – 10 billions	2	0.6		
	Above IDR 10,1 billions	1	0.3		
	Total	348	100		
	Minimum	0			
	Maximum	36,000,000,000			
Sales after loan (annual)	Zero	0	0	434,950,000	2,043,400,000
	Below IDR 300 millions	259	74.4		
	IDR 300m - IDR 1b	65	18.7		
	IDR 1 - 2,5 billions	17	4.9		
	IDR 2,5 – IDR 5 billions	4	1.1		
	IDR 5 – 10 billions	2	0.6		
	Above IDR 10 billions	1	0.3		
	Total	348	100		
	Minimum	5,400,000			
	Maximum	36,000,000,000			

Generally, the findings on mean value and minimum sales show a good improvement in the impact on annual sales; these increased from IDR 333,860,000 to 434,950,000, an improvement of around 30.28%. In addition, the minimum sales also increased from 0, representing a new business just after it has started after financing, to IDR 5,400,000. As can be seen from Table 6.18, a majority of the respondents (around 75%) achieved sales below IDR 300 millions, both before and after receiving loans. Therefore, those respondents can be classified as operators of microenterprises. However, the number of microenterprises decreased after receiving loans, from 78.4% to 74.4%; this indicates a shift from micro to small enterprises.

Sales before loan (annual): Based on the Government Act No. 20/2008 on categories, the findings show that a majority of respondents (78.4%) were classified as microenterprises, since they achieved annual sales below IDR 50 millions, followed by 17.8% who were classified as small enterprises, in particular achieving sales between IDR 300 millions and IDR 1 billion (14.1%). It should be noted that IDR 0 net income refers to a newly established business immediately after financing had been received.

Sales after loan (annual): It seems that there is an improvement in sales after the receipt of loans. This was based on the shifting distribution of the percentage of respondents who moved to a higher category: those below IDR 300 millions dropped to 74.4%, while those between IDR 300 million and IDR 1 billion improved to 18.7%.

In an attempt to provide further impact analysis, Table 6.19 shows the comparison of net income value before and after loans. Similarly to the findings on annual sales, as indicated by the mean values, a reasonable improvement is observed in the mean value of annual net income, which increased from IDR 57,773,000 to IDR 68.322,000 representing a 18.25% increase after the receipt of loans.

Net income before loans (annual): The result in Table 6.19 shows that almost all respondents (95.4%) achieved annual net incomes below IDR 300 millions before loans. Annual net incomes of more than IDR 300 were only achieved by a very small percentage of respondents (1.2%).

Net income after loans (annual): The findings show that the percentage of respondents who achieved annual net incomes below IDR 300 millions increased to 98.3% as the respondents with IDR 0 net income moved up to this higher category. The number of respondents who achieved net incomes above IDR 300 millions also increased to 2.1%. Thus, it may be argued that the financing had a positive impact not only on microenterprises but also on small and medium-sized enterprises.

Table 6.19: Impact on Value of Net Income

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Net income before loan (annual)	Zero	12	3.5	57,773,000	327,907,000
	Below IDR 300m	331	95.4		
	IDR 300 m - IDR 1b	1	0.3		
	IDR 1 - 2,5 billions	1	0.3		
	IDR 2,5–IDR 5 billion	2	0.6		
	IDR 5 – 10 billions	0	0		
	Above IDR 10 billions	0	0		
	Total	347	100		
	Minimum	0			
	Maximum	4,800,000,000			
Net income after loan (annual)	Zero	0	0	68,322,000	268,970,000
	Below IDR 300 m	342	98.3		
	IDR 300m- IDR 1b	3	0.9		
	IDR 1 - 2,5 billions	1	0.3		
	IDR 2,5 – IDR 5b	2	0.6		
	IDR 5 – 10 billions	0	0		
	Above IDR 10 billions	0	0		
	Total	348	100		
	Minimum	1,200,000			
	Maximum	3,600,000,000			

6.4.2 Impact on Business and Household Expenditures

The economic impact on business and household expenditures are presented in Table 6.20 and Table 6.21. The findings suggest a significant impact on business expenditure, as indicated by improvement of the mean value; which increased from IDR 191,930,000 to IDR 291,690,000 after loans, thus increasing by 52%.

Business expenditures before loans (annual): The results show that majority of the respondents (82.1%) spend below IDR 300 million on business expenditure. Business expenditure of IDR 0 was incurred by 4.3% of the respondents due to them starting new businesses or service businesses that did not require any expenditure.

Business expenditures after loans: As can be seen from Table 6.20, 79% of the respondents had business expenditures below IDR 300 millions, while 15.6% expended between IDR 300 millions and IDR 1 billions annually. The number of respondents whose business costs were below IDR 300 decreased as compared to before loans as they moved to a new, higher category. Similarly, the number of respondents who spent between IDR 300 and IDR 1 billion increased from 10.7% to 15.6%. These are reliable indications of a good impact resulting from financing. It should be noted that business expenditures of IDR 0 might resulted from the nature of some specific service businesses, such as selling mobile top-ups directly from mobile phones, which does not incur any costs.

Table 6.20: Impact on Business Expenditures

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Business expenditures before loan (annual)	Zero	15	4.3	191,930,000	648,823,000
	Below IDR 300m	285	82.1		
	IDR 300m - IDR 1b	37	10.7		
	IDR 1 - 2,5 billions	8	2.3		
	IDR 2,5 – IDR 5 b.	0	0		
	IDR 5 – 10 billions	2	0.6		
	Above IDR 10 billions	0	0		
	Total	347	100		
	Minimum	0			
	Maximum	9,000,000,000			
Business expenditures after loan	Zero	3	0.9	291,690,000	1,124,230,000
	Below IDR 300m	274	79.0		
	IDR 300m - IDR 1b	54	15.6		
	IDR 1 - 2,5 billions	13	3.7		
	IDR 2,5 – IDR 5 b.	1	0.3		
	IDR 5 – 10 billions	1	0.3		
	Above IDR 10 billions	1	0.3		
	Total	347	100		
	Minimum	0			
	Maximum	18,000,000,000			

Further discussion on the impact on household expenditures in particular is presented in Table 6.21. Based on the National (East Java) Poverty Line of IDR 245,035/person/month in March 2012 (Biro Pusat Statistik, 2012: 215) and international poverty line of USD2/person/day, in which the average exchange rate data from Bank Indonesia from mid-August to mid-November was USD 1 = IDR 8.794, USD 2/person/day was equal to IDR 17,589/day/person or IDR 527,660/month/person.

Consequently, based on the national poverty line, the findings show that 40% of the respondents are considered poor before receiving loans, a figure that could be reduced to 29.9% after loans, a reduction of 11 percentage points. Meanwhile, based on the UN poverty line, the percentage of poor respondents was 83.9% before loans, reduced to 78.4% after loans, which is a reduction of 5 percentage points. Thus, based on the findings, it can be inferred that microfinance has a positive impact in terms of reducing poverty. In addition, on average, household expenditures increased from IDR 352,754 before loans to IDR 609,312 per month after loans. In other words, there was a 72% improvement after loans. This might indicate an increased standard of living as a result of the financing.

Table 6.21: Impact on Household Expenditures

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Annual Household expenditure (before loan)	**East Java Poverty Line**			352,754	1,079,824
	Below poverty line	139	40.1		
	Above poverty line	208	59.9		
	Total	347	100		
	Minimum	-1,605,315			
	Maximum	9,264,895			
	International Poverty line			-7,911,591	1,221,505
	Below poverty line	291	83.9		
	Above poverty line	56	16.1		
	Total	347	100		
	Minimum	- 4,148,940			
	Maximum	8,417,020			
Annual Household expenditure (after loan)	**East Java Poverty Line**			609,312	1,201,922
	Below poverty line	104	29.9		
	Above poverty line	244	70.1		
	Total	348	100		
	Minimum	-1,305,315			
	Maximum	9,264,895			
	International Poverty line			-534,994	1,287,215
	Below poverty line	273	78.4		
	Above poverty line	75	21.6		
	Total	348	100		
	Minimum	-3,848,940			
	Maximum	8,417,020			

Household expenditures before loans: The findings in Table 6.21 show that 40% of the respondents had monthly household expenditures below the national poverty line and 83.9% of the respondents had monthly incomes below the UN poverty line.

Household expenditures after loans: As can be seen from Table 6.21, the percentage of respondents living below the poverty line was 29.9% (national poverty line) and 78.4% (UN poverty line).

As regards to the impact on monthly expenditures, Table 6.22 shows the impact particularly on business expenditures and the impact on household expenditures is depicted in Table 6.23. Overall, the majority of the respondents claimed that the received financing had 'no effect' on their businesses expenditures, except on stock. Among others, rent was highly likely to be unaffected by the loans (almost 92%), followed by wages (almost 84%). Although the overall outlook was unpromising, for the variable that directly relates to business, *i.e.* stock, the majority of the respondents declared a positive effect (around 60%). The details are as follows:

Tools/minor equipment: Although the majority of the respondents stated that there was 'no effect' on minor equipment (around 67%), the percentage of respondents who declared a positive impact was much higher (around 33%) than that of the respondents who claimed a negative impact (0.3%).

Stock: Stock seems to be the most important expenditure for the respondents, as the majority of the respondents (around 65% in total) declared a positive effect, mainly a 'major positive effect' (almost 50%). The results show that only 2.3% of the respondents answered 'minor negative impact' and none of them answered 'major negative impact'.

Rent (per year): There is a clear indication that rent paid per year is highly likely to be unaffected by loans (stated by around 92%), which might be explained by the fact that the respondents operated their businesses from their homes. This is in line with the findings from the previous table that the premises did not change. However, 6.6% of the respondents declared a 'positive impact'.

Table 6.22: Impact on Business Expenditures per Month

Variables	Description	Frequency	Valid Percent	Mean	Median
Tools/minor equipment	Major negative effect	0	0	3.37	3
	Minor negative effect	1	0.3		
	No effect	232	66.7		
	Minor positive effect	99	28.4		
	Major positive effect	16	4.6		
	Total	348	100		
Stock (e.g. shop stock, raw materials *etc.*)	Major negative effect	0	0	3.69	4
	Minor negative effect	8	2.3		
	No effect	129	37.2		
	Minor positive effect	173	49.9		
	Major positive effect	37	10.7		
	Total	347	100		
Rent (per year)	Major negative effect	0	0	3.07	3
	Minor negative effect	3	0.9		
	No effect	319	91.9		
	Minor positive effect	23	6.6		
	Major positive effect	2	0.6		
	Total	347	100		
Utilities	Major negative effect	0	0	3.35	3
	Minor negative effect	2	0.6		
	No effect	233	67.1		
	Minor positive effect	102	29.4		
	Major positive effect	10	2.9		
	Total	347	100		
Transport	Major negative effect	1	0.3	3.2	3
	Minor negative effect	3	0.9		
	No effect	260	74.9		
	Minor positive effect	71	20.5		
	Major positive effect	12	3.5		
	Total	347	100		
Wages	Major negative effect	0	0	3.18	3
	Minor negative effect	0	0		
	No effect	291	83.9		
	Minor positive effect	48	13.8		
	Major positive effect	8	2.3		
	Total	347	100		
Loan repayment	Major negative effect	0	0	3.30	3
	Minor negative effect	6	1.7		
	No effect	252	72.6		
	Minor positive effect	69	19.9		
	Major positive effect	20	5.8		
	Total	347	100		

Utilities: The results indicate that a majority of the respondents (67%) declared 'no effect' on utilities expenditure, followed by around 29% of the respondents who stated 'minor positive effect'.

Transport: Similar to findings on other variables in this question, almost 75% of the respondents declared 'no effect' on transport expenditures. However, 24% of the respondents stated a positive effect, mainly a 'minor positive effect' (20.5%).

Wages: A large majority (84%) of the respondents' expenditures on wages were not affected by the loans. However, around 16% of the respondents reported a positive impact, mainly a 'minor positive impact' (13.8%), and none of the respondents experienced a negative effect.

Loan repayments: The findings show that the majority of the respondents (72.6%) stated 'no effect' on loan repayments, followed by almost 20% who declared a 'minor positive effect'.

The second part of the impact on expenditures, particularly on household expenditures, is presented in the Table 6.23. In general, similar to the findings in the business expenditures, a large majority of the respondents claimed that there was 'no effect' on household expenditures, mainly transport, household utensils and furniture. However, a significant number of the respondents declared a positive impact, mainly on food and education expenditures. The details are as follows:

Food: Although the majority of the respondents claimed 'no effect' on food expenditures (67.3%), almost 30% declared a positive effect, mainly a minor positive effect (28.3%). This might indicate that the food consumption pattern of the majority of the respondents did not change since they had a stable pattern of food consumption.

Health/medical: These expenditures had the smallest positive effect (16%), compared to other household expenditures, while 83% or the respondents stated 'no effect'. This might be a good indication of the good health of the respondents as they did not need to increase medical expenditures.

Table 6.23: Impact on Household Expenditures per Month.

Variables	Description	Frequency	Valid Percent	Mean	Median
Food	Major negative effect	2	0.6	3.28	3
	Minor negative effect	8	2.3		
	No effect	233	67.3		
	Minor positive effect	98	28.3		
	Major positive effect	5	1.4		
	Total	346	100		
Health/medical	Major negative effect	0	0	3.17	3
	Minor negative effect	2	0.6		
	No effect	288	83.0		
	Minor positive effect	53	15.3		
	Major positive effect	4	1.2		
	Total	347	100		
Education	Major negative effect	1	0.3	3.30	3
	Minor negative effect	4	1.2		
	No effect	241	69.9		
	Minor positive effect	90	26.1		
	Major positive effect	9	2.6		
	Total	345	100		
Clothing	Major negative effect	1	0.3	3.23	3
	Minor negative effect	2	0.6		
	No effect	267	76.9		
	Minor positive effect	71	20.5		
	Major positive effect	6	1.7		
	Total	347	100		
Transport	Major negative effect	1	0.3	3.21	3
	Minor negative effect	1	0.3		
	No effect	273	78.7		
	Minor positive effect	67	19.3		
	Major positive effect	5	1.4		
	Total	347	100		
Household utensils	Major negative effect	0	0	3.30	3
	Minor negative effect	1	0.3		
	No effect	245	70.4		
	Minor positive effect	97	27.9		
	Major positive effect	5	1.4		
	Total	348	100		
Furniture/electronic purchases (per year)	Major negative effect	1	0.3	3.24	3
	Minor negative effect	0	0		
	No effect	265	76.4		
	Minor positive effect	77	22.2		
	Major positive effect	4	1.2		
	Total	347	100		

Education: Although almost 70% of the respondents declared ‘no effect’ on education expenditures, a positive effect was affirmed by almost 29%. This might indicate the improving educational level of the respondents’ family members, although 1.5% of the respondents claimed a negative effect.

Clothing: The expenditure on clothing by almost 80% of the respondents was not affected by loans, which might indicate that the respondents were not consumptive buyers as they have a stable consumption of clothing. However, around 22% of the respondents increased their clothing expenditures, mainly noting a ‘minor effect’ (19.3%).

Transport: This expenditure achieved the highest ‘no effect’ response, since the majority of the respondents (78.7%) claimed ‘no effect’ on transport expenditures, followed by a minor positive effect (19.3%).

Household utensils: The majority of the respondents answered ‘no effect’ (70.4%), followed by ‘minor positive effect’ (27.9%).

Furniture/electronic purchases (per year): As with other expenditures, a large majority of the respondents also claimed ‘no effect’ (76.4%), while 22.2% of the respondents stated a minor positive effect, which might indicate an improvement in the quality of household property.

6.4.3 Impact on Assets

The findings on impacts on assets based on the respondents’ perceptions are presented in Table 6.24. Although the majority of the respondents declared that there was ‘no effect’ on all types of assets, there were still some improvements to be noted. Among others, productive assets received the highest positive impact, both minor and major, for almost 60% of respondents. This was followed by electrical goods (around 30%), savings (28%) and private cars/motorcycles (27%). It can be argued that the respondents preferred to invest their incomes in productive assets to support their business operations rather than investing in high-value fixed assets which were unaffordable. Negative effects were also experienced by a very small percentage of the respondents (less than 1%) in regard to all types of assets. The details are as follows:

Land/Agricultural: This asset class was highly unlikely to be affected assets by loans, therefore, 85% of the respondents declared ‘no effect’. Around 12% of the respondents stated ‘minor positive effects’. This implies that the respondents could not afford to purchase this expensive fixed asset.

Buildings: The results show that more than 75% of the respondents declared ‘no effect’ on buildings. However, around 24% of the respondents experienced a minor increase in building activities.

Private cars/motorcycles: The option of ‘no effect’ was declared by around 72% of the respondents, followed by 23.6% of the respondents answering ‘minor positive effect’, as can be seen from Table 6.24.

Cattle: Based on the findings, cattle were the most unaffected assets as almost all of the respondents (92%) answered ‘no effect’. This is due to the unpopularity of keeping cattle, except for stock breeders who formed just a small part of the respondents’ fields of business.

Productive assets: Because these assets are the most important assets for business operations, around 43% of the respondents declared a ‘minor positive impact’ and 17% of them answered ‘major positive effect’, which was the highest percentage of the remainder. However, the findings show that 39% of the respondents claimed ‘no effect’.

Electrical goods: The results in Table 6.24 indicate that almost 70% of the respondents stated that loans have ‘no effect’ on electrical goods. However, 28% of the respondents reported a minor positive effect.

Jewellery (gold): Jewellery or gold as an investment seems to be unattractive for a large majority of the respondents (around 88%). The findings suggest that only 10.8% of the respondents declared a ‘minor positive effect’.

Savings: As depicted in Table 6.24, the savings of around 70% of the respondents were not affected by loans, while around 26% of the respondents reported a ‘minor positive effect’.

Table 6.24: Impact on Assets

Variables	Description	Frequency	Valid Percent	Mean	Median
Land/Agricultural	Major negative effect	1	0.3	3.15	3
	Minor negative effect	2	0.6		
	No effect	295	85.3		
	Minor positive effect	41	11.8		
	Major positive effect	7	2.0		
	Total	346	100		
Buildings	Major negative effect	1	0.3	3.28	3
	Minor negative effect	0	0		
	No effect	260	75.4		
	Minor positive effect	70	20.3		
	Major positive effect	14	4.1		
	Total	345	100		
Private cars/motorcycles	Major negative effect	1	0.3	3.29	3
	Minor negative effect	3	0.9		
	No effect	249	71.8		
	Minor positive effect	82	23.6		
	Major positive effect	12	3.5		
	Total	347	100		
Cattle	Major negative effect	0	0	3.08	3
	Minor negative effect	1	0.3		
	No effect	318	91.9		
	Minor positive effect	24	6.9		
	Major positive effect	3	0.9		
	Total	346	100		
Productive assets	Major negative effect	1	0.3	3.76	3
	Minor negative effect	2	0.6		
	No effect	135	39.2		
	Minor positive effect	147	42.7		
	Major positive effect	59	17.2		
	Total	344	100		
Electrical goods	Major negative effect	0	0	3.31	3
	Minor negative effect	2	0.6		
	No effect	240	69.6		
	Minor positive effect	97	28.1		
	Major positive effect	6	1.7		
	Total	345	100		
Jewellery (gold)	Major negative effect	0	0	3.12	3
	Minor negative effect	3	0.9		
	No effect	301	87.5		
	Minor positive effect	37	10.8		
	Major positive effect	3	0.9		
	Total	344	100		
Savings	Major negative effect	0	0	3.30	3
	Minor negative effect	5	1.5		
	No effect	240	69.8		
	Minor positive effect	89	25.9		
	Major positive effect	10	2.9		
	Total	344	100		

6.4.4 Impact on Economic Activities

The impacts on economic activities are shown in Table 6.25. The classification of this impact is slightly different from the previous classifications, as ‘moderate positive impact’ is inserted between ‘minor’ and ‘major positive impact’ with the aim of obtaining more detailed and reliable responses about this particular variable. Among others, the most positive effect was on the volume of goods/services, followed by quality of products. Bookkeeping appears to be the variable receiving the least positive impact and the highest number of ‘no effect’ responses. Unfortunately, a small number of the respondents also declared a negative effect on almost all economic activity variables except premises. The details are as follows:

Volume of goods/services sold: Overall, positive effects were reported by almost 73% of the respondents, who mainly answered ‘moderate positive effect’ (37.4%), followed by ‘minor positive effect’ (26.7%). As can be seen from Table 6.25, only a very small number of respondents claimed ‘negative effect’ (3.4%). This may imply a significant improvement in the volume of goods/services sold, which indicates the businesses’ development.

Quality of goods/services: The result shows that the quality of products seems to be increasing, as almost half of the respondents reported a positive effect, with ‘moderate effect’ being the main choice (27.3%). Unfortunately, the other half of the respondents (50%) declared ‘no effect’ on the quality of goods/services while 0.6% of the respondents answered ‘negative effect’.

Diversification into new goods/services: The findings show that a majority of the respondents (62.4%) stated ‘no effect’ on this variable, while another 37% of the respondents declared a positive effect, in particular a ‘moderate positive effect’ (around 20%).

Table 6.25: Impact on Economic Activities

Variables	Description	Frequency	Valid Percent	Mean	Median
Volume of goods/services sold	Negative effect	12	3.4	3.24	4
	No effect	83	23.9		
	Minor positive effect	93	26.7		
	Moderate positive effect	130	37.4		
	Major positive effect	30	8.6		
	Total	348	100		
Quality of goods/services	Negative effect	2	0.6	2.85	2
	No effect	174	50.0		
	Minor positive effect	61	17.5		
	Moderate positive effect	95	27.3		
	Major positive effect	16	4.6		
	Total	348	100		
Diversification into new goods/services	Negative effect	2	0.6	2.62	2
	No effect	216	62.4		
	Minor positive effect	49	14.2		
	Moderate positive effect	68	19.7		
	Major positive effect	11	3.2		
	Total	346	100		
Production technology	Negative effect	2	0.6	2.16	2
	No effect	304	87.6		
	Minor positive effect	26	7.5		
	Moderate positive effect	12	3.5		
	Major positive effect	3	0.9		
	Total	347	100		
Bookkeeping	Negative effect	2	0.6	2.14	2
	No effect	311	89.9		
	Minor positive effect	18	5.2		
	Moderate positive effect	14	4.0		
	Major positive effect	1	0.3		
	Total	346	100		
Premises	Negative effect	0	0	.37	2
	No effect	273	78.4		
	Minor positive effect	32	9.2		
	Moderate positive effect	32	9.2		
	Major positive effect	11	3.2		
	Total	348	100		

Production technology: More than 87% of the respondents answered ‘no effect’, which may indicate that they were using adequate production technology. Besides, most of the respondents’ fields of business did not involve producing goods. However, the other respondents still reported a positive effect (around 12% in total), mainly a ‘minor positive effect’ (7.5%).

Bookkeeping: The results in Table 6.25 indicate that almost 90% of the respondents claimed ‘no effect’; bookkeeping thus had the largest ‘no effect’ score. However, fewer than 10% of the respondents reported a positive effect on bookkeeping, mainly a ‘minor positive effect’.

Premises: The findings show that the option of ‘no effect’ on premises was recorded by a majority of the respondents (78%). In other words, they operated their businesses in their previous premises. However, around 21% of the respondents improved their premises, mainly claiming a minor (9.2%) and moderate (9.2%) positive effect. It should be noted that none of the respondents claimed a ‘negative effect’ on premises, which indicates their ability to sustain their businesses.

6.4.5 Impact on Employment

Impact on employment before and after loans is presented in Table 6.26 and Table 6.27. According to ADB categories, an enterprise is considered a microenterprise if it has five workers or fewer (ADB, 2009: 22). The findings on total workers before loans show that a large majority of the respondents (92.8%) had less than five workers. Thus, it can be argued that, under the ADB categories, almost all of the respondents were classified as operators of microenterprises. In addition, the respondents are highly likely to be single workers, both male and female, before and after loans. The findings on mean value suggest that there were slightly more male workers than female workers, at 1.25 and 1.22 respectively. Similarly, the maximum values also show that the maximum number of male workers (20 male workers) was higher than maximum number of female workers (18 female workers). The details are as follows:

Table 6.26: Employment before Loan

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Number of males working in respondent's business (paid and unpaid including family members and respondent)	0	102	29.3	1.25	1.832
	1	179	51.4		
	2	27	7.8		
	3	16	4.6		
	4	10	2.9		
	5	3	.9		
	6	3	.9		
	7	2	.6		
	8	3	.9		
	11	2	.6		
	20	1	.3		
	Total	348	100.0		
	Minimum	0			
	Maximum	20			
Number of females working in respondent's business (paid and unpaid including family members and respondent)	0	107	30.7	1.22	2.142
	1	191	54.9		
	2	22	6.3		
	3	9	2.6		
	4	5	1.4		
	5	3	.9		
	7	1	.3		
	8	1	.3		
	9	2	.6		
	10	3	.9		
	12	1	.3		
	15	1	.3		
	18	2	.6		
	Total	348	100.0		
	Minimum	0			
	Maximum	18			
Total number of persons working in respondent's business (paid and unpaid including family members and respondent)	0	8	2.3	2.46	3.341
	1	151	43.4		
	2	102	29.3		
	3	36	10.3		
	4	19	5.5		
	5	7	2.0		
	6	5	1.4		
	7	4	1.1		
	8	5	1.4		
	9	2	.6		
	10	1	0.3		
	Above 10	8	0.2		
	Total	348	100		
	Minimum	0			
	Maximum	38			

Male workers before loans: As can be seen from Table 6.26, more than half (51.1%) of the respondents were self-employed with no other workers. Another 29.6% of the respondents reported no male workers in the business, which means that only a woman or women work there. The results also show that 29.3% of the respondents had no male workers, which may suggest that the female participants worked alone or had only female workers.

Female workers before loans: Similarly, the findings indicate that the majority of the respondents' businesses had only a single female worker (54.9%), followed by zero female workers (27.4%), which may suggest that the male participants either worked alone or employed only male workers.

Total workers before loans: As can be seen from Table 6.26, the bulk of the respondents (43.4%) had one worker, while 29.3% of them had two. If respondents reported zero workers, this indicates new businesses which had just started upon receipt of loans.

Table 6.27 presents the impact on employment after loans. Based on the maximum value, the findings show an improvement in the maximum numbers of male workers and female workers. While the maximum number of male workers increased from 20 to 29 male workers after loans, the maximum number of female workers improved from 18 to 20. Similarly, the mean values of both male and female workers also increased, from 1.25 to 1.66 and from 1.22 to 1.37 respectively. Thus, on average, as indicated by the mean value, the total number of workers after loans also increased, from 2.46 to 3.03. In addition, the percentage of respondents who worked alone before loans (43.4%) decreased to 40.2% after loans, followed by an improvement in the total number of workforces of more than one person. This indicates a shift in respondents who have moved to a new, higher category. This finding may indicate that the respondents' businesses are highly likely to improve and have a direct positive impact on employment. The details are as follows:

Male workers after loans: As can be seen from Table 6.27, there is no change as compared to before loans; in the majority of cases, males operated the businesses alone (47.1%). On average, the number of male workers was 1.66. Similarly, zero workers indicate that the female respondents were working alone or worked with female workers only.

Female workers after loans: The results suggest that the single worker was still dominant amongst the respondents (52.3%). The mean value representing average number of female workers was 1.37. Again, in this case zero female workers means that the male respondents were working alone or only worked with male workers.

Table 6.27a: Impact on Employment after Loan

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Number of males working in respondent's business (paid and unpaid including family members and respondent)	0	95	27.3	1.66	2.695
	1	164	47.1		
	2	25	7.2		
	3	21	6.0		
	4	14	4.0		
	5	9	2.6		
	6	2	.6		
	7	5	1.4		
	8	4	1.1		
	9	1	.3		
	10	3	.9		
	11	2	.6		
	12	1	.3		
	20	1	.3		
	29	1	.3		
	Total	348	100.0		
	Minimum	0			
	Maximum	29			
Number of females working in respondent's business (paid and unpaid including family members and respondent)	0	97	27.9	1.37	2.210
	1	182	52.3		
	2	29	8.3		
	3	13	3.7		
	4	7	2.0		
	5	7	2.0		
	6	3	.9		
	7	2	.6		
	8	1	.3		
	9	1	.3		
	10	2	.6		
	12	1	.3		
	15	1	.3		
	18	1	.3		
	20	1	.3		
	Total	348	100.0		
	Minimum	0			
	Maximum	20			

Total workers after loans: The findings indicate that the bulk of the respondents were single workers (40.2%), followed by respondents who reported two workers in their businesses (25.9%).

Persons allocating more time to productive activities: The findings show that the respondents declared that they themselves spend more time (63.5%) than other persons in the business, followed by spouses (21.8%). This may be explained by the fact that the majority of respondents run family businesses, which mainly involve only the respondents and their spouses. As the results indicate, when there is a business partner, only 0.4% of them allocate more time to the business after loans.

Table 6.27b: Impact on Employment after Loan

Variables	Description	Frequency	Valid Percent	Mean	Standard Deviation
Total number of workers	1	140	40.2	3.0316	4.04323
	2	90	25.9		
	3	43	12.4		
	4	21	6.0		
	5	14	4.0		
	6	5	1.4		
	7	8	2.3		
	8	9	2.6		
	9	3	.9		
	10	3	.9		
	11 – 20	8	0.2		
	21 – 30	2	0.1		
	Above 31	2	0.1		
	Total	348	100		
	Minimum	1			
	Maximum	38			
Persons allocating more time to productive activities as a result of the loan. (the respondents might choose more than one)	Self	318	63.5	-	-
	Spouse	109	21. 8		
	Other household members	38	7.6		
	Employees (non family members)	34	6.8		
	Business partner	2	0.4		
	Total	501	100		

6.5. REPORTING THE PERCEPTIONS ON SOCIAL IMPACT

This section describes the findings related to social impact on the respondents in terms of whether they received social services or not (Table 6.28). Subsequently, this section reveals which social services are provided by BMT/BPRS to their customers, and how these impact the respondents in social (Table 6.29), religious (Table 6.30) and other personal aspects (Table 6.31).

6.5.1 Social Services

Table 6.28 shows that the bulk of the respondents (52.5%) did not receive social service development programmes, followed by 28.1% of the respondents who declared that they ‘do not know or do not remember’ about this service. It should be noted that the percentage of respondents who received social development programmes was 19.4%, mainly consultancy services (10.7%) and religious training (6.7%). This may be explained by the fact that the majority of the institutions did not provide social services due to the cost incurred in providing these services and the limited number of staff.

Table 6.28: Social Services

Variables	Description	Frequency	Valid Percent
Social services (the respondents might answer more than one option)	Management training (organisational, management and bookkeeping *etc*)	6	1.7
	Technical training	1	0.3
	Consultancy services	38	10.7
	Religious training related to business ethics	24	6.7
	No social services development programme	187	52.5
	Don’t know/don’t remember	100	28.1
	Total	356	100

6.5.2 Social Impact

Table 6.29 presents social impacts based on the respondents’ perceptions. In general, although relationships with both spouse/family members and with other group members were not affected (affirmed by around 60%), around 40% of the respondents noted an improvement in their relationships. It is worth noting that ‘negative effect’ is very minor, since it is less than 1%.

Relationship with spouse/family members: As can be seen from Table 6.26, improvements in relationships with spouse/family members was noted by around 39% of the respondents, although the majority still claimed there was ‘no effect’ (60.4%). In detail, ‘minor’ and ‘moderate effects’ were claimed by 17.9% and 16.2% respectively. This might imply that higher income positively influences relationships with spouse/family members.

Table 6.29: Social Impact

Variables	Description	Frequency	Valid Percent	Mean	Median
Relationships with spouse/family members	Negative effect	3	0.9	2.62	2
	No effect	209	60.4		
	Minor effect	62	17.9		
	Moderate effect	56	16.2		
	Major effect	15	4.3		
	Total	346	100		
Relationships with other group members (if respondent is a member of a group)	Negative effect	1	0.5	2.50	2
	No effect	134	65.7		
	Minor effect	39	19.1		
	Moderate effect	27	13.2		
	Major effect	3	1.5		
	Total	204	100		

Relationship with other group members: The findings show that 65.7% of the respondents claimed there was ‘no effect’ on this specific relationship. This high ‘no effect’ result may have resulted from the low percentage of borrowers who are members of a group in order to get financing and the insignificant role of the financing group in helping members. The option ‘minor effect’ was chosen by 19.1% of the respondents.

6.5.3 Religious Impact

Religious impact is presented in Table 6.30, including Islamic knowledge and practice in both personal and business life. The findings outline that majority of the respondents (around 80%) declared ‘no effect’ on religious life. However, a positive religious impact was claimed by around 20% of the respondents.

Knowledge of Islam: Based on the survey outcome, only around 22% of the respondents noted an improvement on Islamic knowledge; namely, ‘minor effect’ (11.3%) and ‘moderate effect’ (8.1%). This may be due to the limited number of respondents who receive religious training (6.7%).

Islamic practice: The findings show that the percentage of respondents who answered 'no effect' is even higher for this variable than for Islamic knowledge; the details are as follows:

Personal life: As can be seen in Table 6.30, a large majority of the respondents answered 'no effect' (81.1%), followed by 'minor effect' (8.4%) and 'moderate effect' (7.3%).

Business life: Similarly, the findings show that a large majority of the respondents claimed 'no effect' (81.7%), followed by 'minor effect' (9.9%), and 'moderate effect' (6.1%).

Table 6.30: Religious Impact

Variables	Description	Frequency	Valid Percent	Mean	Median
Knowledge of Islam	Negative effect	1	0.3	2.35	2
	No effect	268	77.7		
	Minor effect	39	11.3		
	Moderate effect	28	8.1		
	Major effect	9	2.6		
	Total	345	100		
Islamic practice in personal life	Negative effect	1	0.3	2.31	2
	No effect	279	81.1		
	Minor effect	29	8.4		
	Moderate effect	25	7.3		
	Major effect	10	2.9		
	Total	344	100		
Islamic practice in business life	Negative effect	1	0.3	2.28	2
	No effect	281	81.7		
	Minor effect	34	9.9		
	Moderate effect	21	6.1		
	Major effect	7	2.0		
	Total	344	100		

6.5.4 Other Impacts

Impacts on aspects of personal life are presented in Table 6.31. As can be seen in the table, a majority of the respondents declared 'no effect' in all aspects of this impact. However, significant improvements did exist, mainly in women's opportunities for decision-making, with almost half of the respondents (48.7%) stating a positive impact.

Table 6.31: Other Impacts

Variables	Description	Frequency	Valid Percent	Mean	Median
Children's education	Negative effect	6	1.7	2.44	2
	No effect	229	66.6		
	Minor effect	69	20.1		
	Moderate effect	31	9.0		
	Major effect	9	2.6		
	Total	344	100		
Nutrition	Negative effect	3	0.9	2.42	2
	No effect	231	67.0		
	Minor effect	80	23.2		
	Moderate effect	25	7.2		
	Major effect	6	1.7		
	Total	345	100		
Housing stock	Negative effect	1	0.3	2.38	2
	No effect	243	70.4		
	Minor effect	76	22.0		
	Moderate effect	18	5.2		
	Major effect	7	2.0		
	Total	345	100		
Health	Negative effect	4	1.2	2.31	2
	No effect	261	75.7		
	Minor effect	55	15.9		
	Moderate effect	19	5.5		
	Major effect	6	1.7		
	Total	345	100		
Family empowerment	Negative effect	1	0.3	2.44	2
	No effect	235	67.9		
	Minor effect	72	20.8		
	Moderate effect	32	9.2		
	Major effect	6	1.7		
	Total	346	100		
Women's decision-making power	Negative effect	0	0	2.82	2
	No effect	177	51.3		
	Minor effect	67	19.4		
	Moderate effect	88	25.5		
	Major effect	13	3.8		
	Total	345	100		

Children's education: The findings show that the option 'no effect' was reported by 67% of the respondents, followed by 'minor effect' (20%). Unfortunately, this result suggests that a small percentage of the respondents (1.7%) claimed a 'negative effect'.

Nutrition: It seems that there are no significant improvements in nutrition since 67% of the respondents claim ‘no effect’, as presented in Table 6.31. However, a ‘minor effect’ was stated by 23% of the respondents, which indicates a good impact.

Housing stock: Again, similar to the previous findings, a large majority of the respondents answered ‘no effect’ (70.4%) followed by ‘minor effect’ (22%).

Health: The results show that 75.7% of the respondents answered ‘no effect’, while 15.9% of the respondents declared a ‘minor effect’

Family empowerment: The results did not show any difference in this aspect, as a large majority of the respondents answered ‘no effect’ (67.9%), followed by ‘minor effect’ (20.8%)

Women’s decision-making power: The findings reveal, among others, that this variable shows the best performance in terms of positive impact on the respondents’ lives: 25.5% of respondents answered ‘moderate effect’ and 19.4% of them answered ‘minor effect’. This is a good indication that the improvement of business resulting from financing improved women’s decision-making power.

6.6. MAJOR ISSUES AND PROBLEMS OF MICRO AND SMALL ENTERPRISES IN EAST JAVA, INDONESIA

This section attempts to answer the research questions about the major issues and problems reportedly faced by microenterprises in East Java, Indonesia, including problems in managing their businesses, level of knowledge of Islamic terms used in financing products, the original intention of borrowing money compared to actual use of the funds, collateral, and arrears issues.

6.6.1. Problems Experienced by Businesses

Managing a business can be challenging task due to a number of factors. In evidencing this, the findings in the previous chapter indicate that some of the respondents had business problems. This section is intended to further examine as to whether there is a correlation between certain subgroups and the kinds of business problems they experienced. For this, the Mann-Whitney U Test (MWU) and the Kruskal-Wallis Test (KW) were applied. The MW test is applied to the variables involving not more than two categories such as main sources of income, gender, religious activity, areas of business, type of micro financing sources, and subgroups membership. The KW test, on the other hand, is applied to the variables with more than three categories involving other sources of financing, age subgroups, education, business field, manager/owner, place of business, business age, productive asset (grouped), annual sales (grouped), and total workers after financing (grouped). The summaries of the significant findings related to each of the identified business problem are shown in Tables 6.33 to 6.37. Due to the limited amount of space available, the findings of non-significant subgroups are not presented in detail.

6.6.1.1. Production Problems

The previous chapter indicated that 69.8% of the respondents declared that they 'never' had production problems. However, the remaining respondents faced production problems, ranging from 'rarely' to 'often'. As can be seen from Table 6.33, based on the confidence level of p=.05, the findings from MWU test and KW test show statistically significant differences in the following variables: areas of business (p=0.24), other sources of income (p=.025), business field (p=.011), and total workers after financing (p=.000).

It should be noted that, for each variable, the subgroups with highest mean rank had fewest production problems; in other words, the subgroups with lowest mean rank had the most production problems. Therefore, it can be assumed that the fewest production problems were reportedly faced by respondents in rural areas, those who had other incomes as teachers/lecturers or were retired, those employed in government-owned companies, those in manufacturing/craft businesses, those with businesses established for over 51 years, and those who had between 6 and 10 workers in total. In addition, the most production problems were faced by respondents in urban areas, those who had other sources of income as employees in government-owned companies, those in food production businesses, those with businesses established for between 41 and 50 years, and those with between 11 and 20 workers in total.

Table 6.33: MWU Test and KW Test: Production Problems

Variable	Subgroup	N	Mean Rank	z,	Asymp. Sig. (*p*)	Effect Size
Problems of Production	**Areas Of Business** Rural Urban Total N	 116 232 348	 188.46 167.52	-2.263	.024	-0.121
	Other Sources Of Income Civil Servant/ Gov. Officials Employee in Private comp. Employee in gov-owned Co Teacher/Lecturer Professional Retired Students Housewives None Other Total N	 6 27 1 3 0 2 0 71 209 28 347	179.17 189.15 269.00 122.00 0 122.00 0 173 166 221	15.989	.025	0.858
	Business Field Trade/shops/retail Manufacturing/craftsman Services Transportation Agriculture services/ Forestry/stock breeder Food production Total	 212 25 35 4 27 45 348	 169.72 223.48 176.21 171.25 198.56 154.31	14.951	.011	0.801
	Business age subgroups Below 10 years 11 – 20 years 21 – 30 years 31 -40 years 41 – 50 years Above 51 years Total	 183 102 39 19 2 2 347	 171.80 163.57 186.76 224.18 122.00 233.25	11.999	.035	0.644
	Total workers after financing Single worker 2 -5 workers 6-10 workers 11-20 workers Above 21 workers Total	 140 168 28 8 4 348	 160.18 177.68 237.21 122.00 208.13	25.258	.000	1.353

The same tests were conducted for the other variables. However, no statistically significant differences were found among subgroups of microenterprises as main sources of income, gender, religious activity, type of micro financing sources, age, education, manager/owner, place of business, productive assets (grouped) and annual sales.

Therefore, it was highly likely that the size of business in terms of assets or sales was not directly linked to production problems, although there seems to have been a correlation between the number of workers and production problems.

6.6.1.2. Financial Problems

As depicted in Table 6.34, financial problems seem to be the toughest problems, as this category had the greatest total percentage of respondents who answered ‘sometimes’ and ‘often’ (40%) and the lowest percentage of ‘never’ (32.5%). In other words, around 70% of the respondents had financial problems, ranging from ‘sometimes’ to ‘often’. This section aims to examine which subgroups of respondents reported the most financial problems.

Table 6.34: MWU Test and KW Test: Financial Problems

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Problems of Finances	**Areas of Business**					
	Rural	116	201.36	-3.676	.000	-0.197
	Urban	232	161.07			
	Total N	348				
	Micro financing sources					
	BMT	179	186.27	-2.343	.019	-0.126
	BPRS	169	162.04			
	Total N	348				
	Income Other Than From Microenterprises					
	Civil Servant/Gov. Officials	6	108.25	16.944	.018	0.910
	Employee in Private company	27	169.78			
	Employee in Gov-Owned Co.	1	258.50			
	Teacher/Lecturer	3	57.00			
	Retired	2	157.75			
	Housewife	71	179.80			
	None	209	169.02			
	Other	28	225.30			
	Total N	347				
	Total workers after financing					
	Single worker	140	165.78	15.448	.004	0.828
	2 -5 workers	168	170.32			
	6-10 workers	28	217.55			
	11-20 workers	8	272.56			
	Above 21 workers	4	157.75			
	Total	348				

The results of MWU and KW tests show statistically significant differences among subgroups of areas of business (*p*=.000), type of micro financing institution (*p*=.019), income other than from microenterprises **(***p*=.018), and total number of workers after financing (*p*=.004).

It should be noted that, in this group, the subgroups with a higher mean ranking implies bigger financial problems. Thus, the most financial problems are highly likely to be found among respondents in urban areas, BMT respondents, employees in government-owned companies, and those with between 11 and 20 workers in total.

The findings of both tests show no statistically significant differences among subgroups of microenterprises in relation to the main sources of income, gender, religious activity, membership of subgroups, other sources of income, age, education, business field, manager/owner, place of business, business age, productive assets (grouped) and annual sales. Therefore, it was highly likely that the size of business in terms of assets or sales was not directly linked to production problems, although there seems to have been a correlation between the number of workers and production problems.

6.6.1.3. Bookkeeping Problems

The aim of this section is to examine further which subgroups of respondents 'never' had bookkeeping problems. As can be seen from the Table 6.7, 93.1% of respondents claimed they 'never' had bookkeeping problems. Similarly, the MWU and KW tests were applied in this section, and the findings show statistically significant differences among subgroups of areas of business (*p*=.002), income other than from microenterprises (*p*=.017), place of business location (*p*=.000), and business age subgroups (*p*= .042).

It should be noted that in this part, the subgroups with the highest mean ranking had the fewest bookkeeping problems. Therefore, the respondents with fewest bookkeeping problems were in rural areas, had income other than from microenterprises in 'other' criteria (rice mills), had 'other' places of business location (rice mills), and had businesses aged above 51 years. Meanwhile the most bookkeeping problems were faced by the respondents with the lowest mean ranking, and were those who were in urban areas, had other income as employees in government-owned companies, were teachers/lecturers and were retired, had business locations in industrial estates, used traditional markets and agricultural land, and had businesses aged between 21 and 30 years and between 41 and 50 years.

Table 6.35: MWU Test and KW Test: Bookkeeping Problems

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (p)	Effect size
Problems of Bookkeeping	**Areas Of Business**					
	Rural	116	185.07	-3.155	.002	-0.169
	Urban	232	169.22			
	Total	348				
	Income Other Than From Microenterprises					
	Civil Servant/Gov. Official	6	191.67	17.035	.017	0.914
	Employee in Private co	27	168.19			
	Employee in Gov. Comp.	1	162.00			
	Teacher/Lecturer	3	162.00			
	Retired	2	162.00			
	Housewife	71	171.56			
	None	209	171.22			
	Other	28	205.32			
	Total	347				
	Place of Business Location					
	Fully Mobile	47	180.00	26.626	.000	1.429
	Home	136	176.25			
	Home shop	53	184.68			
	Industrial estate	1	162.00			
	Traditional market	104	162.00			
	Agricultural land	5	162.00			
	Other	1	340.00			
	Total	347				
	Business Age Subgroups					
	Below 10 years	183	173.25	11.544	.042	0.620
	11 – 20 years	102	175.87			
	21 – 30 years	39	162.00			
	31 -40 years	19	188.95			
	41 – 50 years	2	162.00			
	Above 51 years	2	251.00			
	Total	347				

As the results show, no statistically significant differences among subgroups of microenterprises as main sources of income, gender, religious activity, type of micro financing sources, membership of subgroups, age, education, business field, manager/owner, productive assets (grouped), and annual sales. Therefore, it was highly likely that the size of business in terms of assets or sales was not directly linked to bookkeeping problems.

6.6.1.4. Management Problems

As can be seen from Table 6.7 in the previous chapter, a large number of respondents (93.1%) declared that they 'never' had management problems. Therefore, this section investigates as to which subgroups of respondents had fewer management problems.

The results of the MWU test and KW test, as depicted in Table 6.36, show statistically significant differences among subgroups of gender (p=.001), areas of business (p=.000), income other than from microenterprises (p= .004), business field (p=.020), main manager/owner (p= .019), and total number of workers (p=.000).

As for this section, the subgroups with the highest ranking had the fewest management problems. Therefore, the respondents with the fewest management problems were male, lived in rural areas, were employees in government companies, were in service businesses, had other family members as the main manager/owner, located the business in 'other' areas (rice mills), and had more than 21 or between 6 and 10 workers. On the other hand, the respondents with the most management problems were female, lived in urban areas, had other income as teacher/lecturer and retired, were in transportation businesses, had business partners as main manager/owner, were located on industrial estates and agricultural land, and had between 11 and 20 workers.

The findings of both tests suggest that there were no statistically significant differences among subgroups of microenterprises as main sources of income, religious activity, type of micro financing sources, membership of subgroups, age, education, business age, productive assets (grouped), and annual sales. Therefore, it was highly likely that the size of business in terms of assets or sales was not directly linked to production problems, although there seems to have been a correlation between the number of workers and production problems.

Table 6.36: MWU Test and KW Test: Management Problems

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (p)	Effect size
Problems of Management	**Gender**					
	Male	189	181.80	-3.358	.001	-0.180
	Female	159	165.83			
	Total	348				
	Areas Of Your Business					
	Rural	116	186.49	-3.580	.000	-0.192
	Urban	232	168.50			
	Total	348				
	Income Other Than From Microenterprises					
	Civil Servant/ Gov. Official	6	190.42	20.978	.004	1.126
	Employee in Private Co.	27	168.70			
	Employee in Gov. Co.	1	330.00			
	Teacher/Lecturer	3	162.50			
	Retired	2	162.50			
	Housewife	71	172.42			
	None	209	171.67			
	Others	28	193.43			
	Total	347				
	Business Field					
	Trade/shops/retail	212	170.70	13.339	.020	0.715
	Manufacturing/craftsman	25	190.76			
	Services	35	192.54			
	Transportation	4	162.50			
	Agriculture services/ forestry/stock breeder	27	181.48			
	Food production	45	166.22			
	Total	348				
	Main Manager/Owner					
	Self	312	172.06	9.897	.019	0.531
	Spouse	31	195.56			
	Other family member	4	204.38			
	Business partner	1	162.50			
	Total	348				
	Place of Business Location					
	Fully Mobile	47	173.52	23.473	.001	1.260
	Home	136	180.28			
	Home shop	53	175.91			
	Industrial estate	1	162.50			
	Traditional market	104	164.11			
	Agricultural land	5	162.50			
	Other	1	339.50			
	Total	347				
	Total numbers of workers					
	Single worker	140	166.21	22.518	.000	1.207
	2 -5 workers	168	175.88			
	6-10 workers	28	206.50			
	11-20 workers	8	162.50			
	Above 21 workers	4	206.88			
	Total	348				

6.6.1.5. Marketing Problems

Recalling the findings in Table 6.7 in the previous chapter, 62.4% of the respondents declared that they 'never' had marketing problems. This section, therefore, further examines which subgroups of respondents had the fewest marketing problems.

Table 6.37: MWU Test and KW Test: Marketing Problems

Variable	Subgroup	N	Mean Rank	z,	Asymp. Sig. (*p*)	Effect size
Problems of Marketing	**Religious Activity**					
	Yes	290	167.70	-3.263	.001	-0.175
	No	58	208.51			
	Total	348				
	Micro financing sources					
	BMT	179	190.61	-3.557	.000	-0.191
	BPRS	169	157.43			
	Total	348				
	Business Field					
	Trade/shops/retail	212	170.83	17.485	.004	0.937
	Manufacturing/craftsman	25	149.62			
	Services	35	193.56			
	Transportation	4	143.75			
	Agriculture services/ forestry/stock breeder	27	141.46			
	Food production	45	213.34			
	Total	348				
	Productive Assets					
	Zero	74	199.14	16.334	.001	0.877
	Below IDR 50 millions (micro)	212	175.17			
	IDR 51 - IDR 500 millions (small)	58	141.03			
	IDR 501- IDR 10 billions (medium)	3	108.50			
	Total	347				

The results of MWU and KW tests in Table 6.37, show statistically significant differences among subgroups of religious activity (p=.001), micro financing sources (p=.000), business field (p= .004), and productive asset (p= .001). It should be noted that the subgroups with the highest mean ranking had the fewest management problems. Therefore, the respondents with the fewest management problems were not religiously active, were BMT respondents, and had zero productive assets. In contrast, the most marketing problems were faced by the respondents with lowest mean ranking, who were religiously active, BPRS respondents, in agricultural businesses, and had productive assets between IDR 501 millions and IDR 10 billions (medium-sized enterprises).

Both tests found no statistically significant differences among subgroups of microenterprises as main sources of income, gender, membership of subgroups, other sources of income, age, education, manager/owner, place of business, business age, annual sales and total workers after financing.

Therefore, it was highly likely that the size of business in terms of sales and total workers was not directly linked to production problems, although there seems to have been a correlation between productive assets and production problems.

6.6.2. The Level of Understanding of Islamic Terms Used in Financing Products

Islamic microfinance institutions apply specific Islamic terms to their financing products. The previous chapter, particularly Table 6.14, shows that a large majority of the respondents had a poor understanding of the Islamic terms. This section aims to investigate further which subgroups of respondents had a better understanding of Islamic terms used in Islamic banking, including an understanding of the following: *riba, musyarakah, mudharabah, murabahah, salam dan qard hassan*.

The MWU test and the KW test were applied to identify the differences among various control variable sub-groups in their response to the statements provided. The MWU test is applied to microenterprises as main sources of income, religious activity, areas of business, type of micro financing sources and membership of subgroups, while the KW test is applied to gender, other sources of income, religious education, age, education, duration of membership in BMT/BPRS, duration of time spent as borrower from BMT/BPRS, instalments, business age, last received financing, business field, main manager/owner, place of business location, marital status, total financing, household expenditure after financing, productive asset (grouped), annual sales (grouped), and total number of workers after financing (grouped).

The findings of both tests demonstrate statistically significant differences in all Islamic terms among subgroups in microenterprises as main sources of income, gender, other sources of income, religious education, duration of membership of BMT/BPRS, and duration of time spent as borrower from BMT/BPRS. However, the tests also found no statistically significant differences concerning all Islamic terms among subgroups of group membership, instalment, last loan received (month), marital status, total loan, household expenditures, and annual sales after loan.

The summaries of the significant findings of each problem are shown in Tables 6.38 to 6.43. It should be noted that the findings of non-significant subgroups were not presented in detail due to space limitations.

6.6.2.1. Level of Understanding of *Riba*

The purpose of this section is to examine further which subgroups of respondents had a 'fair' understanding of *riba*, as the overall results in Table 6.14 indicates 41.8% of them. As can be seen in Table 6.38, statistical tests using MWU test and KW test demonstrate statistically significant differences among subgroups of religious activity (p=.010), microenterprise as main source of income (p=.011), other sources of income (p=.000), gender (p=.000), religious education (p=.000), last completed education (p=.000), duration of membership of BMT/BPRS (p=.000), duration of time as borrowers from BMT/BPRS (p=.000), place of business location (p=.031), and productive assets (p=.011). It should be noted that the highest mean ranking indicates the highest level of understanding. Therefore, the respondents with the highest level of understanding of *riba* were active in religious activities, had microenterprises that were not main sources of income, were teachers/lecturers, were male, had informal religious education, were educated to Diploma I/II level, had been members of BMT/BPRS for between 11 and 15 years, were borrowers from BMT/BPRS for between 6 and 10 years, had 'other' place of business location (rice mills), and had productive assets of between IDR 501 millions and 10 billions (medium-sized enterprises).

Table 6.38a: MWU Test and KW Tests: Level of Understanding of *Riba*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Riba	**Religious activity**			-2.585	.010	-0.139
	Yes	289	179.86			
	No	58	144.79			
	Total	347				
	Microenterprise as main sources of income			-2.551	.011	-0.137
	Yes	307	168.90			
	No	39	209.69			
	Total	346				
	Other sources of income			27.173	.000	
	Civil Servant/Government Officials	6	195.25			
	Employee in Private co.	27	223.22			
	Employee in Gov-owned	1	177.50			
	Teacher/Lecturer	3	310.67			
	Retired	2	293.00			
	Housewife	71	151.30			
	None	209	165.96			
	Other	27	211.44			
	Total	346				
	Gender			-3.920	.000	-0.210
	Male	188	192.25			
	Female	159	152.42			
	Total	347				
	Religious education			21.912	.000	1.176
	Formal	80	194.01			
	Informal	70	208.19			
	None	197	153.73			
	Total	347				
	Last completed education			42.060	.000	2.261
	Not completed Primary School	24	114.04			
	Primary school	78	140.10			
	Junior High or equivalent	78	172.63			
	Senior High or equivalent	122	183.89			
	Diploma I/II	4	264.00			
	Diploma III	3	215.67			
	Diploma IV/Bachelor (S1)	35	236.97			
	Master (S2)	2	235.00			
	Total	346				
	Duration of membership of BMT/BPRS			15.866	.000	0.854
	Below 5 years	269	162.86			
	6 – 10 years	53	199.91			
	11 – 15 years	23	229.57			
	Total	345				

Table 6.38b: MWU Test and KW tests: Level of Understanding of *Riba*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
	Duration of time as borrower of BMT/BPRS					
	Below 5 years	285	163.23	17.852	.000	0.961
	6 – 10 years	45	221.38			
	11 – 15 years	15	213.47			
	Total	345				
	Place of business location					
	Fully Mobile	46	180.43	13.911	.031	0.747
	Home	136	178.56			
	Home shop	53	187.94			
	Industrial estate	1	293.00			
	Traditional market	104	151.28			
	Agricultural land	5	223.70			
	Other	1	341.00			
	Total	346				
	Productive Assets					
	Zero	74	201.03	11.159	.011	0.599
	Below IDR 50 millions (micro)	212	168.29			
	IDR 51 - IDR 500 millions (small)	58	156.19			
	IDR 501m- IDR 10 billions (medium)	3	255.33			
	Total	347				

The findings in Table 6.38a and Table 6.38b also depict that the respondents with the lowest level of understanding of *riba* were those with the lowest mean ranking, and were not active in religious activity, had microenterprises as the main sources of income, were female, had no religious education, had not completed primary school, had been members of BMT/BPRS for less than 5 years, had been borrowers from BMT/BPRS for less than 5 years, had places of business location in traditional markets, and had productive assets of between IDR 51 and IDR 500 millions.

It should be mentioned that both tests were applied to other variables; however, there were no statistically significant differences among subgroups of areas of business, group membership, age, instalment, business age, last loan, business field, manager/owner, marital status, total loan, total workers, household expenditure, and annual sales after loan.

6.6.2.2. Level of Understanding of *Musharakah*

The purpose of this section is to examine further which subgroups of the respondents had a 'poor' understanding of *musharakah*, as the overall results in Table 6.14 shows that 85.3% of the respondents have a poor understanding. Statistical findings in Table 6.39a, Table 6.39b and Table 6.39c show statistically significant differences among subgroups of the following variables: areas of business (*p*=.010), type of financing sources (*p*=.000), microenterprises as main sources of income (*p*=.041), other sources of income (*p*=.000), gender (*p*=.000), age (*p*=.036), religious education (*p*=.000), last completed education (*p*=.000), duration of membership of BMT/BPRS (*p*=.011), duration of time as borrower of BMT/BPRS (*p*=.017), main manager and owner (*p*=.032), and place of business location (*p*=.059). In this part, the highest mean rankings indicate the lowest level of understanding of *musharakah*. The respondents with the lowest level of understanding of *musharakah* were those in rural areas, BMT respondents, microenterprises that were not main sources of income, teachers/lecturers, male, having formal religious education, last completed education from Diploma I/II, duration of membership of BMT/BPRS of between 11 and 15 years, time as borrower of BMT/BPRS between 6 and 10 years, business partner as main manager and owner, place of business located on agricultural land, and business age over 51 years. The highest mean rankings imply the lowest level of understanding of *musharakah*. On the other hand, the respondents with the highest level of understanding, those with the lowest mean rankings, were those in urban areas, BPRS customers, having microenterprises as main sources of income, business partner as main manager and owner, place of business located in industrial estates and rice mills, and having businesses aged between 41 and 50 years.

Table 6.39a: MWU Test and KW Tests: Level of Understanding of *Musharakah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Musharakah	**Areas of Business**					-0.137
	Rural	115	186.03	-2.559	.010	
	Urban	232	168.03			
	Total	347				
	Type of financing sources					-0.225
	BMT	178	194.64	-4.185	.000	
	BPRS	169	152.26			
	Total	347				

Table 6.39b: MWU Test and KW Tests: Level of Understanding of *Musharakah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Musharakah	**MEs as main sources of income**					
	Yes	307	171.11	-2.040	.041	-0.110
	No	39	192.29			
	Total	346				
	Other sources of income					
	Civil Servant/Gov Officials	6	176.17			
	Employee in Private co.	27	208.28			
	Employee in Gov-owned Co	1	148.50			
	Teacher/Lecturer	3	275.17			
	Retired	2	148.50			
	Housewife	71	157.85			
	None	209	166.47			
	Other	27	225.20			
	Total	346				
	Gender					
	Male	188	187.47	-4.422	.000	
	Female	159	158.08			
	Total	347				-0.237
	Age					
	21-30	50	198.00			
	31-40	123	173.70			
	41-50	107	166.07	11.901	.036	0.640
	51-60	53	171.07			
	61-70	12	148.50			
	Above 71	1	148.50			
	Total	346				
	Religious education					
	Formal	80	202.76			
	Informal	70	185.68	32.883	.000	1.765
	None	197	158.17			
	Total	347				
	Last completed education					
	Not completed Primary Sch	24	148.50			
	Primary school	78	161.58			
	Junior High or equivalent	78	164.41			
	Senior High or equivalent	122	178.06	36.004	.000	1.936
	Diploma I/II	4	285.00			
	Diploma III	3	148.50			
	Diploma IV/Bachelor (S1)	35	207.67			
	Master (S2)	2	231.50			
	Total	346				
	Duration of membership of BMT/BPRS					
	Below 5 years	269	167.73	8.988	.011	0.484
	6 – 10 years	53	190.87			
	11 – 15 years	23	193.41			
	Total	345				

Table 6.39c: MWU Test and KW Tests: Level of Understanding of *Musharakah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Musharakah	**Duration of time as borrower of BMT/BPRS**					
	Below 5 years	285	168.85	8.193	.017	0.441
	6 – 10 years	45	195.77			
	11 – 15 years	15	183.63			
	Total	345				
	Main manager and owner					
	Self	311	174.17	8.816	.032	0.473
	Spouse	31	164.61			
	Other family member	4	190.13			
	Business partner	1	346.50			
	Total	347				
	Place of business location					
	Fully Mobile	46	174.80	12.123	.059	0.652
	Home	136	180.30			
	Home shop	53	181.18			
	Industrial estate	1	148.50			
	Traditional market	104	158.38			
	Agricultural land	5	219.70			
	Other	1	148.50			
	Total	346				
	Business age					
	Below 10 years	182	177.00	10.829	.055	0.582
	11 – 20 years	102	165.29			
	21 – 30 years	39	161.92			
	31 -40 years	19	204.29			
	41 – 50 years	2	148.50			
	Above 51 years	2	231.75			
	Total	346				

As mentioned earlier, the same empirical procedure were also applied to other variables including religious activity, micro financing sources, group membership, business membership, last loan received, business field, marital status, total loan, household expenditure, and annual sales after loan. However, no statistically significant differences among subgroups could be established.

6.6.2.3. Level of Understanding of *Mudharabah*

The purpose of this section is to further examine which subgroups of the respondents had a 'poor' understanding of *mudharabah,* as evidenced in Table 6.14, the majority of the respondents (84%) admitted a 'poor' understanding.

As can be seen in Table 6.40a and Table 6.40b, statistical tests using MWU test and KW test produced statistically significant differences among subgroups of the following variables: type of financing sources (*p*=.017), microenterprises as main sources of income (*p*=.000), other sources of income (*p*=.000), gender (*p*=.054), religious education (*p*=0.000), last completed education (*p*=.002), duration of membership of BMT/BPRS (*p*=0.30), duration of time as borrower of BMT/BPRS (*p*=.055), place of business location (*p*=.041).

Table 6.40a: MWU and KW tests Results: Level of Understanding of *Mudharabah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Mudharabah	**Type of financing sources**					
	BMT	177	180.42	-2.389	.017	-0.129
	BPRS	167	164.11			
	Total	344				
	Main sources of income					
	Yes	304	167.46	-3.741	.000	-0.202
	No	39	207.36			
	Total	343				
	Other sources of income					
	Civil Servant/Gov. Officials	6	172.67	29.936	.000	1.616
	Employee in Private co.	27	185.89			
	Employee in Gov-owned Co.	1	311.00			
	Teacher/Lecturer	3	273.67			
	Retired	2	228.00			
	Housewife	71	168.76			
	None	208	163.75			
	Other	25	212.48			
	Total	343				
	Gender					
	Male	185	178.59	-1.925	.054	-0.104
	Female	159	165.42			
	Total	344				

Table 6.40b: MWU and KW tests Results: Level of Understanding of *Mudharabah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Mudharabah	**Religious education**					
	Formal	78	196.21	25.492	.000	1.374
	Informal	69	187.62			
	None	197	157.82			
	Total	344				
	Last completed education					
	Not completed Primary School	24	145.00	22.170	.002	1.197
	Primary school	77	157.94			
	Junior High or equivalent	78	166.63			
	Senior High or equivalent	121	179.26			
	Diploma I/II	4	186.50			
	Diploma III	3	200.33			
	Diploma IV/Bachelor (S1)	34	206.76			
	Master (S2)	2	145.00			
	Total	343				
	Duration of membership of BMT/BPRS					
	Below 5 years	268	167.24	7.032	.030	0.313
	6 – 10 years	52	181.59			
	11 – 15 years	22	199.61			
	Total	342				
	Duration of time as borrower of BMT/BPRS					
	Below 5 years	284	168.38	5.795	.055	0.313
	6 – 10 years	44	192.70			
	11 – 15 years	14	168.14			
	Total	342				
	Place of business location					
	Fully Mobile	46	182.85	13.121	.041	0.708
	Home	134	175.94			
	Home shop	53	186.74			
	Industrial estate	1	145.00			
	Traditional market	103	154.67			
	Agricultural land	5	178.20			
	Other	1	145.00			
	Total	343				

The highest mean rankings represent the lowest level of understanding of *mudharabah*. Therefore, the respondents with the lowest level of understanding were BMT respondents, those with microenterprises that were not the main sources of income, teachers/lecturers, males, having formal religious education, last completed education of Diploma IV/Bachelor (S1), duration of membership of BMT/BPRS between 11 and 15 years, duration of time as borrower of BMT/BPRS of between 6 and 10 years, and place of business located in home/shop. In contrast, the respondents with the highest level of understanding of *mudharabah*, those with the lowest mean rankings, were BPRS respondents, females, having no religious education, last completed education non-completion of Primary School and Master's (S2), duration of membership of BMT/BPRS below 5 years, duration of time as borrower of BMT/BPRS between 11 and 15 years, place of business located in industrial estate and rice mill.

It should be noted that no statistically significant differences among subgroups of the following variables: area of business, group membership, age, instalments, business ages, last loan, business field, manager/owner, marital status, total loan, household expenditures, annual sales, productive assets, and total workers.

6.6.2.4. Level of Understanding of *Murabahah*

The purpose of this section is to assess further which subgroups of the respondents had a 'poor' understanding of *murabahah*, as a large majority of the respondents (85.3%) in Table 6.14 reported as 'poor' understanding. Table 6.41a and Table 6.41b provide a detailed understanding of only the significant statistical results from MWU test and KW test for the subgroups of the following variables: areas of business (p=.000), microenterprises as main sources of income (p=.000), other sources of income (p=.000), gender (p=.000), religious education (p=.000), last completed education (p=.031), duration of membership of BMT/BPRS (p=.002), duration of time as borrower of BMT/BPRS (p=.005), business age (p=.050), business field (p=.018), the main manager/owner (p=.017), place of business location (p=.004). The lowest level of understanding of *murabahah* was indicated by the highest mean ranking. Thus, those respondents with the lowest level of understanding of *murabahah* were in rural areas, had microenterprises that were not main sources of income, male, had formal religious education, last completed education was Diploma III, duration of membership of BMT/BPRS between 11 and 15 years, duration of time as borrower of BMT/BPRS between 6 and 10 years, business aged above 51 years, business field in manufacturing/crafts, business partner as the main manager/owner, and place of business located at home. On the other hand, the respondents with the highest level of understanding of *murabahah* were those with the lowest mean rankings, and were in urban areas, had microenterprises as main sources of income, were female, had no religious education, had education levels of non-completed Primary School and Master's (S2), duration of membership of BMT/BPRS below 5 years, duration of time as borrower of BMT/BPRS below 5 years, business aged between 41 and 50 years, in food production business, were themselves main manager/owner, and had place of business located on industrial estates. The details of the significant findings are as follows:

Table 6.41a: MWU and KW Tests: Level of Understanding of *Murabahah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (p)	Effect size
Murabahah	**Areas of business**					
	Rural	115	190.49	-3.621	.000	-0.195
	Urban	231	165.04			
	Total	346				
	Main sources of income			-5.794	.000	-0.312
	Yes	306	166.21			
	No	39	226.27			
	Total	345				
	Other sources of income					
	Civil Servant/Government Officials	6	175.58	68.874	.000	3.708
	Employee in Private co.	26	201.75			
	Employee in Gov-owned Co.	1	313.50			
	Teacher/Lecturer	3	274.67			
	Retired	2	230.75			
	Housewife	71	162.33			
	None	209	161.02			
	Other	27	244.74			
	Total	345				
	Gender					
	Male	188	185.87	-4.075	.000	-0.219
	Female	158	158.78			
	Total	346				
	Religious education					
	Formal	80	198.13	31.896	.000	1.715
	Informal	69	191.01			
	None	197	157.37			
	Total	346				
	Last completed education					
	Not completed Primary School	24	148.00	15.454	.031	0.832
	Primary school	78	161.35			
	Junior High or equivalent	78	172.26			
	Senior High or equivalent	122	177.53			
	Diploma I/II	4	189.38			
	Diploma III	3	203.17			
	Diploma IV/Bachelor (S1)	34	199.71			
	Master (S2)	2	148.00			
	Total	345				

Table 6.41b: MWU and KW Tests: Level of Understanding of *Murabahah*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Murabahah	**Duration of membership of BMT/BPRS**					
	Below 5 years	268	166.66	12.673	.002	0.683
	6 – 10 years	53	187.46			
	11 – 15 years	23	206.09			
	Total	344				
	Duration of time as borrower of BMT/BPRS					
	Below 5 years	284	167.80			
	6 – 10 years	45	198.66			
	11 – 15 years	15	182.97			
	Total	344				
	Business Age					
	Below 10 years	181	178.23	11.050	.050	0.595
	11 – 20 years	102	163.07			
	21 – 30 years	39	161.35			
	31 -40 years	19	195.71			
	41 – 50 years	2	148.00			
	Above 51 years	2	242.75			
	Total	345				
	Business field					
	Trade/shops/retail	210	166.59	13.609	.018	0.732
	Manufacturing/craftsman	25	195.32			
	Services	35	193.36			
	Transportation	4	189.38			
	Agriculture services/ forestry/stock breeder	27	193.91			
	Food production (small café, restaurant, catering *etc.*)	45	164.51			
	Total	346				
	The main manager/owner					
	Self	311	171.32	10.177	.017	0.547
	Spouse	30	188.25			
	Other family member	4	189.38			
	Business partner	1	345.50			
	Total	346				
	Place of business location					
	Fully Mobile	45	171.16	19.286	.004	1.038
	Home	136	187.17			
	Home shop	53	177.03			
	Industrial estate	1	148.00			
	Traditional market	104	153.08			
	Agricultural land	5	186.00			
	Other	1	148.00			
	Total	345				

It should be mentioned that no statistically significant differences among subgroups were found in the following variables: micro financing sources, group memberships, age, instalments, last loan received, marital status, total loan, household expenditures, annual sales after loan, and productive assets.

6.6.2.5. Level of Understanding of *Salam*

This section explores participants' understanding of 'salam' in relation to the subgroups of the control variables. It should be reiterated that 90.8% of the participants reported that they have a 'poor' understanding of *salam*, as depicted in Table 6.14. As the evidence depicted in Table 6.42a and Table 6.42b, statistical tests using MWU test and KW test reveal significant differences among subgroups of the following variables: areas of business (p= .004), type of financing sources (p=.004), other sources of income (p=.000), gender (p=.004), microenterprises as main sources of income (p=.000), religious education (p=.000), last completed education (p=.001), duration of membership of BMT (p=.024), main manager and owner (p=.005), place of business location (p=.001), and business age (p=.025). In examining the results, it should be noted that the highest mean rankings indicate the lowest level of understanding of *salam*. Therefore, the respondents with the lowest level of understanding were in rural areas, BMT respondents, had microenterprises that were not main sources of income, males, had formal religious education, last completed education was Diploma IV/Bachelor's (S1), duration of membership of BMT/BPRS between 11 and 15 years, duration of time as borrower of BMT/BPRS between 11 and 15 years, had business partner as main manager and owner, place of business located in rice mill, and business age above 51 years. In contrast, the respondents with the highest level of understanding of *salam* were those with the lowest mean rankings; they were in urban areas, were BPRS respondents, had microenterprises as the main sources of income, female, formal religious education, last completed education was non-completed Primary School and Master's (S2), duration of membership of BMT/BPRS below 5 years, duration of time as borrower of BMT/BPRS below 5 years, other family member as main manager/owner, place of business located on industrial estate, business age of 41 – 50 years.

Table 6.42a: MWU Test and KW Test: Level of Understanding of *Salam*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Level of Understanding of *Salam*	**Areas of business**					
	Rural	115	184.96	-2.856	.004	-0.153
	Urban	232	168.57			
	Total	347				
	Type of financing sources					
	BMT	178	181.57	-2.877	.004	-0.154
	BPRS	169	166.02			
	Total	347				
	Microenterprises as main sources of income					
	Yes	307	170.97	-2.665	.008	-0.143
	No	39	193.41			
	Total	346				
	Other sources of income					
	Civil Servant/Government Officials	6	158.00	40.159	.000	2.159
	Employee in Private co.	27	209.83			
	Employee in Gov-owned Co.	1	158.00			
	Teacher/Lecturer	3	280.33			
	Retired	2	158.00			
	Housewife	71	165.14			
	None	209	167.77			
	Other	27	196.78			
	Total	346				
	Gender					
	Male	188	181.14	-2.875	.004	-0.154
	Female	159	165.56			
	Total	347				
	Religious education					
	Formal	80	190.21	21.137	.000	1.135
	Informal	70	185.76			
	None	197	163.24			
	Total	347				
	Last completed education					
	Not completed Primary School	24	158.00	25.178	.001	1.354
	Primary school	78	164.50			
	Junior High or equivalent	78	171.61			
	Senior High or equivalent	122	172.09			
	Diploma I/II	4	200.25			
	Diploma III	3	214.33			
	Diploma IV/Bachelor (S1)	35	207.64			
	Master (S2)	2	158.00			
	Total	346				

Table 6.42b: MWU Test and KW Test: Level of Understanding of *Salam*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Level of Understanding of *Salam*	**Duration of membership of BMT/BPRS**			17.418	.000	0.938
	Below 5 years	269	167.19			
	6 – 10 years	53	189.72			
	11 – 15 years	23	202.43			
	Total	345				
	Duration of time as borrower of BMT/BPRS			7.483	.024	0.403
	Below 5 years	285	169.63			
	6 – 10 years	45	188.04			
	11 – 15 years	15	191.97			
	Total	345				
	Main manager and owner			12.771	.005	0.686
	Self	311	173.02			
	Spouse	31	180.35			
	Other family member	4	158.00			
	Business partner	1	346.50			
	Total	347				
	Business age			12.811	.025	0.689
	Below 10 years	182	173.72			
	11 – 20 years	102	171.05			
	21 – 30 years	39	161.83			
	31 -40 years	19	202.97			
	41 – 50 years	2	157.50			
	Above 51 years	2	242.00			
	Total					

It should also be mentioned that no statistically significant differences among the subgroups of the following variables could not be found: religious activity, group membership, age, instalments, business age, last loan received (months), business field, marital status, total loan, household expenditures, and annual sales after loan.

6.6.2.6. Level of Understanding of *Qard Hasan*

This section assesses further which subgroups of the respondents had a ‘poor’ understanding of *qard hassan*, as admitted by a large majority of the respondents (90.8%) in the results reported in Table 6.14.

The findings depicted in Table 6.43a, Table 6.43b and Table 6.43c show statistically significant differences among subgroups of the following variables: religious activity (p=.030), type of financing sources (p=.000), microenterprises as main sources of income (*p*=.000), other sources of income (*p*= .000), gender (*p*= .013), religious education (*p*=.000), last completed education (*p*=.030), duration of membership (*p*=.018), business age (*p*=.020) and main manager/owner (*p*=.005).

In giving further meaning to the results, the mean rankings are compared; the respondents with the highest mean rankings have the lowest level of understanding of *qard hassan.* Thus, the respondents with the lowest levels of understanding were active in religious activity, BMT respondents, had microenterprises that were not the main sources of income, male, had formal religious education, Diploma I/II, duration of membership of BMT/BPRS between 6 and 10 years, duration of time as borrower of BMT/BPRS between 6 and 10 years, business age above 51 years, and business partner as main manager/owner. In contrast, the respondents with the highest level of understanding of *qard hasan,* those with the lowest mean rankings, and were not active in religious activities, were BPRS respondents, had microenterprises as main sources of income, were female, had no religious education, last completed education was non-completed Primary School, Diploma III and Master's (S2), duration of membership of BMT/BPRS below 5 years, duration of time as borrower of BMT/BPRS below 5 years, business aged between 41 and 50 years, and other family member as main manager and owner.

Non-significant differences were found in the following variables: area of business, group memberships, age, instalments, business age, last loan, business field, place of business, marital status, total loan, household expenditures, and annual sales after loan. The details of the significant findings are as follows:

Table 6.43a: MWU test and KW test: Level of Understanding of *Qard Hasan*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Qard Hasan	**Religious activity**					
	Yes	290	177.12	-2.167	.030	-0.116
	No	58	161.41			
	Total	348				
	Type of financing sources					
	BMT	179	186.78	-4.678	.000	-0.251
	BPRS	169	161.49			
	Total	348				

Table 6.43b: MWU test and KW test: Level of Understanding of *Qard Hasan*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Qard Hasan	**Main sources**					
	Yes	308	169.79	-4.440	.000	-0.238
	No	39	207.23			
	Total	347				
	Other sources of income					
	Civil Servant/Government Officials	6	158.50	55.940	.000	3.003
	Employee in Private co.	27	191.26			
	Employee in Gov-owned Co.	1	158.50			
	Teacher/Lecturer	3	280.17			
	Retired	2	158.50			
	Housewife	71	168.26			
	None	209	165.82			
	Other	28	226.55			
	Total	347				
	Gender					
	Male	189	180.65	-2.482	.013	-0.133
	Female	159	167.19			
	Total	348				
	Religious education					
	Formal	80	186.53	16.264	.000	0.873
	Informal	70	186.05			
	None	197	164.63			
	Total	347				
	Last completed education					
	Not completed Primary School	24	158.50	15.475	.030	0.831
	Primary school	79	171.72			
	Junior High or equivalent	78	169.48			
	Senior High or equivalent	122	175.34			
	Diploma I/II	4	246.25			
	Diploma III	3	158.50			
	Diploma IV/Bachelor (S1)	35	189.13			
	Master (S2)	2	158.50			
	Total	347				
	Duration of membership of BMT/BPRS					
	Below 5 years	270	169.14	9.273	.010	0.499
	6 – 10 years	53	189.63			
	11 – 15 years	23	187.48			
	Total	346				
	Duration of time as borrower of BMT/BPRS					
	Below 5 years	286	170.15	8.056	.018	0.433
	6 – 10 years	45	192.10			
	11 – 15 years	15	181.60			
	Total	346				

Table 6.43c: MWU test and KW test: Level of Understanding of *Qard Hasan*

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Qard Hasan	**Business age**					
	Below 10 years	183	174.13	13.346	.020	0.716
	11 – 20 years	102	166.51			
	21 – 30 years	39	175.23			
	31 -40 years	19	205.00			
	41 – 50 years	2	158.00			
	Above 51 years	2	242.00			
	Total	347				
	Main manager and owner					
	Self	312	173.48	12.743	.005	0.683
	Spouse	31	181.32			
	Other family member	4	158.50			
	Business partner	1	346.50			
	Total	348				

6.6.3. The Intention of Borrowing

This section investigates as to whether there were any changes in the intention of borrowing by comparing the original intention and the actual use of the funds, and further explores the reasons for the change in intention.

The original purposes of financing and the actual use of the funds have been discussed in the previous chapter. Table 6.16 shows that 93.7% of the respondents had the intention of using the funds as ‘working capital’, while 5.2% of the respondents intended using the funds as ‘fixed capital’. The results indicate that only 1.1% of the respondents had the original intention of using the funds for ‘consumption’ purposes. However, the findings also show changes in actual use of the funds. The percentage of respondents who used funds for ‘working capital only’ was only 68.4%, which is around 26% lower than the percentage for original intention. This section compares between original intention and actual use of the funds by Chi-Square Test. The results in Table 6.44 depicts a significant relationship between original intended purpose and actual use of funds, as can be seen from the Fisher Exact Test at p=.000 with a very strong effect size, r= .937. The Fisher Exact Test is used because the assumption of the Chi-Square was violated as 13 cells

(72.2%) have expected counts of less than 5. Effect size was measured based on the *Phi* value.

Based on the cross-tabulation test presented in Table 6.44, the findings indicate that there were changes in the actual use as compared to the original intended purpose of financing as follows:

(i) Of the 93.7% of the respondents who had originally intended to use the funds as working capital, 73% kept to their original intentions while 23.6% used the funds for consumption and working capital - this part was the largest crucial part since they used the funds for consumption;

(ii) of the 5.2% of the respondents who had originally intended to use the funds as fixed capital, 66.7% of the respondents kept to their original intentions while 22.2% of the respondents used the funds for both fixed and working capital; .

Table 6.44: Cross-tabulation: The Intended Purpose and the Actual Use of Funds

Description			The original intended purpose of the financing			Total	Fisher Exact Test	Effect Size
			Working capital	Fixed capital	Consumption			
The actual use of financing.	Working capital only	Count	238	0	0	238	.000	.937
		% original intention	73.0%	.0%	.0%			
	Fixed capital only	Count	2	12	0	14		
		% original intention	.6%	66.7%	.0%	4.0%		
	Consumption only	Count	1	0	0	1		
		% original intention	.3%	.0%	.0%	.3%		
	Both fixed and working capital	Count	7	4	0	11		
		% original intention	2.1%	22.2%	.0%	3.2%		
	Consumption and working capital	Count	77	1	4	82		
		% original intention	23.6%	5.6%	100.0 %	23.6%		
	Consumption and fixed capital	Count	1	1	0	2		
		% original intention	.3%	5.6%	.0%	.6%		
Total		Count	326	18	4	348		
		% original intention	100%	100%	100%	100%		

(iii) all of the 1.1% of the respondents who had originally intended the funds for consumption actually used them for both consumption and working capital, which was better, as some funds were utilised for production purposes rather than just consumption

To further explore the background information to the change in the actual use of funds, a new dichotomous variable, namely 'change of fund used', was created and introduced to the analysis which is a product if a comparison between original intention and actual use of funds. Then, the Chi-Square test was applied to find the relationship between this variable and other variables.

Table 6.45: Cross-tabulation: Change in Using Fund

			Change of Using fund			Chi Square	Effect Size
			No	Yes	Total		
Type of Islamic microfinance institution	1 BMT	Count	118	61	179	.016[a]	-.135
		% within Change of using fund	47.2%	62.2%	51.4%		
	2 BPRS	Count	132	37	169		
		% within Change of using fund	52.8%	37.8%	48.6%		
Total		Count	250	98	348		
		% within Change of using fund	100%	100.0 %	100%		
Religious activity	Yes	Count	215	75	290	.049[b]	.114
		% within Change of using fund	86.0	76.5	83.3%		
	No	Count	35	23	58		
		% within Change of using fund	14.0%	23.5%	16.7%		
Total		Count	250	98	348		
		% within Change of using fund	100%	100.0%	100%		

[a]Continuity correction, which provides a more precise result. Chi-Square: .012
[b]Continuity correction, which provides a more precise result. Chi-Square: .033

As shown in Table 6.45, the findings suggest significant relationships between 'change of using fund' and type of micro financing sources (p=.016, r=-.135) and between 'change of using fund' and religious activity (p= .049, r=.114). According to Cohen's criteria, the effect size was categorised as follows: 0.10 as small effect, 0.3 as medium effect, 0.5 as large effect (Pallant, 2007: : 217). Therefore, those two variables had a small effect size. This test was also applied to gender, business areas, business field, education, manager/owner, decision-maker on how to use the funds, and arrears; however, the findings show no significant relationships between those variables.

6.6.4. Higher Collateral Provided to Borrow Money

The previous chapter in Table 6.16 presented microenterprise owners' opinions on collateral provided to borrow money as compared to total amount borrowed, taking into account the total borrowed money. The findings demonstrate that 90.4% of the respondents provided higher collateral than the total amount borrowed. This section aims to further explore which sections of the respondents provided higher collateral, based on the Chi-Square Test and cross-tabulation analyses, for which the results are depicted in Table 6.46a and Table 6.46b. Based on the confidence level of *p*=.05, the results show significant relationships between higher collateral and the following variables: type of financing sources (*p*=.000), business field (*p*=.050) and number of financings taken (*p*=.002). The findings also show no significant relationships between higher collateral and other variables: business areas (*p*=.073) and total amount borrowed (*p*=.212). Overall, the subgroups of the respondents who provided higher collateral were BPRS respondents (58.7%), in trade/shops/retail business (59.1%), and number of financings taken between 1 and 5 (85.6%). The result also shows that respondents in urban areas (61.4%) provided higher collateral. In terms of total amount borrowed, the higher collateral was provided by the respondents who borrowed between IDR 10 and IDR 20 millions (19.5%), followed by the total amount borrowed between IDR 20 and 30 millions (10.7%).

Table 6.46a. Cross-tabulation: Total Collateral Provided to Borrow Money

Description	Collateral has been higher		Collateral has been lower		Total		Chi Square	Effect size
	Freq.	%	Freq.	%	Freq.	%		
Type of financing sources							.000	.107
BMT	109	41.2	26	92.8	135	46.2		
BPRS	155	58.7	2	7.1	157	53.8		
Total	264	100	28	100	292	100		

Table 6.46b:Cross-tabulation: Total Collateral Provided to Borrow Money

Description	Collateral has been higher		Collateral has been lower		Total		Chi Square	Effect size
	Freq.	%	Freq.	%	Freq.	%		
Business areas								
Rural	102	38.6	6	21.4	108	37.0	.073	.105
Urban	162	61.4	22	78.6	184	63.0		
Total	264	100	28	100	292	100		
Business field								
Trade/shops/retail	156	**59.1**	13	46.4	169	57.9	.050[a]	.069
Manufacturing/craftsman	23	8.7	2	7.1	25	8.6		
Services	29	11.0	6	21.4	35	12.0		
Transportation	3	1.1	1	3.6	4	1.4		
Agriculture services/ forestry/stock breeder	25	9.5	0	0.0	25	8.6		
Food production	28	10.6	6	21.4	34	11.6		
Total	264	100	28	100	292	100		
Number of financings taken								
1-5	226	**85.6**	18	64.3	244	83.6	.002[b]	.230
6-10	36	13.6	7	25.0	43	14.7		
11-15	2	0.8	2	7.1	4	1.4		
Above 15	0	0.0	1	3.6	1	0.3		
Total	264	100	28	100	292	100.0		
Total amount borrowed								
Below IDR 1 million	4	1.5	2	7.1	6	2.1	.212[c]	-.041
IDR 1 – 2 millions	10	3.8	0	0.0	10	3.4		
IDR 2 – 3 millions	8	3.1	4	14.3	12	4.1		
IDR 3 - 4 millions	16	6.1	0	0.0	16	5.5		
IDR 4 - 5 millions	21	8.0	4	14.3	25	8.6		
IDR 5 – 6 millions	16	6.1	0	0.0	16	5.5		
IDR 6 - 7 millions	8	3.1	1	3.6	9	3.1		
IDR 7 -8 millions	12	4.6	0	0.0	12	4.1		
IDR 8 – 9 millions	6	2.3	2	7.1	8	2.8		
IDR 9 -10 billions	24	9.2	1	3.6	25	8.6		
IDR 10 -20 millions	51	19.5	5	17.9	56	19.3		
IDR 20 -30 millions	28	10.7	3	10.7	31	10.7		
IDR 30 – 40 millions	8	3.1	1	3.6	9	3.1		
IDR 40 -50 millions	17	6.5	2	7.1	19	6.6		
IDR 50 -60 millions	3	1.1	0	0.0	3	1.0		
IDR 60-70 millions	4	1.5	0	0.0	4	1.4		
IDR 70-80 millions	5	1.9	0	0.0	5	1.7		
IDR 80 – 90 millions	8	3.1	1	3.6	9	3.1		
IDR 90–100 millions	13	5.0	2	7.1	15	5.2		
Total	262	100	28	100	290	100		

[a]Fisher Exact Test is used due to the violation of Chi-Square assumption
[b]Fisher Exact Test is used due to the violation of Chi-Square assumption
cFisher Exact Test is used due to the violation of Chi-Square assumption

To further assess the statistically significant relationships among subgroups, the MWU-Test and KW Test were applied and the results are reported in Table 6.47a, 6.47b, which shows statistically significant relationships among the subgroups of type of financing sources (*p*= .000) and number of financings (*p*= .000). Based on the findings, the respondents who provided higher collateral, those with the highest mean rankings, were BMT respondents and those who had taken financing more than 15 times.

Table 6.47a: MWU Test and KW Test: Higher Collateral

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Higher Collateral	**Type of financing sources**			-5.195	.000	-0.304
	BMT	135	160.62			
	BPRS	157	134.36			
	Total	292				
	Number of financings taken:			-5.195	.000	-0.304
	1-5	244	143.27			
	6-10	43	156.27			
	11-15	4	205.50			
	Above 15	1	278.50			
	Total	292				
	Total amount borrowed			23.121	.186	1.358
	Below IDR 1 million	6	179.83			
	IDR 1 – 2 millions	10	131.50			
	IDR 2 – 3 millions	12	179.83			
	IDR 3 - 4 millions	16	131.50			
	IDR 4 - 5 millions	25	154.70			
	IDR 5 – 6 millions	16	131.50			
	IDR 6 - 7 millions	9	147.61			
	IDR 7 -8 millions	12	131.50			
	IDR 8 – 9 millions	8	167.75			
	IDR 9 -10 billions	25	137.30			
	IDR 10 -20 millions	56	144.45			
	IDR 20 -30 millions	31	145.53			
	IDR 30 – 40 millions	9	147.61			
	IDR 40 -50 millions	19	146.76			
	IDR 50 -60 millions	3	131.50			
	IDR 60-70 millions	4	131.50			
	IDR 70-80 millions	5	131.50			
	IDR 80 – 90 millions	9	147.61			
	IDR 90–100 millions	15	150.83			
	Total	290				
	Business areas:			-1.790	.073	-0.105
	Rural	108	140.61			
	Urban	184	149.96			
	Total	292				

Table 6.47b: MWU Test and KW Test: Higher Collateral

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Higher Collateral	**Business field:**			9.339	.096	0.547
	Trade/shops/retail	169	143.73			
	Manufacturing/craftsman	25	144.18			
	Services	35	157.53			
	Transportation	4	169.00			
	Agriculture services/ forestry/stock breeder	25	132.50			
	Food production (small café, restaurant, catering)	34	158.26			
	Total	292				

It should be noted that the tests were also applied on business areas, business field and total amount borrowed; however, no significant relationships were found for those variables.

6.6.5. Arrears

As regards to the occurrence of arrears, the findings presented in Table 6.17 demonstrate that 79.6% of the respondents did not have arrears, while 20.4% of the respondents had arrears mainly due to business failures (57.8%) and distress/urgent consumption needs (34.9%). Therefore, this section's purpose is to further discuss the relationship between arrears and other variables using the Chi-Square test. The findings in Table 6.48a and Table 6.48b suggest significant relationships between arrears and type of micro financing sources (p= .047), particularly showing that BMT respondents (61%) had more arrears problems than BPRS respondents (38%). The test was also applied on the variables of business area, business field, number of financings taken, and total amount borrowed. However, no significant relationships between those variables were found.

Table 6.48a: Cross-tabulation: Arrears

	Had arrears		Not had arrears		Total		Chi Square	Effect size
	Freq.	%	Freq.	%	Freq.	%		
Type of financing sources							.047	.107
BMT	44	**62.0**	135	48.7	179	51.4		
BPRS	27	38.0	142	51.3	169	48.6		
Total	71	100.0	277	100.0	348	100.0		

Table 6.48b: Cross-tabulation: Arrears

Variables	Had arrears		Not had arrears		Total		Chi Square	Effect size
	Freq.	%	Freq.	%	Freq.	%		
Business areas								
Rural	19	26.8	97	35.0	116	33.3	.188	-.071
Urban	52	**73.2**	180	65.0	232	66.7		
Total	71	100.0	277	100.0	348	100.0		
Business field								
Trade/shops/retail	45	**63.4**	167	60.3	212	60.9		
Manufacturing/craftsman	4	5.6	21	7.6	25	7.2		
Services	8	11.3	27	9.7	35	10.1		
Transportation	2	2.8	2	0.7	4	1.1		
Agriculture services/ forestry/stock breeder	3	4.2	24	8.7	27	7.8		
Food production	9	12.7	36	13.0	45	12.9		
Total	71	100.0	277	100.0	348	100.0		
Number of financings taken								
1-5	59	**83.1**	234	84.5	293	84.2	.946[b]	-.016
6-10	10	14.1	36	13.0	46	13.2		
11-15	1	1.4	4	1.4	5	1.4		
Above 15	1	1.4	3	1.1	4	1.1		
Total	71	100.0	277	100.0	348	100.0		
Total amount borrowed								
Below IDR 1 million	3	4.2	16	5.8	19	5.5	.155[c]	.008
IDR 1 – 2 millions	7	**9.9**	19	6.9	26	7.5		
IDR 2 – 3 millions	6	8.5	14	5.1	20	5.8		
IDR 3 - 4 millions	6	8.5	12	4.4	18	5.2		
IDR 4 - 5 millions	4	5.6	25	9.1	29	8.4		
IDR 5 – 6 millions	3	4.2	14	5.1	17	4.9		
IDR 6 - 7 millions	0	0.0	9	3.3	9	2.6		
IDR 7 -8 millions	1	1.4	13	4.7	14	4.0		
IDR 8 – 9 millions	3	4.2	5	1.8	8	2.3		
IDR 9 -10 billions	8	**11.3**	19	6.9	27	7.8		
IDR 10 -20 millions	7	**9.9**	56	**20.4**	63	18.2		
IDR 20 -30 millions	10	**14.1**	21	7.6	31	9.0		
IDR 30 – 40 millions	0	0.0	9	3.3	9	2.6		
IDR 40 -50 millions	4	5.6	16	5.8	20	5.8		
IDR 50 -60 millions	1	1.4	2	0.7	3	.9		
IDR 60-70 millions	1	1.4	3	1.1	4	1.2		
IDR 70-80 millions	2	2.8	3	1.1	5	1.4		
IDR 80 – 90 millions	1	1.4	8	2.9	9	2.6		
IDR 90–100 millions	4	5.6	11	4.0	15	4.3		
Total	71	100.0	275	100.0	346	100.0		

[a]Fisher Exact Test is used due to the violation of Chi-Square assumption, 2 cells (16.7%) have expected counts of less than 5.
[b]Fisher Exact Test is used due to the violation of Chi-Square assumption, 4 cells (50.0%) have expected counts of less than 5
[c]Fisher Exact Test is used due to the violation of Chi-Square assumption, 17 cells (44.7%) have expected counts of less than 5

In addition, MWU Test and Kruskal Wallis Test were applied to further explore the significant differences among subgroups in some variables. The findings suggest statistically significant differences among subgroups of type of financing sources (*p*= .047), indicating that BMT respondents with mean ranking of 167.23 were highly likely to have more arrears problems than BPRS respondents with the mean ranking of 182.20. Hence, this finding corresponds with the above findings. However, the statistically significant differences were not found among subgroups in the following variables: business areas (*p*=.189), business field (*p*=.535), number of financings taken (*p*=.990) and total amount borrowed (*p*=.231).

Table 6.49: MWU Test and KW Test: Arrears

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Arrears	**Type of financing sources**			-1.988	.047	-0.107
	BMT	179	167.23			
	BPRS	169	182.20			
	Total	348				
	Business areas			-1.315	.189	-0.070
	Rural	116	181.50			
	Urban	232	171.00			
	Total	348				
	Business field			4.103	.535	0.220
	Trade/shops/retail	212	173.07			
	Manufacturing/craftsman	25	182.16			
	Services	35	170.23			
	Transportation	4	123.00			
	Agriculture services/forestry/stock breeder	27	190.67			
	Food production (small café, restaurant, catering)	45	175.20			
	Total	348				
	Number of financings taken			.116	.990	0.006
	1-5	293	174.96			
	6-10	46	172.17			
	11-15	5	175.20			
	Above 15	4	166.50			
	Total	348				

6.7. MICROENTERPRISES' PERCEPTIONS OF THE FINANCING AND NON-FINANCING SERVICES PROVIDED BY BMT AND BPRS

This section attempts to further analyse the factors affecting decision-making on whether to borrow money from BMT or BPRS based on the statistically significant differences among BMT and BPRS. As presented in Table 6.10 in the previous chapter, the top four factors, based on the highest percentage of respondents who reported agreement ranging from 'agree' to 'strongly agree' on the factors, were simple procedure (94%), location (93.4%), good service (92.2%), and flexible collateral (90.5%). The rankings of the remaining factors are as follows: *shariah*-compliant (81.9%), cheaper cost (74.9%), influence from particular party (33.7%), provision of social service (7.6%), socialisation (5.5%) and advertisement (1.7%). The MWU test was applied in this case, and the findings are presented in Table 6.50a and Table 6.50b suggesting statistically significant differences among subgroups (under the confidence level of *p*=.05) for the following factors: *shariah*-compliant (*p*=.001), easy procedure (*p*=.001), cheaper cost (*p*=.000), flexible and easy collateral (*p*=.000) and proper location (*p*=.024). The subgroups with higher mean rankings are those with the highest agreement on these factors. Overall, the BMT respondents had the highest agreement on the five variables with statistically significant differences, as mentioned above. It should be noted that the significant differences were not found for the other variables: influence from/following particular people (*p*=.068), advertisements (*p*=.067), socialisation from particular party (*p*=.274), provision of social services (*p*=.992) and good service (*p*=.293).

Table 6.50a: MWU Test: Factors in Borrowing from BMT/BPRS

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Shariah-compliant	**Type of financing sources**			-3.387	.001	-0.182
	BMT	179	188.81			
	BPRS	169	159.34			
	Total	348				
The procedure to get funds is not complicated.	**Type of financing sources**			-3.216	.001	-0.173
	BMT	178	185.03			
	BPRS	169	162.39			
	Total	347				
Cost-related financing product is cheaper	**Type of financing sources**			-5.805	.000	-0.312
	BMT	178	199.11			
	BPRS	169	147.55			
	Total	347				

Table 6.50b: MWU Test: Factors in Borrowing from BMT/BPRS

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Flexible and easy collateral	**Type of financing sources**			-4.639	.000	-0.249
	BMT	178	190.02			
	BPRS	169	157.12			
	Total	347				
Located in various places and easy to reach.	**Type of financing sources**			-2.259	.024	-0.121
	BMT	178	182.00			
	BPRS	169	165.57			
	Total	347				
Influence from/ following particular people (Parents, friends, colleagues	**Type of financing sources**			-1.825	.068	-0.098
	BMT	178	164.96			
	BPRS	169	183.53			
	Total	347				
Advertisements in printed or electronic media (TV, radio).	**Type of financing sources**			-1.832	.067	-0.098
	BMT	177	165.25			
	BPRS	169	182.14			
	Total	346				
Socialisation from particular party	**Type of financing sources**			-1.094	.274	-0.059
	BMT	178	168.98			
	BPRS	169	179.29			
	Total	347				
Provision of social services (training, consultancy *etc.*)	**Type of financing sources**			-.010	.992	-0.001
	BMT	178	173.04			
	BPRS	167	172.95			
	Total	345				
Good service	**Type of financing sources**			-1.051	.293	-0.056
	BMT	178	178.60			
	BPRS	169	169.15			
	Total	347				

In order to further examine which factors are deemed important in decision-making on whether to borrow money from BMT/BPRS, exploratory factor analysis was employed, in particular Principal Component Analysis (PCA) with the Varimax rotation technique. The purpose of the factor analysis in this section is to determine the possibility of reducing the ten factors to a smaller number of factors and to discover which factors are important in influencing decision-making on whether to borrow money from BMT/BPRS.

Before the factor analysis can be conducted, it is important to check the suitability of the data based on the result of KMO and Bartlett's Test of Sphericity for all ten factors. The KMO value should be higher than .06 and the Bartlett's significance should be less than the critical of p=.05. The result in Table 6.51 indicates that the KMO value was 0.764 and Bartlett's Test of Sphericity shows the statistical significance as p=.000, supporting the factorability of the correlation matrix. Therefore, the factor analysis can be further conducted.

Table 6.51: KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		**.764**
Bartlett's Test of Sphericity	Approx. Chi-Square	1228.647
	Df	45
	Sig.	**.000**

Another requirement is to check the correlation matrix to determine the strength of the relationship between the two factors. To assess the relationship, the cells with coefficients above 0.3 should be found in the matrix. In this case, the correlation matrix contained many cells above 0.3. In addition, according to Field (2005: 641), factor analysis can be run if the determinant is greater than .00001. The determinant which resulted from this test was 0.027, which satisfies the requirement.

Based on Kaiser's criterion, the total variance is presented in Table 6.52. The results show that the ten factors can be reduced to two factors, based on the initial eigenvalues above 1. The first factor shows initial eigenvalues of 2.828 and the second factor has initial eigenvalues of 2.563. The two factors explain a cumulative total of 53.9% of the variance, 28.2% for the first factor and 25.6% for the second factor, while the remaining eight factors can only explain 46.1% of the total variation.

Table 6.52: Total Variance Explained

	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings[a]
Component	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total
1	**2.828**	**28.276**	**28.276**	2.828	28.276	28.276	2.827
2	**2.563**	**25.630**	**53.906**	2.563	25.630	53.906	2.563
3	.998	9.976	63.882				
4	.854	8.536	72.418				
5	.771	7.707	80.125				
6	.631	6.307	86.432				
7	.533	5.326	91.758				
8	.427	4.275	96.033				
9	.217	2.175	98.208				
10	.179	1.792	100.000				
Extraction Method: Principal Component Analysis.							
a. When components are correlated, sums of squared loadings cannot be added to obtain a total variance.							

The final result of rotated factors in Table 6.53 shows that the ten items are distributed into two factors, with 4 items loading above 0.3 in factor 1 and 6 items loading above 0.3 in factor 2. This is ideal as there should be three or more items loading onto each component, so this solution is optimal (Pallant, 2007: 192). The first factor contains four items, with loading ranging from 0.553 up to 0.913, while factor two consists of six items, with loading ranging from 0.437 up to 0.792.

The four items attached to 'factor one' are 'socialisation from a particular party, advertisement in printed and electronic media, provision of social services and influence from/following particular people; these can be labelled external factors. The six items attached to factor two are procedure to obtain funds is not complicated, flexible and easy collateral, cost-related financing product is cheaper, *shariah*-compliant, good service, and location; these can be labelled internal/personal benefit factors.

Table 6.53: Component Matrix: Factors Influencing Decision to Borrow from BMT/BPRS

Variables	**Factor**		**Communality of each variable**
	External	**Internal**	
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc.*)	.913		.835
Advertisements in printed or electronic media (TV, radio).	.912		.832
Provision of social services (training, consultancy *etc.*)	.900		.814
Influence from /following particular people (Parents, friends, colleagues	.553		.311
The procedure to get funds is not complicated.		.792	.633
Flexible and easy collateral		.771	.597
Cost-related financing product is cheaper		.720	.526
Shariah-compliant (*e.g.*. prohibition of *riba* (interest), profit- and loss-sharing system *etc.*)		.628	.396
Good service (staff able to explain banking products clearly and handle complaints quickly).		.476	.254
Located in various places and easy to reach.		.437	.191
Eigenvalue	2.828	2.563	
% of variance	28.276	25.630	
Cumulative %	28.276	53.906	

A further test was conducted to determine which factor was the more important. As can be seen in Table 6.54, based on mean comparison, the average mean of factor 1 was 2.57, and the average mean of factor 2 was 3.97. Therefore, factor 2 is the more important factor for the respondents.

Table 6.54: Ranking and Average Mean For Each Factor

Factor 1: External	Mean value
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc*.)	2.47
Advertisements in printed or electronic media (TV, radio).	2.39
Provision of social services (training, consultancy *etc*.)	2.50
Influence from /following particular people (Parents, friends, colleagues	2.93
Average mean	**2.57**
Factor 2: Internal	**Mean value**
The procedure to get funds is not complicated.	4.02
Flexible and easy collateral	3.97
Cost-related financing product is cheaper	3.78
Shariah-compliant (*e.g.*. prohibition of *riba* (interest), profit- and loss-sharing system *etc*.)	3.91
Good service (staff able to explain banking products clearly and handle complaints quickly).	4.15
Located in various places and easy to reach.	4.02
Average mean	**3.97**

The factor analysis test was also applied to BMT and BPRS separately to determine whether there was any difference in the factors extracted. The test produced different findings for each institution. Based on the BMT data, the results in Table 6.56 shows that the ten factors were reduced to two factors, which is similar to the overall findings. Table 6.55, hence, suggests that the most important factor was factor 2, namely the internal/personal benefit factor, based on the average mean of 4.07, while the external factors seem to be less important, as indicated by the average mean value of 2.54.

Table 6.55: Rotated Component Matrix (BMT)

Variables	Factors		Communality of each variable
	Internal	External	
The procedure to get funds is not complicated.	.810		.659
Cost-related financing product is cheaper	.783		.617
Flexible and easy collateral	.783		.620
Shariah-compliant (*e.g*. prohibition of *riba* (interest), PLS ,*etc*.)	.641		.423
Good service (staff able to explain banking products clearly and handle complaints quickly).	.549		.327
Located in various places and easy to reach.	.483		.236
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc*.)		.911	.831
Advertisements in printed or electronic media (TV, radio).		.878	.780
Provision of social services (training, consultancy *etc*.)		.875	.767
Influence from /following particular people (Parents, friends, colleagues		.546	.309
Eigenvalue	2.970	2.598	
% of variance	29.697	25.984	
Cumulative %	29.697	55.681	

Table 6.56: Ranking and Average Mean for Each Factor (BMT)

Factor 1: External	Mean value
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc.*)	2.44
Advertisements in printed or electronic media (TV, radio).	2.34
Provision of social services (training, consultancy *etc.*)	2.52
Influence from /following particular people (Parents, friends, colleagues	2.85
Average mean	**2.54**
Factor 2: Internal	**Mean value**
The procedure to get funds is not complicated.	4.10
Flexible and easy collateral	4.07
Cost-related financing product is cheaper	3.97
Shariah-compliant (*e.g.*. prohibition of riba (interest), profit- and loss-sharing system *etc.*)	4.02
Good service (staff able to explain banking products clearly and handle complaints quickly).	4.17
Located in various places and easy to reach.	4.08
Average mean	**4.07**

As can be seen in Table 6.57, distinct from the above results, the factor analysis on BPRS respondents resulted in three factors consisting of (i) four external factors, (ii) four internal/personal interest factors: flexible collateral, cheaper cost, good location and easy procedure, and (iii) two factors related to good service and *shariah* compliance.

Table 6.57: Rotated Component Matrix (BPRS)

Variables	Component			Commu-nality of each variable
	1	2	3	
Provision of social services (training, consultancy *etc.*)	.941			.918
Advertisements in printed or electronic media (TV, radio).	.931			.903
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc.*)	.918			.845
Influence from /following particular people (Parents, friends, colleagues	.588			.400
Flexible and easy collateral		.771		.656
Cost-related financing product is cheaper		.656		.488
Located in various places and easy to reach.		.588		.405
The procedure to get funds is not complicated.		.571	.527	.620
Good service (staff able to explain banking products clearly and handle complaints quickly).			.740	.559
Shariah-compliant (*e.g.*. prohibition of *riba* (interest), profit- and loss-sharing system *etc.*)			.711	.545
Eigenvalue	3.148	2.054	1.136	
% of variance	31.479	20.541	11.362	
Cumulative %	31.479	52.020	63.382	

The rankings in terms of importance of the three factors based on the average mean are presented in Table 6.58. The findings indicate that the most important factor was factor 3 (average mean= 3.96), followed by factor 2 (average mean= 3.84) and factor 1 (average mean= 2.61).

Table 6.58: Ranking and Average Mean for Each Factor (BPRS)

Factor 1	**Mean value**
Provision of social services (training, consultancy *etc*..)	2.47
Advertisements in printed or electronic media (TV, radio).	2.44
Socialisation from particular party (*ulema*, experts in Islamic Economics/Banking, *etc*..)	2.50
Influence from /following particular people (Parents, friends, colleagues	3.02
Average mean	**2.61**
Factor 2	**Mean value**
Flexible and easy collateral	3.86
Cost-related financing product is cheaper	3.59
Located in various places and easy to reach.	3.95
The procedure to get funds is not complicated.	3.94
Average mean	**3.84**
Factor 3	**Mean value**
Good service (staff able to explain banking products clearly and handle complaints quickly).	4.13
Shariah-compliant (*e.g*. prohibition of *riba* (interest), profit- and loss-sharing system *etc*.)	3.79
Average mean	**3.96**

6.8. THE ROLE OF BMT AND BPRS IN ECONOMIC DEVELOPMENT

This section attempts to answer the research question on what roles BMT and BPRS can play in the economic development process; this involves analysing the impacts on the respondents' economic and social aspects.

6.8.1. Analysis of the Economic Impact

This section is intended to investigate the roles of BMT and BPRS in economic development based on the microenterprise operators' perceptions on the impacts on sales, income, assets, businesses expenditures, household expenditures, economic activities and employment. The tests applied in this section are as follows:

(i) Wilcoxon Signed Rank Test to test whether there is a change, after financing, in the value of annual sales, net income, business expenditure, household expenditure and number of workers;

(ii) MWU test to explore statistically significant differences among subgroups in type of micro financing sources and impact on assets, impact on economic activities, impact on monthly business expenditures and impact on monthly household expenditures;

(iii) The Spearman Rank Test Order Correlation to explore statistically significant between impact variables and independent variables;

(iv) The Binary Logistics Regression to predict what variables are the best predictors of the economic impact.

The Wilcoxon Signed Rank Test was applied to all the respondents and to specific subgroups of BMT respondents and BPRS respondents in order to obtain a more detailed insight into the impact on each institution.

6.8.1.1. Impact on Sales

Impact on sales were analysed based on the Wilcoxon Signed Rank Test to investigate whether there was a change in the value of annual sales from the situation before financing to after financing, as can be seen in Table 6.59. The test was applied to all the respondents and to specific subgroups of BMT respondents and BPRS respondents in order to obtain a more detailed insight into the impact on each institution. The findings show that annual sales of total respondents were significantly higher after financing (median=IDR 120,000,000) than annual sales before financing (median=IDR 84,000,000), at a significance level of p=.000, which is lower than the confidence level of p=.05. The annual sales of BMT respondents were also significantly higher after financing (median=IDR 108,000,000) than annual sales before financing (median=IDR 72,000,000), at a significance level of =.000. The BPRS respondents also reported an improvement in annual sales after financing (median=IDR 132,000,000) compared to before financing (median=IDR 108,000,000), at a significance value of p=.000. Based on the improvement of median rank, BMT respondents had performed better than BPRS respondents since their improvement was higher, at IDR 36,000,000 and IDR 24,000,000 respectively.

Table 6.59: Wilcoxon Signed Rank Test: Impact on Annual Sales

Variable	Description	N	Median Rank	Z	Asymp. Sig. (*p*)	Effect size
Total respondents	Before financing	348	84,000,000	-10.841	.000	-0.031
	After financing	348	120,000,000			
	Increase		36,000,000			
BMT' respondents	Before financing	179	72,000,000	-8.097	.000	-0.045
	After financing	179	108,000,000			
	Increase		36,000,000			
BPRS' respondents	Before financing	169	108,000,000	-7.432	.000	-0.044
	After financing	169	132,000,000			
	Increase		24,000,000			

6.8.1.2. Impact on Net Income

Impact on net income were analysed through Wilcoxon Signed Rank Test with the objective of investigating whether there was a change in the value of annual net income from the situation before financing to after financing. The results in Table 6.60 show that annual net incomes of total respondents were significantly higher after financing (median=IDR 27,000,000) than annual net incomes before financing (median=IDR 18,000,000), at a significance level of *p*=.000, which is lower than the confidence level of .05. The annual net incomes of BMT respondents were also significantly higher after financing (median= IDR 18,000,000) than before financing (median=IDR 15,700,000), at a significance level of *p*=.000. Similarly, the annual net incomes of BPRS respondents were also significantly higher after financing (median=IDR 36,000,000) than before financing (median=IDR 24,000,000), at a significance level of *p*=.000. The improvement of annual net incomes of BPRS respondents (IDR 12,000,000) was around three times higher than the BMT respondents (IDR 3,300,000).

Table 6.60: Wilcoxon Signed Rank Test: Impact on Annual Net Income

Variable	Description	N	Median Rank	Z	Asymp. Sig. (*p*)	Effect size
Total respondents	Before financing	347	18,000,000	-10.661	.000	-0.031
	After financing	348	27,000,000			
	Increase		9,000,000			
BMT' respondents	Before financing	178	14,700,000	-8.042	.000	-0.045
	After financing	179	18,000,000			
	Increase		3,300,000			
BPRS' respondents	Before financing	169	24,000,000	-7.235	.000	-0.044
	After financing	169	36,000,000			
	Increase		12,000,000			

6.8.1.3. Impact on Businesses Expenditures

As regards to the impacts on business expenditures, the analysis was conducted with two tests: (i) Wilcoxon Signed Rank Test was utilised to investigate whether there is a change in the value of annual business expenditure from the situation before financing to after financing (Table 6.61); (ii) MWU test was employed to explore the statistically significant differences among subgroups in type of micro financing sources and impact on monthly business expenditure after financing (Table 6.61).

The results of the Wilcoxon Signed Rank Test in Table 6.61 show that annual business expenditures were significantly higher after financing (median=IDR 84,000,000) than before financing (median=IDR 60,000,000), at a significance level of *p*= .000, which is lower than the confidence level of .05. Similarly, the annual business expenditures of BMT respondents were significantly higher after financing (median=IDR 72,000,000) than before financing (median=IDR 48,000,000), at a significance level of *p*= .000. The annual business expenditures of BPRS respondents were significantly higher after financing (median=IDR 97,000,000) than before financing (median=IDR 72,000,000), at a significance level of *p*= .000. In this case, both institutions' respondents experienced almost the same level of improvement, although BPRS respondents performed slightly better (IDR 25,800,000) than BMT respondents (IDR 24,000,000).

Table 6.61: Wilcoxon Signed Rank Test: Impact on Annual Business Expenditure

Variable	Description	N	Median Rank	Z	Asymp. Sig. (*p*)	Effect size
Total Respondents	Before financing	347	60,000,000	-11.328	.000	-0.608
	After financing	347	84,000,000			
	Increase		24,000,000			
BMT' Respondents	Before financing	179	48,000,000	-8.315	.000	-0.621
	After financing	179	72,000,000			
	Increase		24,000,000			
BPRS' Respondents	Before financing	168	72,000,000	-7.865	.000	-0.607
	After financing	168	97,800,000			
	Increase		25,800,000			

Table 6.22 in the previous chapter showed that a large majority of the respondents reported 'no impact' on monthly business expenditures. The rankings of the 'no effect'

responses are as follows: rent (91.9%), wages (83.9%), transport (74.9%), loan repayment (72.6%), utilities (67.1%), tools/minor equipment (66.7%), stock (37.2%). The rankings of 'positive impacts' are as follows: stock (60.6%), tools/minor equipment (33%), utilities (32.3%), loan repayment (25.7%). This section aims to further discuss the statistically significant differences among subgroups in type of micro financing sources in the impact on monthly business expenditures. As can be seen in Table 6.62a and Table 6.62b, based on the critical confidence level of p=.05, the findings suggest statistically significant differences among subgroups of type of financing institutions and the following monthly business expenses: stock (p=.000), utilities (p= .008), transport, and financing repayment (p= .001). However, there were no significant differences among subgroups of type of financing institutions in the variables of tools/minor equipment, rent, and wages. The subgroups with higher mean rankings reported less impact on business expenditure. Overall, the subgroups reporting the least effect were BPRS respondents, except in financing repayment.

Table 6.62a: MWU Test: Impact on Monthly Business Expenditure after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (p)	Effect Size
Tools/minor equipment	**Type of financing sources**			-.976	.329	-0.052
	BMT	179	170.28			
	BPRS	169	178.97			
	Total	348				
Stocks (*e.g.* shop stock, raw materials *etc.*)	**Type of financing sources**			-3.577	.000	-0.192
	BMT	178	156.97			
	BPRS	169	191.94			
	Total	347				
Rent (per year)	**Type of financing sources**			-.101	.920	-0.005
	BMT	178	173.75			
	BPRS	169	174.26			
	Total	347				
Utilities	**Type of financing sources**			-2.658	.008	-0.143
	BMT	178	162.57			
	BPRS	169	186.04			
	Total	347				
Transport	**Type of financing sources**			-1.954	.051	-0.105
	BMT	178	166.25			
	BPRS	169	182.16			
	Total	347				
Wages	**Type of financing sources**			-1.301	.193	-0.070
	BMT	178	169.64			
	BPRS	169	178.59			
	Total	347				

Table 6.62b: MWU Test: Impact on Monthly Business Expenditure after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect Size
Financing repayment	**Type of financing sources**			-3.358	.001	-0.180
	BMT	178	187.75			
	BPRS	169	159.52			
	Total	347				

6.8.1.4. Impact on Household Expenditures

Similar to the analysis above, impacts on household expenditures were analysed based on two tests: (i) Wilcoxon Signed Rank Test was utilised to investigate whether there was a change in the value of annual household expenditure from the situation before financing to after financing, as in Table 6.63; (ii) MWU test was employed to explore the statistically significant differences between subgroups in type of micro financing sources and impact on monthly household expenditure after financing, the results of which are displayed in Table 6.64a and Table 6.64b..

The results of the Wilcoxon Signed Rank Test in Table 6.63 show that annual household expenditures of total respondents were significantly higher after financing (median= IDR 16,800,000) than before financing (median= IDR 12,000,000), at a significance level of p=.000 which is lower than the confidence level of p=.05. Similarly, annual household expenditures of BMT respondents were significantly higher after financing (median= IDR 14,400,000) than before financing (median= IDR 12,000,000), at a significance level of p=.000. The annual household expenditures of BPRS respondents were also significantly higher after financing (median=IDR 18,000,000) than before financing (median=IDR 12,000,000), at a significance level of p=.000. The BPRS respondents' increase (IDR 6,000,000) was more than double that of BMT respondents (IDR 2,200,000).

Table 6.63: Wilcoxon Signed Rank Test: Impact on Annual Household Expenditure

Variable	Description	N	Median Rank	Z	Asymp. Sig. (*p*)	Effect size
Total respondents	Before financing	347	12,000,000	-9.520	.000	-0.511
	After financing	348	16,800,000			
	Increase		4,800,000			
BMT' respondents	Before financing	178	12,000,000	-6.197	.000	-0.464
	After financing	179	14,400,000			
	Increase		2,200,000			
BPRS' respondents	Before financing	169	12,000,000	-7.308	.000	-0.562
	After financing	169	18,000,000			
	Increase		6,000,000			

Reiterating the previous results, as presented in Table 6.23, the majority of the respondents reported 'no effect' on monthly household expenditures, with the following rankings: health (83%), transport (78.7%), clothing (76.9%), furniture (76.4%), household utensils (70.4%), education (69.9%) and food (67.3%). However, several respondents reported a positive impact on household expenditure, with rankings as follows: food (29.7%), household utensils (29.3%), education (28.7%), furniture (23.4%), clothing (22.2%), transport (20.7%) and health (16.5%). The purpose of this section is, however, to further explore which subgroups in the type of financing institution showed statistically significant differences, for which MWU test was conducted. Table 6.64a and Table 6.64b show the statistically significant differences among subgroups of type of financing institution in transport expenditures (p=.045) and furniture/electrical purchases per year (p=.011). The statistically significant differences were not found in household expenditures on food (p=.598), health/medical (p=.169), education (p=.426), clothing (p=.249), and household utensils (p=.169). It should be noted that the higher mean rankings indicate the least effect; therefore, BPRS respondents reported least effect in general.

Table 6.64a: MWU Test: Impact on Monthly Household Expenditure after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Food	**Type of financing sources**			-.527	.598	-0.028
	BMT	177	171.23			
	BPRS	169	175.88			
	Total	346				
Health/medical	**Type of financing sources**			-1.375	.169	-0.074
	BMT	178	169.30			
	BPRS	169	178.95			
	Total	347				

Table 6.64b: MWU Test: Impact on Monthly Household Expenditure after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Education	**Type of financing sources**			-.796	.426	-0.043
	BMT	177	169.67			
	BPRS	168	176.51			
	Total	345				
Clothing	**Type of financing sources**			-1.152	.249	-0.062
	BMT	178	169.58			
	BPRS	169	178.66			
	Total	347				
Transport	**Type of financing sources**			-2.007	.045	-0.108
	BMT	178	166.51			
	BPRS	169	181.89			
	Total	347				
Household utensils	**Type of financing sources**			-1.375	.169	-0.074
	BMT	179	168.78			
	BPRS	169	180.56			
	Total	348				
Furniture/ electronic purchases (per year)	**Type of financing sources**			-2.527	.011	-0.136
	BMT	178	164.22			
	BPRS	169	184.30			
	Total	347				

6.8.1.5. Impact on Assets

This section explores the significant differences between subgroups in type of financing sources in terms of the impact on assets after financing. As presented in Table 6.24, a large majority of the respondents reported 'no effect' on impact on assets after financing, with rankings as follows: cattle (91.9%), gold jewellery (87.5%), land/agricultural (85.3%), buildings (75.4%), private cars/motorcycles (71.8%), savings (69.8%), electronic goods (69.6%). However, some positive impacts were reported by the respondents, with the following rankings: productive assets (59.9%), electrical goods (29.8%), savings (28.8%), private cars/motorcycles (27.1%), buildings (24.4%), land (13.8%), gold jewellery (11.7%), and cattle (7.8%). In further exploring, MWU test results in Table 6.65 with a confidence level of *p*= .05, statistically significant differences were found in almost all the variables: buildings (*p*= .013), private cars/motorcycles (*p*=.000), cattle (*p*=.011), productive assets (*p*=.000), electronic goods (*p*=.001), jewellery (*p*=.004); the exceptions were land and buildings (*p*=.065) and savings (*p*=.323). Overall, the subgroups with higher mean rankings, which indicate least effect, were BPRS respondents.

Table 6.65: MWU Test: Impact on Assets after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (*p*)	Effect size
Land/ agriculture	**Type of financing sources**			-1.843	.065	-0.099
	BMT	177	167.54			
	BPRS	169	179.74			
	Total	346				
Buildings	**Type of financing sources**			-2.493	.013	-0.134
	BMT	176	163.15			
	BPRS	169	183.25			
	Total	345				
Private cars/ motorcycles	**Type of financing sources**			-3.904	.000	-0.210
	BMT	178	157.91			
	BPRS	169	190.95			
	Total	347				
Cattle	**Type of financing sources**			-2.542	.011	-0.137
	BMT	178	167.22			
	BPRS	168	180.15			
	Total	346				
Productive assets	**Type of financing sources**			-6.360	.000	-0.343
	BMT	177	141.84			
	BPRS	167	204.99			
	Total	344				
Electrical goods	**Type of financing sources**			-3.281	.001	-0.177
	BMT	177	159.26			
	BPRS	168	187.48			
	Total	345				
Jewelry (gold)	**Type of financing sources**			-2.895	.004	-0.156
	BMT	177	163.85			
	BPRS	167	181.66			
	Total	344				
Savings	**Type of financing sources**			-.989	.323	-0.053
	BMT	177	176.63			
	BPRS	167	168.12			
	Total	344				

6.8.1.6. Impact on Economic Activities

As regards to the impact of financing on economic activities, as presented in Table 6.25, the rankings of activities with highest positive impacts reported by the respondents were as follows: volume of goods/services (72.7%), quality of goods/services (49.4%), diversification into new goods/services (37.1%), premises (21.6%), production technology (11.9%), and bookkeeping (9.5%). The MWU test in this section aims to further explore the significant differences between subgroups of type of micro financing sources and the impact on particular aspects of economic activities. The findings in Table 6.66 shows statistically significant differences in volume of goods/services (p=.007), quality of goods/services (p=.000), production technology (p=.023) and premises (p=.000). However, no significant differences were found in 'diversification into new goods/services' (p=.319) and 'bookkeeping' (p=.500). It should be noted that in this section, the higher mean rankings imply the higher impacts, which were reported by BPRS respondents in general.

Table 6.66: MWU Test: Impact on Economic Activities after Financing

Variable	Subgroup	N	Mean Rank	Z	Asymp. Sig. (p)	Effect size
Volume of goods/services sold	**Type of financing sources**			-2.698	.007	-0.145
	BMT	179	160.98			
	BPRS	169	188.82			
	Total	348				
Quality of goods/services	**Type of financing sources**			-5.576	.000	-0.299
	BMT	179	147.58			
	BPRS	169	203.02			
	Total	348				
Diversification into new goods/services	**Type of financing sources**			-.996	.319	-0.054
	BMT	177	168.98			
	BPRS	169	178.23			
	Total	346				
Production technology	**Type of financing sources**			-2.281	.023	-0.122
	BMT	178	167.15			
	BPRS	169	181.21			
	Total	347				
Bookkeeping	**Type of financing sources**			-.674	.500	-0.036
	BMT	178	171.66			
	BPRS	168	175.45			
	Total	346				
Premises	**Type of financing sources**			-3.886	.000	-0.208
	BMT	179	159.88			
	BPRS	169	189.99			
	Total	348				

6.8.1.7. Impact on Employment

In examining the impact of financing on employment, the Wilcoxon Signed Rank Test is employed in this section in order to determine whether there was a change in the number of male workers, female workers and total workers from the situation before financing to that after financing. The results of the Wilcoxon Signed Rank Test in Table 6.67 shows that the number of male workers was significantly higher after financing with mean value of 1.66 than before financing with mean value of 1.25, at a significance level of p=.000 which is lower than the confidence level of .05. The number of female workers was also higher after financing (mean=1.37) than before financing (mean=1.22), at a significance level of p=.000. In total, the number of workers employed after financing with mean value of 3.03 was higher than before financing with mean value of 2.46. Further analysis of the comparison between BMT and BPRS shows that the increase in total number of workers of the BPRS customers was slightly higher (mean=0.59) than for BMT respondents (mean=0.55). However, the BMT respondents seem to have experienced a greater increase in the number of female workers (mean=.019) than BPRS respondents (mean=.012).

Table 6.67: Wilcoxon Signed Rank Test: Impact on Number of Workers

Variable			N	Mean Rank[a]	Z	Asymp. Sig. (p)	Effect size
Total respondents	Male workers	Before financing	348	1.25	-5.568	.000	-0.016
		After financing	348	1.66			
		Increase		0.41			
	Female workers	Before financing	348	1.22	-4.666	.000	-0.013
		After financing	348	1.37			
		Increase		0.15			
	Total workers	Before financing	348	2.46	-6.258	.000	-0.018
		After financing	348	3.03			
		Increase		0.57			
BMT' respondents	Male workers	Before financing	179	1.00	-4.457	.000	-0.025
		After financing	179	1.36			
		Increase		0.36			
	Female workers	Before financing	179	1.09	-4.146	.000	-0.023
		After financing	179	1.28			
		Increase		0.19			
	Total workers	Before financing	179	2.09	-5.599	.000	-0.031
		After financing	179	2.64			
		Increase		0.55			
BPRS' respondents	Male workers	Before financing	169	1.51	-3.476	.001	-0.021
		After financing	169	1.98			
		Increase		0.47			
	Female workers	Before financing	169	1.34	-2.478	.013	-0.015
		After financing	169	1.46			
		Increase		0.12			
	Total workers	Before financing	169	2.85	-3.365	.001	-0.020
		After financing	169	3.44			
		Increase		0.59			

[a]Mean rank used instead of median rank in order to show the improvement in more detail since median rank does not provide such information.

6.8.1.8. Economic Impact: Correlation and Regression Analysis

This section provides further analyses on the relationship among independent variables and impact variables. For this, initially a correlation analysis is employed with the objective of exploring the nature and the strength of the relationship between variables. The correlation coefficient, which indicate the strength of relationship, between -1 to +1 could be categorized into three group, small (.10 to .29), medium (.30 - .49) and large correlation (.50–1.0) (Cohen, 1988. 79-81). In relation to the nature of the data used in this study, which are non-parametric with dichotomous and ranked data, the Spearman Rank Correlation Test is applied. The correlation coefficients are presented in Table 6.68a and Table 6.68b based on the significance level of 1% and 5%.

Table 6.68a and Table 6.68b depicts that there are statistically significant correlation between all economic impact categories and land assets, private car/motorcycle, productive assets, electric goods, jewellery, membership length, borrowers length, times borrow, total loan, male workers, female workers and total workers. For example: land assets have positive correlation with sales (*rho*=.180), net income (*rho*=.196), business expenditure (*rho*=158), household expenditure (*rho*=.137) and total assets (*rho*=.130), with small strength of relationship in all cases. This implies that the respondents having larger value of assets relate to high economic impact.

Table 6.68a and Table 6.68b also indicate other positive significant correlations also have been found between economic impacts and the duration of becoming members and borrowers, with small strength of correlations in all cases, as the value of *rho* are lower than .29. Furthermore, as can be seen in Table 6.68a and Table 6.68b, there are positive significant correlation between membership length and sales (*rho*=.200), net income (*rho*=.200), business expenditure (*rho*=.172), household expenditures (*rho*=.207) and total workers (*rho*=.160). As for borrowing duration, the significant correlations are found in the improvement of sales (*rho*=.178), net income (*rho*=.154), business expenditure (*rho*=.155), household expenditure (*rho*=.224) and total workers (*rho*=169). Hence, this indicates that the respondents having longer duration of membership and borrowing relates to high economic impact.

Other positive but small significant correlations are also found between number of repeated borrowing and sales (*rho*=.210), net income (*rho*=.171), business expenditure (*rho*=.164), household expenditure (*rho*=.150) and total workers (*rho*=.180). Similarly, the findings also show positive significant correlation between total loan and sales (*rho*=.327), net income (*rho*=.290), business expenditure (*rho*=.307), household expenditure (*rho*=.323) and total workers (*rho*=.249). These findings, hence, indicate that the more repeated times of borrowing and higher amount of total loan relate to having high economic impact. The results also indicate that variables such as male workers, female workers and total workers have positive significant correlation with all economic impact categories described in Table 6.68, which indicate that the respondents having larger number of workers positively relates to high economic impact.

In extending the analysis, the Spearman Rank Order Correlation test has been applied to explore the correlation between independent variables and dependent impact variables of assets, productive activities, business expenditure and household expenditure (see: Appendix 6.1- Appendix 6.4). Overall, the findings show that, among others, assets and total loans received are the variables which have significant correlation with economic impacts.

Table 6.68a: Spearman Rank Order Correlation: Impact on Improvement of Sales, Income, Expenditures and Total Workers after Financing

Independent Variables	Impact						
	Sales	Income	Bus exp.	House exp	Total worker	Male worker	Female worker
ME main income	-.055	-.028	-.091	-.023	-.070	-.057	-.031
Gender	.036	.022	.104	-.091	-.102	**-.150****	.012
Age	-.083	-.082	-.076	**-.133***	**-.146****	**-.191****	-.023
Religious educat.	**-.147****	**-.141****	-.104	**-.164****	**-.194****	**-.224****	**-.151****
Religious activity	-.090	-.083	-.087	-.039	-.030	-.045	-.009
Household size	.078	.050	.065	**.227****	.085	**.144****	-.043
Business area	-.051	-.069	-.023	**-.123***	-.083	**-.125***	-.048
Business age	.049	.013	.043	.044	-.018	-.059	.040
Asset land	**.180****	**.196****	**.158****	**.137***	**.130***	**.128***	**.140****
Building	.073	.032	.093	-.027	.027	.026	-.001
Private car	**.198****	**.166****	**.204****	**.135***	**.146****	**.137***	.097
Cattle	.054	.073	.026	.077	.066	.046	.060
Prod asset	**.394****	**.400****	**.373****	**.326****	**.153****	**.183****	.105
Electric goods	**.304****	**.311****	**.258****	**.182****	**.151****	**.156****	.059
Jewellery	**.230****	**.211****	**.219****	**.171****	**.151****	.081	**.179****
Saving	**.201****	**.189****	**.183****	.085	.086	.070	.103
Total assets	**.295****	**.267****	**.275****	**.172****	.089	**.106***	.088

Table 6.68b: Spearman Rank Order Correlation: Impact on Improvement of Sales, Income, Expenditures and Total Workers after Financing

Independent Variables	Impact						
	Sales	Income	Bus exp.	House exp	Total worker	Male worker	Female worker
Type of IsMFI	**.123***	**.142****	**.131***	**.190****	-.070	-.009	-.045
Member of group	.022	.007	.006	-.022	-.048	-.037	-.005
Membership duration	**.200****	**.200****	**.172****	**.207****	**.160****	**.128***	**.177****
Borrowers duration	**.178****	**.154****	**.155****	**.224****	**.169****	**.120***	**.205****
Times borrow	**.210****	**.171****	**.164****	**.150****	**.180****	**.127***	**.192****
Duration after last loan	-.002	.020	-.005	.077	.056	.019	.090
Duration of loan payment	.057	.091	.040	**.140****	.075	**.106***	.021
Total loan	**.327****	**.290****	**.307****	**.323****	**.249****	**.229****	**.193****
Actual use loan	-.090	-.073	-.097	.076	.042	.037	.033
Installment	.029	.068	-.001	**.204****	**.145****	**.131***	.102
Male worker	**.180****	**.243****	**.142****	**.272****	**.411****	**.534****	**.113***
Female worker	**.312****	**.348****	**.275****	**.294****	**.501****	**.478****	**.316****
Total worker	**.312****	**.348****	**.275****	**.294****	**.501****	**.478****	**.316****
Social services received (yes/no)	.017	.032	-.007	-.035	**.174****	**.165****	.072
Management training	.014	.061	.004	.063	.048	.063	.080
Technical	-.005	.048	-.015	.042	**.114***	**.121***	**.147****
Consultancy	.001	.015	-.013	-.042	.057	.090	-.056
Religious training	-.002	.004	-.009	-.029	**.181****	**.136***	.081

Notes: Correlation coefficients are presented; **. Correlation is significant at the 0.01 level (2-tailed); *.Correlation is significant at the 0.05 level (2-tailed).

To expand the impact analysis further, binary logistic regression analysis was applied to predict what variables are the best predictors of the economic impact. Prior to applying binary logistic regression analysis, the impact variables are transformed into dichotomous variables, thus negative effect and no effect (previously coded as ‘1’,’2’) are transformed into ‘0’ for no impact, while minor, moderate and major positive effect (previously coded as ‘3’,’4’,’5’) are transformed into ‘1’ for positive impact. In addition, the independent variables transformed with the same code: gender (0=female, 1=male), microenterprises as main source of income (0=no, 1=yes), religious education (0=no, 1=yes), business area (0=urban, 1=rural), type of IsMFI (0=BPRS, 1=BMT), social development programme/services received (0=no, 1=yes).

Table 6.69a and Table 6.69b depicts the findings of binary logistic regression analysis by presenting overall goodness fit of the model, in which all models have high level of significance at p=.000, which also indicates that the model explain between 14%-33.8% (Cox and Snell R^2) and 19.7%-44.3% (Nagelkerke R^2) of the variation in the dependent variable, namely the economic impact. It should be noted that the models correctly classify between 76.2%-90.3% of the cases.

The findings of unique significance level of each independent variable in the model, beta coefficient and odd ratio are also presented in Table 6.69a and Table 6.69b, which shows that the statistical significance of independent variable are varied for each impact in business activities: gender is significant for impact on bookkeeping at p=.016, business areas is significant for impact on premises at p=.004, land/agriculture is significant on impact on technology (p=.042) and bookkeeping (p=.004), productive assets is significant on impact on volume of goods/services (p=.046), types of IsMFI is significant on impact on technology (p=.002), borrowers length is significant on impact on bookkeeping (p=.012), total workers is significant on impact on technology (p=.018), and overall, the social programme/services received were found significant in almost all impact of business activities, except on premises.

The beta coefficients Table 6.69a and Table 6.69b show the contribution of each independent variable in the model in terms of the strength of the determining factors, therefore the largest beta coefficient shows the strongest contribution or impact. As presented in Table 6.69a and 6.69b, the largest coefficients or the strongest determine variables in the models are social development programme/services received by the respondents, except for impact on technology and bookkeeping. This clearly indicates that the respondents reporting positive impacts on economic activities are highly likely relate to the social development programme received.

Similarly, the strongest predictors for each impact on business activities were varied in each model. In particular, for impact on volume of goods/services, the strongest predictor was social development programme/services, confirming an odd ratio of 3.59, which indicate that respondents who received social programme/services were over 3 times more likely to report an impact on volume of goods/services, controlling for all other variables in the model. The odd ratio of social programme/services received on impact on quality of goods/services is 9.07, which means that respondents who received social development programme/services were over 9 times more likely to report impact on quality of goods/services.

Table 6.69a: Summary of Binary Logistic Regression: Impact on Business Activities

Independent Variables	Impact on Business Activities								
	Volume			Quality			Diversification		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
ME main income	-.402	.556	.669	-1.002	.096	.367	-.804	.150	.448
Gender	-.911	.109	.402	-.728	.125	.483	.126	.762	1.134
Religious educ.	-.343	.498	.710	-.166	.710	.847	.326	.397	1.385
Bussines area	-.294	.618	.745	-.712	.146	.491	.614	.144	1.848
Land/agriculture	.000	.675	1.000	.000	.600	1.000	.000	.454	1.000
Productive assets	**.000**	**.046**	1.000	**.000**	**.013**	1.000	.000	.510	1.000
Total other asset	.000	.914	1.000	.000	.786	1.000	.000	.076	1.000
Type of ISMFI	.331	.562	1.392	**-1.274**	**.010**	.280	-.350	.431	.705
Borrowers length	-.003	.699	.997	.004	.537	1.004	.004	.473	1.004
Total loan	.000	.314	1.000	.000	.305	1.000	.000	.173	1.000
Total worker	.224	.078	1.252	**.184**	**.031**	1.202	-.010	.855	.990
Social service received (yes/no)	**1.279**	**.057**	**3.591**	**2.205**	**.000**	**9.070**	**1.043**	**.032**	**2.838**
Constant	.759	.466	2.136	.735	.382	2.085	-.169	.819	.845
Goodness of fit of the model									
Chi-Square			31.739			60.535			31.045
(Sig)			.002			.000			.002
Cox and Snell			.194			.338			.192
Negerkerke			.320			.457			.256
Overall percentage predicted			81.0			75.5			69.2

Table 6.69b: Summary of Binary Logistic Regression: Impact on Business Activities

Independent Variables	Impact variables								
	Technology			Bookkeeping			Premises		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
ME main income	-.564	.479	.569	-.444	.604	.642	.473	.440	1.604
Gender	.118	.852	1.125	1.944	.016	6.985	-.141	.749	.869
Religious educ.	-.665	.256	.514	.121	.842	1.129	.337	.403	1.401
Bussines area	.885	.167	2.423	.641	.339	1.899	**1.276**	**.004**	**3.581**
Land/agriculture	.000	.042	1.000	.000	.004	1.000	.000	.485	1.000
Productive assets	.000	.482	1.000	.000	.501	1.000	.000	.132	1.000
Total other asset	.000	.618	1.000	.000	.550	1.000	.000	.637	1.000
Type of ISMFI	**-2.387**	**.002**	.092	-.463	.515	.629	-.657	.159	.519
Borrowers length	-.002	.783	.998	-.027	.012	.974	.005	.384	1.005
Total loan	.000	.208	1.000	**.000**	**.000**	1.000	.000	.732	1.000

Independent Variables	Impact variables								
	Technology			Bookkeeping			Premises		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
Total worker	.149	**.029**	1.161	.126	.091	1.135	-.016	.750	.984
Social service received (yes/no)	**1.839**	**.018**	**6.290**	**1.709**	**.020**	**5.525**	.778	.124	2.177
Constant	-1.135	.286	.321	-2.935	.018	.053	-2.171	.009	.114
Goodness of fit									
Chi-Square			29.190			42.475			22.189
(Sig)			.004			.000			.035
Cox and Snell			.181			.254			.140
Negerkerke			.323			.443			.197
Overall percentage predicted			89.7			90.3			76.2

6.8.2. Analysis of the Social Impact

With regards to the social impact of micro financing, the findings in the previous chapter, as displayed in Table 6.28, show that 52.5% of the respondents did not receive any social development programmes, while 28.1% of the respondents reported that they ‘don’t know/don’t remember’ these programmes. Therefore, it was concluded that in overall 80.6% of the respondents did not receive social development programmes; implying that only around 20% of the respondents received such programmes.

This section aims to examine and explore the social impacts, including social, religious and other impacts, by utilising three tests. Firstly, factor analysis was employed to explore whether all eleven components of social impacts can be reduced to a smaller number of factors. Secondly, the Chi-Square test was applied to demonstrate whether there is relationship between each impact and the social services received. In order to conduct the Chi-Square test, a new dichotomous variable was created based on the respondents’ replies to the question on what type of social services had been received; the respondents were permitted to select more than one option, if required, in this question. This new variable had two subgroups: ‘received’ and ‘did not receive’ social services. In addition, another new variable was also created, consisting of four subgroups of social services received: ‘zero service’, ‘one service’, ‘two services’, and ‘three services’. Thirdly, the MWU test and the KW tests were conducted to find any statistically significant differences among subgroups.

Before analysing the social impact, it is necessary to determine which social services were delivered by each institution, the results of which are displayed in Table 6.70. Based on the confidence level of p=.05, the Chi-Square test indicates the statistically significant relationships between type of micro financing institution and social services provided to their respondents, particularly in the following services: 'consultancy services' (p= .000), 'religious training on business ethics' (p= .000) and 'don't know/don't remember' (p= .001). Overall, the BMT respondents obtained more social services than BPRS respondents. In addition, more BPRS respondents reported that they had received 'no social services' or that they 'don't know/don't remember' than BMT respondents.

Table 6.70: Cross-tabulation: Social Services Received from BMT and BPRS

Social services	BMT		BPRS		Total		Chi Square	Effect size
	Freq.	%	Freq.	%	Freq.	%		
Management training							.686[a]	-.040
Yes	4	2.2	2	1.2	6	1.7		
No	175	97.8	167	98.8	342	98.3		
Total	179	100	169	100	348	100		
Technical training							1.000[b]	-.052
Yes	1	0.6	0	0	1	0.3		
No	178	99.4	169	100.0	347	99.7		
Total	179	100	169	100	348	100		
Consultancy services							.000	-.193
Yes	30	16.8	8	4.7	38	10.9		
No	149	83.2	161	95.3	310	89.1		
Total	179	100	169	100	348	100		
Religious training related to business ethics							.000	-.219
Yes	22	12.3	2	1.2	24	6.9		
No	157	87.7	167	98.8	324	93.1		
Total	179	100	169	100	348	100		
No social services at all							.221	.071
Yes	90	50.3	97	57.4	187	53.7		
No	89	49.7	72	42.6	161	46.3		
Total	179	100	169		348			
Don't know/ don't remember							.001	.183
Yes	37	20.7	63	37.3	100	28.7		
No	142	79.3	106	62.7	248	71.3		
Total	179	100	169	100	348	100		

[ab]Fisher Exact Test is used

Factor analysis through Principal Component Analysis with Varimax in particular was applied in order to assess the possibility of reducing the number of social impacts to a smaller number of subgroups. The suitability of data was assessed based on the result of KMO and Bartlett's Test of Sphericity for all eleven impacts. The findings in Table 6.71 indicate that the KMO value was 0.863, which is higher than the minimum requirement of 0.06. Further, Bartlett's Test of Sphericity shows the statistical significance as p=.000, lower than the confidence significance level of p=.05, thus supporting the factorability of the correlation matrix.

Table 6.71: KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.863
Bartlett's Test of Sphericity	Approx. Chi-Square	1506.457
	Df	55
	Sig.	.000

Prior to taking further steps, the strength of the relationship between two factors should be assessed in the correlation matrix table to determine the number of cells with coefficients above 0.3. This test revealed many cells with coefficients above 0.3 in the correlation matrix.

As part of the factor analysis, the total variance is presented in Table 6.72 based on Kaiser's criterion. The findings suggest that according to the initial eigenvalues above 1, the eleven impacts can be reduced to three factors. The first factor shows the initial eigenvalues of 5.714, the second factor had initial eigenvalues of 1.434 and the last factor held eigenvalues of 1.116. All three factors explain a cumulative total of 75.12% of the variance: 51.9% for the first factor, 13.03% for the second factor and 10.14% for the third factor respectively.

Table 6.72: Total Variance Explained

Com-ponent	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.714	51.948	51.948	5.714	51.948	51.948	3.005	27.319	27.319
2	1.434	13.036	64.984	1.434	13.036	64.984	2.872	26.112	53.431
3	1.116	10.143	75.127	1.116	10.143	75.127	2.387	21.696	75.127
4	.745	6.772	81.899						
5	.509	4.624	86.524						
6	.418	3.797	90.320						
7	.354	3.216	93.536						
8	.244	2.222	95.758						
9	.205	1.864	97.622						
10	.161	1.461	99.083						
11	.101	.917	100.000						
Extraction Method: Principal Component Analysis.									

Table 6.73 presents the final result of rotated factors, suggesting that the eleven impact items can be distributed among three components, with 5 items loading above 0.3 in the first component, 3 items loading above 0.3 in the second component, and 3 items loading above 0.3 in the third component. According to Pallant (2007: 192), this is ideal as there should be three or more items loading on each component, so this solution is optimal. As can be seen in Table 6.73, the first component contains five items, with loadings ranging from 0.559 to 0.863, while factor two consists of three items, with loadings ranging from 0.874 to 0.917, and factor three has three items with loadings from 0.598 to 0.847.

Table 6.73: Rotated Component Matrix

Variables	Components			Communality of each variable
	Personal	Religious	Social	
Nutrition	.863			.824
Health	.780	.374		.755
Children’s education	.755			.634
Housing stock	.668		.405	.670
Family empowerment	.559		.497	.641
Islamic practice in personal life		.917		.903
Islamic practice in business life		.891		.899
Knowledge of Islam		.874		.874
Relationship with spouse/family members			.847	820
Relationship with other subgroups’ members			.837	.793
Women’s decision-making power	.301		.598	.448
Eigenvalue	5.714	1.434	1.116	
% of variance	51.948	13.036	10.143	
Cumulative %	51.948	64.984	75.127	

The five items attached to component 1 are nutrition, health, children’s education, housing stock and family empowerment, all of which represent personal impacts. The three items attached to component 2 are Islamic practice in personal life, Islamic practice in business life and knowledge of Islam; these are all religious impacts. The three items attached to the last components are relationship with spouse/family members, relationship with other subgroups’ members and women’s decision-making, which are all considered interpersonal relationship impacts.

In order to determine the most important component, a further process on mean comparison was conducted. The findings in Table 6.74 suggest the average mean of each components is 2.40, 2.31 and 2.65 respectively. Therefore, component 3 was considered the most important components for the respondents.

Table 6.74: Ranking and Average Mean for Each Impact

Factor 1: Personal impacts	Mean value
Nutrition	2.42
Health	2.31
Children's education	2.44
Housing stock	2.38
Family empowerment	2.44
Average mean	**2.40**
Factor 2: Religious impact	**Mean value**
Islamic practice in personal life	2.31
Islamic practice in business life	2.28
Knowledge of Islam	2.35
Average mean	**2.31**
Factor 3: Social impact	**Mean value**
Relationship with spouse/family members	2.62
Relationship with other subgroups' members (if you answer yes to question no 23)	
Women's decision-making power	2.82
Average mean	**2.65**

6.8.2.1. Social impact

In the previous chapter, the findings in Table 6.29 show similar results for two variables in social impact; 60% of the respondents reported 'no effect' while 40% reported a positive effect. Since only 8 respondents were members of subgroups (2.30% of the total respondents), this section will focus on the first variable: relationship with spouse/family members. The second variable of relationship with other subgroups' members was not analysed.

The findings of the Chi-Square test in Table 6.75 indicate a statistically significant relationship between 'relationship with spouse/family members' and 'social services received' at $p= .000$, which is lower than the confidence level of $p= .05$. The total percentage of respondents reporting that they had experienced 'no effect' as a result of not receiving social services was 56.1%. However, 25% of the total respondents reported a 'positive effect' despite not receiving any social services. On the other hand, after receiving social services, 12.7% of the total respondents reported a positive effect.

It should be mentioned that the Chi-Square test applied on type of micro financing institutions did not show a significant result ($p= .111$). However, the cross-tabulation in

Table 6.75 shows that 22% of the BMT respondents reported a positive effect. This is larger than the percentage of BPRS respondents who reported the positive effect (16.4%).

Table 6.75: Cross-Tabulation: Relationship with Spouse/Family Members and Social Service

			Relationship with spouse/family members					Total
			Negative effect	No effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	
Social Service	No	Count	3	194	47	35	7	286
		% of Total	.9%	56.1%	13.6%	10.1%	2.0%	82.7%
	Yes	Count	0	16	15	21	8	60
		% of Total	.0%	4.6%	4.3%	6.1%	2.3%	17.3%
Total		Count	3	210	62	56	15	346
		% of Total	.9%	60.7%	17.9%	16.2%	4.3%	100.0%
Fisher Exact Test is used since 3 cells (30.0%) have expected counts of less than 5.								.000
Effect size								.364
Type of Islamic microfinance institution	BMT	Count	2	99	30	36	10	177
		% of Total	.6%	28.6%	8.7%	10.4%	2.9%	51.2%
	BPRS	Count	1	111	32	20	5	169
		% of Total	.3%	32.1%	9.2%	5.8%	1.4%	48.8%
Total		Count	3	210	62	56	15	346
		% of Total	.9%	60.7%	17.9%	16.2%	4.3%	100.0%
Fisher Exact Test is used since 2 cells (20.0%) have expected counts of less than 5								.111
Effect size								.144

6.8.2.2. Religious Impact

Table 6.30, in the previous chapter, presents religious impact after financing, for which a large majority of the respondents reported ‘no effect’, with the following rankings: Islamic practice in personal life (81.7%), Islamic practice in business life (81.1%) and Islamic knowledge (77.7%). However, some respondents reported positive effects as follows: Islamic knowledge (22%), Islamic practice in personal life (18.6%) and Islamic practice in business life (18%). The negative effects were just 0.3% for each religious impact variable.

In further exploring the religious impact, Chi-Square test was employed and the results are presented in Table 6.76a and Table 6.76b, which show statistically significant relationships between all three variables in religious impacts and social services received, as follows: knowledge of Islam (p=.000), Islamic practice in personal life (p=.000) and Islamic practice in business life (p=.000). It should be noted that the size effects or the

Phi values of all three religious impacts were all above 0.5, which is considered very high based on Cohen's criteria. This indicates a very strong relationship between social services and religious impacts.

In detail, in respect of those not receiving social services, 72% of the respondents reported 'no effect' on knowledge of Islam, while 9.9% of the respondents reported a positive effect. A positive effect was reported by 12.1% of the respondents who received social services. Thus, the percentage of positive impacts was higher among the respondents who obtained social services than those who did not. The same findings on the positive effect of social services also occurred for the other two religious impacts. 74.7% of the respondents who did not receive social services reported 'no effect' on Islamic practice in business life, while 8.2% of the respondents reported a positive effect. The percentage of the respondents receiving social service who reported 'no effect' was just 6.4%, while 10.5% reported a positive effect. The response of 'no effect' was recorded by 75.3% of the respondents who did not receive social services, while 7.5% of the respondents reported a positive effect. Of those receiving social services, only 6.4% of the respondents reported 'no effect'; however, 10.5% of the respondents reported a positive effect.

Overall, it should be noted that none of the respondents who obtained social services reported a negative effect, while of those receiving social services, more reported a positive effect than 'no effect'.

Table 6.76a: Cross-tabulation: Religious Impact and Social Services Received

			Negative Effect	No Effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	
Knowledge of Islam								
Social services received	No	Count	1	251	22	10	2	286
		% of Total	.3%	72.8%	6.4%	2.9%	.6%	82.9%
	Yes	Count	0	17	17	18	7	59
		% of Total	.0%	4.9%	4.9%	5.2%	2.0%	17.1%
Total		Count	1	268	39	28	9	345
		% of Total	.3%	77.7%	11.3%	8.1%	2.6%	100.0%
Fisher Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								**.000**
Effect size								.561

Table 6.76b: Cross-tabulation: Religious Impact and Social Services Received

			Negative Effect	No Effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	
Islamic practice in personal life								
Social services received		Count	1	257	15	9	4	286
		% of Total	.3%	74.7%	4.4%	2.6%	1.2%	83.1%
		Count	0	22	14	16	6	58
		% of Total	.0%	6.4%	4.1%	4.7%	1.7%	16.9%
Total		Count	1	279	29	25	10	344
		% of Total	.3%	81.1%	8.4%	7.3%	2.9%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								**.000**
Effect size (Phi Value)								.510
Islamic practice in business life								
Social services received	No	Count	1	259	17	7	2	286
		% of Total	.3%	75.3%	4.9%	2.0%	.6%	83.1%
	Yes	Count	0	22	17	14	5	58
		% of Total	.0%	6.4%	4.9%	4.1%	1.5%	16.9%
		Count	1	281	34	21	7	344
		% of Total	.3%	81.7%	9.9%	6.1%	2.0%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								**.000**
Effect size (Phi Value)								.526

Table 6.77 presents the findings of the Chi-Square test results for the cross tabulation and type of microfinance institutions. As can be seen, statistically significant relationships were found between all three religious impacts and type of microfinance institutions: knowledge of Islam (p=.001), Islamic practice in personal life (p=.010) and Islamic practice in business life (p=.007). BMT respondents reported ‘no effect’ on knowledge of Islam (35.9%), while 15.1% stated a positive effect. 41.7% of BPRS respondents reported ‘no effect’, whereas 6.9% reported a positive effect. In Islamic practice in personal life, 38% of the BMT respondents reported ‘no effect’, while 12.7% reported a positive effect. It should be noted that the effect sizes in all three religious impacts were considered small based on Cohen’s criteria, at 0.212, 0.187 and 0.185 respectively.

Table 6.77: Cross-tabulation: Religious Impact and Type of Microfinance Institutions

			Negative Effect	No Effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	Total
Knowledge of islam								
Type of Islamic microfinance institution	BMT	Count	0	124	23	22	7	176
		% of Total	.0%	35.9%	6.7%	6.4%	2.0%	51.0%
	BPRS	Count	1	144	16	6	2	169
		% of Total	.3%	41.7%	4.6%	1.7%	.6%	49.0%
Total		Count	1	268	39	28	9	345
		% of Total	.3%	77.7%	11.3%	8.1%	2.6%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5.								**.001**
Effect size (Phi Value)								.212
Islamic practice in personal life								
Type of Islamic microfinance institution	BMT	Count	0	131	18	18	8	175
		% of Total	.0%	38.1%	5.2%	5.2%	2.3%	50.9%
	BPRS	Count	1	148	11	7	2	169
		% of Total	.3%	43.0%	3.2%	2.0%	.6%	49.1%
		Count	1	279	29	25	10	344
		% of Total	.3%	81.1%	8.4%	7.3%	2.9%	100.0%
Fisher's Exact Test is used since 3 cells (30.0%) have expected counts of less than 5.								**.010**
Effect size (Phi Value)								.187
Islamic practice in business life								
Type of Islamic microfinance Institution	BMT	Count	0	133	21	17	4	175
		% of Total	.0%	38.7%	6.1%	4.9%	1.2%	50.9%
	BPRS	Count	1	148	13	4	3	169
		% of Total	.3%	43.0%	3.8%	1.2%	.9%	49.1%
		Count	1	281	34	21	7	344
		% of Total	.3%	81.7%	9.9%	6.1%	2.0%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								**.007**
Effect size (Phi Value)								.185

6.8.2.3. Other Impacts

In the previous chapter, Table 6.31 shows that the majority of the respondents reported 'no effect' of other impacts after financing, with rankings as follows: health (75.7%), housing stock (70.4%), family empowerment (67.9%), nutrition (67%), children's education (66.6%) and women's decision-making power (51.3%). However, some respondents reported a positive effect, with the following rankings: women's decision-making power (48.7%), nutrition (32.1%), children's education (31.7%), family empowerment (31.7%), housing stock (29.2%) and health (23.1%). The negative effect was very low: children's education (1.7%), health (1.2), nutrition (0.9%), housing stock

(0.3%). It should be noted that there were no negative effects on women's decision-making power.

This section aims to further explore the social impact through the application of the Chi-Square test. The findings of the Chi-Square test are presented in Tables 7.46a and 7.46b.; tests on social services and type of micro financing institutions show the expected cells with frequencies of less than 5, which violated the assumption of the Chi-Square test; therefore, Fisher's Exact Test results were used.

As can be seen in Table 6.78a and Table 6.78b, statistically significant relationships were found between social services provisions and all six variables in other impacts, as follows: children's education (p= .000), nutrition (p= .005), health (p= .000), housing stock (p= .000), family empowerment (p= .000) and women's decision-making power (p= .001). The respondents receiving social services reported 'no effect' as follows: children's education (58.7%), nutrition (58%), health (66.1%), housing stock (60.9%), family empowerment (61.6%), and women's decision-making power (46.1%). However, under the same conditions, some respondents stated a positive effect, as follows: children's education (22.4%), nutrition (24.1%), health (15.4%), housing stock (21.2%), family empowerment (20.9%), and women's decision-making power (36.5%). Respondents receiving social services reported 'no effect' on the following: children's education (7.8%), nutrition (9%), health (9.6%), housing stock (9.6%), family empowerment (6.4%), and women's decision-making power (5.2%). It should be noted that the receipt of social services had a direct relationship with positive effect on the following: children's education (9.4%), nutrition (8.1%), health (7.8%), housing stock (8%), family empowerment (11.1%), and women's decision-making power (12.2%). Therefore, it can be concluded that the receipt of social services had positive relationships with the statement of positive effect, although the percentage was lower compared to the respondents who did not receive social services.

Table 6.78a : Cross-tabulation: Other Impacts and Social Services Received

			Negative Effect	No Effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	Total
Children's education								
Social Service	No	Count	5	202	55	16	6	284
		% of Total	1.5%	58.7%	16.0%	4.7%	1.7%	82.6%
	Yes	Count	1	27	14	15	3	60
		% of Total	.3%	7.8%	4.1%	4.4%	.9%	17.4%
Total		Count	6	229	69	31	9	344
		% of Total	1.7%	66.6%	20.1%	9.0%	2.6%	100.0%
Fisher's Exact Test is used since 3 cells (30.0%) have expected counts of less than 5								.000
Effect size (Phi Value)								.284
Nutrition								
Social Service	No	Count	2	200	63	18	2	285
		% of Total	.6%	58.0%	18.3%	5.2%	.6%	82.6%
	Yes	Count	1	31	17	7	4	60
		% of Total	.3%	9.0%	4.9%	2.0%	1.2%	17.4%
Total		Count	3	231	80	25	6	345
		% of Total	.9%	67.0%	23.2%	7.2%	1.7%	100.0%
Fisher's Exact Test is used since 5 cells (50.0%) have expected counts of less than 5								.005
Effect size (Phi Value)								.215
Health								
Social Service	No	Count	4	228	38	13	2	285
		% of Total	1.2%	66.1%	11.0%	3.8%	.6%	82.6%
	Yes	Count	0	33	17	6	4	60
		% of Total	.0%	9.6%	4.9%	1.7%	1.2%	17.4%
Total		Count	4	261	55	19	6	345
		% of Total	1.2%	75.7%	15.9%	5.5%	1.7%	100.0%
Fisher's Exact Test is used since 5 cells (50.0%) have expected counts of less than 5								.000
Effect size								.268
Housing stock								
Social services	No	Count	1	210	59	13	1	284
		% of Total	.3%	60.9%	17.1%	3.8%	.3%	82.3%
	Yes	Count	0	33	17	5	6	61
		% of Total	.0%	9.6%	4.9%	1.4%	1.7%	17.7%
Total		Count	1	243	76	18	7	345
		% of Total	.3%	70.4%	22.0%	5.2%	2.0%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								.000
Effect size (Phi Value)								.283
Family empowerment								
Social Service	No	Count	1	213	50	19	3	286
		% of Total	.3%	61.6%	14.5%	5.5%	.9%	82.7%
	Yes	Count	0	22	22	13	3	60
		% of Total	.0%	6.4%	6.4%	3.8%	.9%	17.3%
Total		Count	1	235	72	32	6	346
		% of Total	.3%	67.9%	20.8%	9.2%	1.7%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								.000
Effect size (Phi Value)								.323

Table 6.78b: Cross-tabulation: Other Impacts and Social Services Received

			Negative Effect	No Effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	Total
Women's decision-making power								
Social Service	No	Count	0	159	46	69	11	285
		% of Total	0	46.1%	13.3%	20.0%	3.2%	82.6%
	Yes	Count	0	18	21	19	2	60
		% of Total	0	5.2%	6.1%	5.5%	.6%	17.4%
Total		Count	0	177	67	88	13	345
		% of Total	0	51.3%	19.4%	25.5%	3.8%	100%
Fisher's Exact Test is used since 1 cell (12.5%) has an expected count of less than 5								**.001**
Effect size (Phi Value)								.219

Table 6.79a and Table 6.79b show the findings of the Chi-Square test; a statistically significant relationship observed only between family empowerment and microfinance institutions, at *p*= .046. However, by comparing between BMT and BPRS, the cross-tabulation tables provide more detailed information. First, the response of 'no effect' among BMT respondents was slightly higher than among BPRS respondents, except for family empowerment. Secondly, the reported positive effect was higher for BPRS respondents than for BMT respondents on five variables in other impacts. By combining the percentage of minor, moderate and major positive effect from each impact variables, the comparative analysis of positive effect of BMT and BPRS could be summarised as follows (BMT:BPRS) : children's education (14.60%:17.20%), nutrition (15.40%: 16.80%), health (12.50%:10.70%), housing stock (14.30%:15.10%), family empowerment (19.70% : 12.20%) and women's decision-making power (23.70% : 24.90%). Thus, overall, the BPRS respondents reported a higher positive impact than BMT respondents.

Table 6.79a: Cross-tabulation: Other Impact and Type of Microfinance Institutions

			Negative Effect	No effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	Total
Children education								
Type of Islamic MFI	BMT	Count	3	124	26	20	4	177
		% of Total	.9%	36.0%	7.6%	5.8%	1.2%	51.5%
	BPRS	Count	3	105	43	11	5	167
		% of Total	.9%	30.5%	12.5%	3.2%	1.5%	48.5%
Total		Count	6	229	69	31	9	344
		% of Total	1.7%	66.6%	20.1%	9.0%	2.6%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5.								.074
Effect size (Phi Value)								.154

Table 6.79b: Cross-tabulation: Other Impact and Type of Microfinance Institutions

			Negative Effect	No effect	Minor effect (<25%)	Moderate effect (26-50%)	Major effect (>51%)	Total
Nutrition								
Type of Islamic MFI	BMT	Count	2	122	35	14	4	177
		% of Total	.6%	35.4%	10.1%	4.1%	1.2%	51.3%
	BPRS	Count	1	109	45	11	2	168
		% of Total	.3%	31.6%	13.0%	3.2%	.6%	48.7%
Total		Count	3	231	80	25	6	345
		% of Total	.9%	67.0%	23.2%	7.2%	1.7%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								.564
Effect size (Phi Value)								.095
Health								
Type of Islamic MFI	BMT	Count	3	131	27	12	4	177
		% of Total	.9%	38.0%	7.8%	3.5%	1.2%	51.3%
	BPRS	Count	1	130	28	7	2	168
		% of Total	.3%	37.7%	8.1%	2.0%	.6%	48.7%
Total		Count	4	261	55	19	6	345
		% of Total	1.2%	75.7%	15.9%	5.5%	1.7%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								.630
Effect size (Phi Value)								.090
Housing stocks								
Type of Islamic MFI	BMT	Count	0	129	34	12	3	178
		% of Total	.0%	37.4%	9.9%	3.5%	.9%	51.6%
	BPRS	Count	1	114	42	6	4	167
		% of Total	.3%	33.0%	12.2%	1.7%	1.2%	48.4%
Total		Count	1	243	76	18	7	345
		% of Total	.3%	70.4%	22.0%	5.2%	2.0%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								.311
Effect size (Phi Value)								.115
Family empowerment								
Type of Islamic MFI	BMT	Count	0	109	44	21	3	177
		% of Total	.0%	31.5%	12.7%	6.1%	.9%	51.2%
	BPRS	Count	1	126	28	11	3	169
		% of Total	.3%	36.4%	8.1%	3.2%	.9%	48.8%
Total		Count	1	235	72	32	6	346
		% of Total	.3%	67.9%	20.8%	9.2%	1.7%	100.0%
Fisher's Exact Test is used since 4 cells (40.0%) have expected counts of less than 5								**.046**
Effect size (Phi Value)								.159
Women's decision-making power								
Type of Islamic MFI	BMT	Count	0	95	27	47	8	177
		% of Total	0	27.5%	7.8%	13.6%	2.3%	51.3%
	BPRS	Count	0	82	40	41	5	168
		% of Total	0	23.8%	11.6%	11.9%	1.4%	48.7%
Total		Count	0	177	67	88	13	345
		% of Total	0	51.3%	19.4%	25.5%	3.8%	100.0%
Pearson Chi-Square (0 cells (.0%) have expected counts of less than 5)								.226
Effect size (Phi Value)								.112

6.8.2.4. Social and Religious Impact: Correlation and Regression Analysis

This section provides further analyses of the relationship among independent variables and impact variables based on the Spearman Rank Correlation Test. The correlation coefficients are presented in 6.80a and Table 6.80b based on the significance level of 1% and 5%.

Table 6.80a and Table 6.80b depict that there are statistically significant correlations between social and religious impacts and religious education, type of IsMFI, group membership, receiving of social development programme/services, management training, consultancy and religious meetings. For example: religious education has negative correlation to relationship with spouse/family members (*rho*= -.235), knowledge of Islam (*rho*= -.271), Islamic practice to personal life (*rho*= -.238), Islamic practice to business life (*rho*= -.218). It should be noted that the strength of the relationship are small as *rho*s are lower than .29.

In addition, negative significant correlation is found between social and religious impacts and the types of IsMFI with small strength of relationship. Table 6.80a and 6.80b shows the significant correlation between type of IsMFI and relationship with spouse/family members (*rho*= -.112), knowledge of Islam (*rho*= -.277), Islamic practice to personal life (*rho*= -.298), and Islamic practice to business life (*rho*= -.166).

As can be seen in Table 6.80a and 6.80b, the social development programme/services have positive significant correlation with social and religious impact. In particular, upon receiving social development programme/services correlate positively with relationship with spouse/family members (*rho*= .356), knowledge of Islam (*rho*= .553), Islamic practice to personal life (*rho*= .506) and Islamic practice to business life (*rho*= .522). It should be noted that in this case, the strength of relationship is considered large as *rho*>.5.

Other positive significant correlation with medium strength are found between consultancy services and relationship with spouse/family members (*rho*=.308), knowledge of Islam (*rho*=.458), Islamic practice to personal life (*rho*= .429), and Islamic practice to business life (*rho*= .464).

Furthermore, there is a small positive correlation between management trainings and relationship with spouse/family members (*rho*=.171), knowledge of Islam (*rho*=.249), Islamic practice to personal life (*rho*= .264), Islamic practice to business life (*rho*= .224).

Finally, the findings also indicate small positive correlation between religious meetings and relationship with spouse/family members (*rho*=.155), knowledge of Islam (*rho*=.258), Islamic practice to personal life (*rho*= .264), Islamic practice to business life (*rho*= .238). Overall, the findings suggest that all type of social development programme/services contribute to the social and religious impact with varied correlation strength.

Table 6.80a: Spearman Rank Order Correlation: Impact on Family Relationship and Islamic Practice (Religious activities) after financing

Independent Variables	Impact			
	Relationship with spouse/family	Knowledge of Islam	Practice in personal life	Practice in business life
ME main income	**.144****	**.111***	.102	**.136***
Other income	**-.106***	.077	.035	.059
Marital	-.007	-.095	-.075	-.051
Gender	-.015	-.050	-.041	-.055
Age	-.103	**-.152****	-.107*	-.085
Education	-.055	-.043	-.061	-.075
Religious education	**-.235****	**-.271****	**-.238****	**-.218****
Religious activity	**.142****	-.016	-.030	-.008
Household size	.081	.014	-.008	-.041
Business area	**-.172****	**-.138***	-.099	**-.111***
Business age	.004	-.025	-.024	.012
Asset land	**.249****	.003	.038	.037
Building	**-.210****	-.025	-.013	-.040
Private car	-.090	-.062	-.062	-.074
Cattle	.075	.064	.091	.060
Prod asset	.091	-.043	-.018	-.030
Electronic	.022	-.013	-.005	.005
Jewellery	.031	-.018	-.031	-.026
Saving	.023	.029	.041	.024
Total assets	-.050	**-.118***	-.091	**-.110***
Type of IsMFI	**-.112***	**-.199****	**-.181****	**-.166****
Member of group	**-.192****	**-.277****	**-.298****	**-.259****
Membership duration	**.113***	.057	.038	.024
Borrowers duration	.069	.065	.049	.029
Times borrow	**.161****	.131*	.102	.088
Duration after last loan	-.095	**-.186****	**-.143****	**-.125***
Duration loan repayment	-.010	**-.129***	-.101	-.050

Table 6.80b: Spearman Rank Order Correlation: Impact on Family Relationship and Islamic Practice (Religious activities) after financing

Independent Variables	Impact			
	Relationship with spouse/family	Knowledge of Islam	Practice in personal life	Practice in business life
Total loan	.067	-.057	-.079	-.067
Actual use loan	.083	-.010	-.044	-.041
Installment	.022	-.025	-.022	.004
Male workers	.158**	.111*	.100	.102
Female workers	.061	-.083	-.054	-.068
Total workers	.180**	.067	.090	.071
Social services (yes/no)	**.356****	**.553****	**.506****	**.522****
Management training	**.171****	**.249****	**.264****	**.224****
Technical training	.080	**.125***	-.025	-.025
Consultancy	**.308****	**.458****	**.429****	**.464****
Religious meetings	**.155****	**.258****	**.264****	**.238****

Note: Correlation coefficients are presented; **. Correlation is significant at the 0.01 level (2-tailed);
*. Correlation is significant at the 0.05 level (2-tailed).

To expand the analysis further, binary logistics regression was applied to explore the best predictor of social and religious impact, as independent variables. Table 6.81 depicts the findings of the regression analysis by presenting overall goodness fit of the model, in which all models have high level of significance at p=.000. The whole model explains between 26.2% (Cox and Snell R^2) and 34.9% (Nagelkerke R^2) of the total variations. It should be noted that the models correctly classify between 73.1% of the cases.

Table 6.81 also shows that only one independent variable, which is social development programme/services received, is found to be making statistically significant contribution. This variable is also the strongest predictor of the impact on relationship with spouse/family members, with odd ratio of 11.37. This ratio implies that respondents received social development programme/services were over 11 times over to report impact on relationship with spouse/family members as compared to respondents without social programme/services.

Table 6.81: Summary of Binary Logistic Regression: Social Impact

Independent Variables	Relationship with spouse/family members		
	Coef.	**Sig**	**Odd ratio**
ME main income	-.034	.956	.967
Gender	-.611	.176	.543
Religious educ.	.289	.475	1.336
Business area	.748	.105	2.112
Land/agriculture	.000	.083	1.000
Productive assets	.000	.211	1.000
Total other asset	.000	.118	1.000
Type of ISMFI	-.108	.813	.898
Borrowers length	-.001	.813	.999
Total loan	.000	.220	1.000
Total worker	.043	.455	1.044
Social service received (yes/no)	**2.431**	**.000**	**11.374**
Constant	-.263	.740	.769
Goodness of fit			
Chi-Square			44.041
(Sig)			.000
Cox and Snell			.262
Negerkerke			.349
Overall percentage predicted			73.1

As regard to religious impact, the overall goodness fit of the model shown in Table 6.82 suggests that all models have high level of significance at *p*=.000. The full model including all predictors explains between 33.6%-39.5% (Cox and Snell R^2) and 49.2%-55% (Nagelkerke R^2), and correctly classify between 85.6%-86.9% of the cases.

As shown in Table 6.82, overall, the variables which made unique statistically significant contribution to the model are business areas and social development programme/services received. It should be noted that the strongest predictor of all the religious impact were social programme/services received with very high odd ratio of 46.41 (Islamic knowledge), 27.09 (Islamic practice in personal life) and 17.83 (Islamic practice in business life). These indicate that respondents who had received social development programme/services are over 46 times more likely to report impact on Islamic knowledge.

Table 6.82: Summary of Binary Logistic Regression: Religious Impact

Independent Variables	Islamic knowledge			Islamic Practice in personal life			Islamic Practice in business life		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
ME main income	-.191	.796	.826	-.047	.950	.954	-.784	.255	.457
Gender	-.420	.451	.657	-.753	.216	.471	-.592	.308	.553
Religious educ.	.268	.605	1.307	.280	.598	1.323	-.082	.874	.921
Business area	**1.352**	**.022**	**3.867**	**1.290**	**.035**	**3.633**	**1.225**	**.034**	**3.403**
Land/agriculture	.000	.047	1.000	.000	.212	1.000	.000	.157	1.000
Productive assets	.000	.130	1.000	.000	.120	1.000	.000	.413	1.000
Total other asset	.000	.957	1.000	.000	.347	1.000	.000	.408	1.000
Type of ISMFI	.413	.477	1.511	1.048	.104	2.852	.379	.532	1.461
Borrowers length	-.001	.890	.999	.005	.496	1.005	.004	.568	1.004
Total loan	.000	.493	1.000	.000	.772	1.000	.000	.963	1.000
Total worker	.014	.843	1.014	-.103	.237	.902	-.081	.369	.922
Social service received (yes/no)	**3.838**	**.000**	**46.418**	**3.299**	**.000**	**27.092**	**2.881**	**.000**	**17.832**
Constant	-1.960	.056	.141	-2.393	.028	.091	-1.160	.251	.314
Goodness of fit									
Chi-Square			73.457			67.890			59.424
(Sig)			.000			.000			.000
Cox and Snell			.395			.374			.336
Negerkerke			550.			.540			492
Overall percentage predicted			85.6			86.9			86.2

Table 6.83a and 6.83b depict that all models have high level of significance at p=.000 as shown in overall goodness fit of the model. The whole model explains between 13.9%-30.7% (Cox and Snell R^2) and 19.2%-41.1% (Nagelkerke R^2), and the models correctly classify between 63.9%-76.6% of the cases. All models were significant at p<.05.

As shown in Table 6.83a and 6.83b, the other independent variables that made unique contribution to the model were varied for each impact. Gender contributes significantly to impact on nutrition and women decision making power, while business area has been found to be significant on impact of family empowerment. Type of ISMFI also contributes to the impact on children education and family empowerment. Finally, on the impact on health and housing stock, the 'total workers' is found to contribute significantly with a large coefficient.

Similar to the findings on social and religious impact, Table 6.83a and 6.83b depicts that the largest contributing variables in the models is social development program/services received by the respondents. The odd ratio of 6.82 towards impact on family empowerment and 6.20 towards impact on women empowerment recorded to be amongst the highest odd ratio in the models. This ratio implies that respondents received social development programme/services were over 6 times likely to report positive impact on family empowerment and women decision making power.

Table 6.83a: Summary of Binary Logistic Regression: Other impact

Independent Variables	Other impacts								
	Children education			Nutrition			Health		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
ME main income	-.234	.685	.791	-.322	.562	.724	-.185	.749	.831
Gender	-.615	.161	.541	**-.899**	**.031**	.407	-.675	.121	.509
Religious educ.	.132	.736	1.141	.454	.229	1.574	-.043	.913	.958
Business area	.316	.470	1.371	.061	.890	1.063	.194	.663	1.215
Land/agriculture	.000	.123	1.000	.000	.883	1.000	.000	.163	1.000
Productive assets	.000	.533	1.000	.000	.132	1.000	.000	.144	1.000
Total other asset	.000	.009	1.000	.000	.099	1.000	.000	.269	1.000
Type of IsMFI	**-1.144**	**.016**	.319	-.394	.382	.674	-.148	.749	.862
Borrowers length	.001	.816	1.001	-.005	.414	.995	.003	.602	1.003
Total loan	.000	.493	1.000	.000	.957	1.000	.000	.885	1.000
Total worker	.074	.227	1.077	.127	.052	1.135	**.142**	**.020**	**1.153**
Social service received (yes/no)	**1.084**	**.031**	**2.956**	**1.177**	**.017**	**3.246**	**1.126**	**.021**	**3.082**
Constant	.326	.669	1.385	.149	.844	1.161	-.864	.267	.422
Overall Model goodness of fit									
Chi-Square	31.280			27.953			21.519		
(Sig)	002			.006			.043		
Cox and Snell	.196			.176			.139		
Negerkerke	.265			.236			.192		
Overall percentage predicted	72.0			63.9			69.4		

Table 6.83b: Summary of Binary Logistic Regression: Other Impact

Independent Variables	Other impact								
	Housing Stock			Family empowerment			Women decision making power		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
ME main income	.119	.842	1.126	.269	.664	1.308	.023	.971	1.023
Gender	-1.413	.002	.243	-.716	.132	.489	**-1.541**	**.001**	.214
Religious educ.	.793	.052	2.210	.350	.414	1.419	.312	.444	1.367
Business area	.287	.542	1.332	**.935**	**.051**	2.547	.832	.085	2.298
Land/agriculture	.000	.316	1.000	.000	.213	1.000	.000	.635	1.000
Productive assets	.000	.779	1.000	.000	.717	1.000	.000	.334	1.000
Total other asset	.000	.176	1.000	.000	.535	1.000	.000	.204	1.000
Type of IsMFI	-.580	.236	.560	**1.055**	**.033**	2.873	.008	.986	1.008
Borrowers length	-.008	.229	.992	-.008	.208	.992	-.001	.810	.999

Independent Variables	Other impact								
	Housing Stock			Family empowerment			Women decision making power		
	Coef.	Sig	Odd	Coef.	Sig	Odd	Coef.	Sig	Odd
Total loan	.000	.973	1.000	.000	.039	1.000	.000	.417	1.000
Total worker	**.199**	**.009**	1.221	.071	.337	1.073	**.183**	**.036**	1.201
Social service received (yes/no)	**1.624**	**.003**	**5.073**	**1.921**	**.001**	**6.827**	**1.825**	**.003**	**6.204**
Constant	-.592	.461	.553	-1.990	.018	.137	.143	.862	1.154
Overall Model goodness of fit									
Chi-Square	41.852			53.142			39.879		
(Sig)	.000			.000			.000		
Cox and Snell	.251			.307			.240		
Negerkerke	.338			.411			.327		
Overall percentage predicted	69.7			76.6			74.5		

6.9. THE ROLE OF BMT AND BPRS IN POVERTY ALLEVIATION

The role of BMT and BPRS in poverty alleviation is measured based on the Head Count Index, which measures the number of respondents living under the international poverty line and national (East Java) poverty line (BPS) divided by the total number of respondents of each type of institution. As mentioned before, the international poverty line set the income at USD 2/person/day (World Bank, 2012: 41), in which the average exchange rate data from Bank Indonesia from mid-August to mid-November was USD1=IDR8.794; it was therefore equal to IDR 17.589/day/person and IDR 527.660/month/person. Meanwhile, BPS set East Java's poverty line at IDR 245.035/person/month in March 2012 (Biro Pusat Statistik, 2012: 215) Based on these two standards, a comparative analysis before and after financing for each type of institution was conducted, and the results are presented in Tables 6.84 and Table 6.85. As the national poverty line is set based on individual household expenditure, the computed process is conducted by multiplying the number of each respondent's total family members with the poverty line as a baseline of judgement of whether the respondents live under or above the poverty line.

As can be seen in Table 6.84, the number of poor respondents of both BMT and BPRS decreased after financing, with varying percentages. The percentage of BMT respondents living under the international poverty line was 85.4% before financing, falling to 84.4% after financing; this indicates a reduction of only 1%. Meanwhile, according to the national poverty line, 44.4% of the respondents were living under the poverty line before financing, falling to 36.3% after financing (an 8% reduction). It should be noted that the minimum household expenditure improved after financing as compared to before financing.

Table 6.84: Number of BMT Respondents with Household Expenditure under the Poverty Line

Variable	Description	Frequency	Percent	Mean	Standard Deviation
International poverty line of USD 2/day equal to IDR 17,589/day/person (IDR 527,660/month/person)					
Monthly Household expenditure (before loan)	Below poverty line	152	85.4	-872,832.24	1,071,870.56
	Above poverty line	28	14.6		
	Total	178	100		
	Minimum	-4,148,940			
	Maximum	3,361,700			
Monthly Household expenditure (after loan)	Below poverty line	151	84.4	-748,741.78	1,075,823
	Above poverty line	28	15.6		
	Total	179	100		
	Minimum	-3,848,940			
	Maximum	3,361,700			
Indonesia (East Java) poverty line of IDR 245,035 /month/person					
Monthly Household expenditure (before financing)	Below poverty line	79	44.4	284,660.02	900,133.36
	Above poverty line	99	55.6		
	Total	178	100		
	Minimum	-1,605,315			
	Maximum	4,774,852			
Monthly Household Expenditure (after financing)	Below poverty line	65	36.3	408,599.69	906,311.51
	Above poverty line	114	63.7		
	Total	179			
	Minimum	-1,305,315			
	Maximum	4,774,825			

Table 6.85 shows that 82.2% of BPRS respondents were under the international poverty line before financing, falling to 72.2% after financing; thus, there was a 10% reduction, which is higher than for the BMT respondents. In addition, according to the Statistics Indonesia poverty line, 35.5% of the respondents were under the poverty line before financing, falling to 23.1% after financing, which indicates a 12.4% reduction.

Table 6.85a: Number of BPRS Respondents with Household Expenditure Under the Poverty Line

Variable	Description	Frequency	Percent	Mean	Standard Deviation
International poverty line of USD 2/day equal to IDR 17,589/day/person (IDR 527,660/month/person)					
Monthly Household expenditure (before loan)	Below poverty line	139	82.2	-706,024.61	1,359,468.12
	Above poverty line	30	17.8		
	Total	169			
	Minimum	-3,248,940			
	Maximum	8,417,020			

Table 6.85b: Number of BPRS Respondents with Household Expenditure under the Poverty Line

Variable	Description	Frequency	Percent	Mean	Standard Deviation
Monthly Household expenditure (after loan)	Below poverty line	122	72.2	-308,598.57	1,447,689.64
	Above poverty line	47	27.8		
	Total	169	100		
	Minimum	-2,565,960			
	Maximum	8,417,020			
Indonesia (East Java) poverty line of IDR 245,035 /month/person					
Monthly Household expenditure (before financing)	Below poverty line	60	35.5	424,475.38	1,240,046.73
	Above poverty line	109	64.5		
	Total	169			
	Minimum	-1,170,210			
	Maximum	9,264,895			
Monthly Household Expenditure (after financing)	Below poverty line	39	23.1	821,901.42	1,423,075.77
	Above poverty line	130	76.9		
	Total	169			
	Minimum	-870,210			
	Maximum	9,264,895			

6.10. CONCLUSION

This chapter briefly explored the characteristics of the respondents as preliminary findings of the results gathered from the questionnaires distributed to microenterprises which received financing from BMT/BPRS. The main characteristics of the respondents, as indicated by the majority of the respondents, are as follows: married, aged between 31 and 40 years, having a degree from Senior High School or less, and all Muslims with no religious education but religiously active. In regard to their business profiles, they relied on their businesses as main sources of income, having small family sizes of 4 or less, mostly operating businesses in urban areas and holding average total assets of IDR 310,000,000. Their financing performances were good since the majority of them had never had arrears. In addition, they are mostly repaying by monthly installments, choosing *murabahah* as the main preferred mode of financing, and mostly having small loans under IDR 10 millions for durations of one year or less.

The findings on economic impacts seem to be mixed, while the value of annual sales, net incomes, and business and household expenditures increased significantly after loans, although the majority of the respondents declared ‘no effect’. Based on the Indonesian government categories for productive assets, 61% of the respondents in this study can be classified as microenterprise operators, while, on the basis of annual sales, 78% of the respondents were categorised as microenterprises. In addition, in terms of the categorisation of number of workers by ADB, the findings suggest that 93% of the respondents are microenterprise operators as they had five workers or less.

As regards to the impact, it should also be noted that, based on the United Nations poverty line, the percentage of poor respondents decreased from 83.9% to 78.4% after financing, while, under the national poverty line, it decreased from 40.1% to 29.9% after financing. Concerning the social, religious and other impacts, although the majority of the respondents declared ‘no effect’ some positive effects have been reported by the respondents.

As continuation of the descriptive analysis, this chapter also present the findings of a number of further tests to analyse the issues and problems of microenterprises, the factors affecting decision-making on whether to borrow from BMT/BPRS and the role of BMT and BPRS in economic development. The tests utilised include Chi-Square test, MWU test, KW test, Wilcoxon Signed Rank Test, Factor Analysis, Spearman Rank Order Correlation Test and Binary Logistic Regression.

The main findings can be summarised as follows:

(i) the most business problems were experienced by respondents in urban areas, BMT respondents, and those in food production businesses;

(ii) the highest level of understanding of Islamic terms used in microfinance was reported by female respondents, those living in urban areas, and those who had been members of BMT/BPRS for less than 5 years;

(iii) the reasons why the respondents changed the use of the funds were connected with the type of institutions from which they borrowed money (in this case BMT respondents were highly likely to change the use of the funds), and the level of religious activity of the respondents (in that respondents who were active in religious matters tended to change the use of the funds);

(iv) the respondents who tended to provide higher collateral were BMT respondents and had taken financing more than 15 times;

(v) BMT respondents are likely to find themselves in arrears;

(vi) In terms of factors affecting the respondents' decision-making, the most important factors for the respondents were internal/personal benefit factors which included the uncomplicated procedure for obtaining funds, flexible and easy collateral, cost-related financing products being cheaper, *shariah* compliance, and good service and location; meanwhile the external factors, which include socialisation by particular party, advertisements in printed and electronic media, provision of social services and influence from/following particular people, were less important.

In particular, with regard to the role of BMT and BPRS in economic development, the Wilcoxon Signed Rank Test suggested a positive result; improvements after loans occur in the annual value of sales, net income, businesses expenditures, household expenditures and employment. Although the results varied case by case, in general the BPRS respondents were likely to experience a higher impact after obtaining financings. Despite the good result of the above test, the perception of the impacts was dominated by 'no effect', although there were a significant number of positive impacts reported.

Overall, the social impacts were highly likely to be related to the social services received by the respondents, in that the BMT respondents obtained more social services than the BPRS respondents. Although a majority of the respondents reported 'no effect' on social impact, significant positive effects were nonetheless declared by the respondents.

To conclude, as the various statistical evidences presented in this chapter show BMT and BPRS have the potential to develop enterprises, particularly micro and small enterprises. However, both institutions should improve their services, both financial and social, in responding to the requirements and demands of their clients, as this will further accelerate the development of their clients' businesses.

Chapter 7
EXPLORING THE PROSPECTS, PROBLEMS AND ECONOMIC DEVELOPMENT ROLE OF BMT AND BPRS: EMPIRICAL ANALYSIS ON SUPPLIERS PERSPECTIVES

7.1. INTRODUCTION

Chapter 6 presented descriptive and inferential statistical analysis of the primarty data collected on Islamic micro financing in Indonesia through the clients of BMTs and BPRS'. This chapter takes the analysis one step further in providing further empirical analyses.

As mentioned in Chapter 5, Research Methodology chapter, in an attempt to provide further sophistication for this study, interviews were also conducted with the officials of 22 BMT and BPRS in East Java, Indonesia, concerning the current issues, problems and prospects in providing financial services to microenterprises (MEs). Thus, the aim of this chapter is to complement the quantitative analysis presented in the previous two chapters. In doing so, this chapter aims:

(i) to explore the prospects of BMTs, BPRS and microenterprises;

(ii) to investigate the issues and problems they face in providing the services;

(iii) to identify the financial and non-financial services provided for microenterprises;

(iv) to examine how the relationships between BMTs, BPRS and the microenterprises have been maintained, and

(v) to explore the roles of BMTs and BPRS in economic development.

Due to the nature of the semi-structured interviews used in this research, which contain closed- and open-ended questions, two types of analysis are employed: descriptive statistical analysis using SPSS for the data involving statistical data and qualitative-oriented interview coding analysis using N-Vivo 9; the latter is a special software helping to analyse qualitative data collected through interviews.

This chapter consists of a number of subsections, starting with definitions of the research questions, followed by data analysis using both coding analysis and descriptive analysis for each research question, before moving on to discuss the results.

7.2. DEFINING THE RESEARCH QUESTIONS

In order to respond to the aim and objectives of this study, primary data from interviews are considered an important source of analysis. In order to structure the interview analysis in this chapter, the following research questions particularly for the analysis in this chapter are developed within the main aim of the study as identified in Chapter 1.

(i) What are the prospects of BMT, BPRS and MEs in East Java, Indonesia?

The objective of this research question is to explore the interviewees' perceptions of the future prospects of BMT and BPRS, as well as the prospects of microenterprises (MEs) in their geographical areas. This is an important research question as it aims to provide background information for the following research questions.

(ii) What are the major issues and problems of BMT and BPRS in East Java, Indonesia?

This research question is designed with quite extensive and detailed questions in the interview sessions in order to capture the necessary information on the current issues and problems faced by BMTs and BPRS. The interview questions for this research question include the following:

(a) Clients' understanding of terms used in Islamic banking products;

(b) required collateral;

(c) risk and moral hazard experienced during the business's operation;

(d) consideration of developing more authentic products to respond to the local needs and environment;

(e) frequency in dealing with ten identified problems, ranging from lack of capital to problems related to staff;

(f) opinions on problem of lack of funding, both in interviewees' institutions and in other microfinance institutions;

(g) training for staff: type and frequency; and

(h) development planning.

Both open- and closed-ended questions were considered in the analysis of this research question through the identified interview questions, which necessitated the use of both descriptive statistical analysis and coding analysis.

It should be reiterated that the aim of this research question is to investigate the actual problems faced in the field in providing financing services to micro and small enterprises.

(iii) What financing and non-financing services are provided by BMTs and BPRS for developing MEs?

The aim of this research question is to investigate how financing and non-financing services have been provided by BMT and BPRS in developing micro and small enterprises. Hence, with the aim of capturing the complete information, the detailed questions in the interview schedule include the following:

(a) type of financing approach applied and the reasons why the institution applies that approach;

(b) the most popular financing product and the reasons for its popularity, including the profit share ratio applied and the duration of financing;

(c) financing evaluation process and time required to evaluate the financing request;

(d) collection of repayment and strategies to improve collection rate; and

(e) type of enterprise and social development services provided to customers.

(iv) How have the relationships between BMTs, BPRS and MEs been maintained?

Considering that these are unique, community-based organisations, this interview question was designed to explore how the BMTs and BPRS have managed to broaden their outreach and maintained relationships with their clients.

(v) What is the role of BMT and BPRS in economic development?

The aim of this research question is to explore the interviewees' perceptions of BMTs' and BPRS' role in economic development; in particular, have the interviewees observed any changes in the lives of their clients after the borrowers have completed the financing process and has there been any development in society due to positive activities of Islamic microfinance? The findings from this research question is considered beneficial in the sense of complementing the findings from the questionnaire schedule on the same issues as presented in the previous chapters. Hence, by having two different perspectives or sources of information, the findings on this issue are further substantiated and verified.

7.3. OPERATIONALISING THE RESEARCH: FORMING THE CODING

In line with the formulated research questions set out above for interview analysis in this chapter, the following sections present the findings developed from the analysis of the interviews. However, in terms o operationalizing the research questions, Tables 7.1- 7.5 are presented to provide the definitions of coding utilised for the interview data collected in this chapter.

As part of the initial coding, Table 7.1 depicts the list of codes used by the interviewees in response to the question on the prospects of BMTs, BPRS and MEs.

Table 7.1: List of Codes for Research Question 1

Descriptive code		1st level codes	Pattern Code
PROSPECT OF BMTs and BPRS		**PROS**	
PROS	BMTs and BPRS	PROS-BMT	Pros-bmt-good
			Pros-bmt-compete
			Pros-bmt-changemindset
			Pros-bmt-market
			Pros-bmt-skills
PROS	Microenterprises	PROS-ME	Pros-me-good
			Pros-me-support
			Pros-me-consumptive
			Pros-me-empowerment
			Pros-me-noidea

As above, in terms of operationalisation, Table 7.2a and Table 7.2b depicts the list of codes used in analysing the interview material for questions related to issues and problems including the clients' level of understanding, collateral requirements, risk and moral hazard, product development, business problems and provision of training for staff.

Table 7.2a: List of Codes for Research Question 2

Descriptive code		1st level codes	Pattern Code
ISSUES and PROBLEMS			
	Understanding of Islamic terms		
		Terms-yes	
			Terms-explain
		Terms-no	
			Terms-educate
			Term-notcare
	Collateral required	Terms-yes	
		Terms-explain	
	Risk and moral hazard	Risk	
			Risk-liquid-no
			Risk-liquid-yes
			Risk-default
			Risk-default-handle
			Risk-bad-behave
			Risk-collate-sold
			Risk-bad-prevent
		Hazard	
			Hazard-misuse
			Hazard-handle
			Hazard-collateral
			Hazard-character
			Hazard-sell

Table 7.2b: List of Codes for Research Question 2

Descriptive code		1st level codes	Pattern Code
ISSUES and PROBLEMS			
	Product development	Prod-dev	
			Prod-rahn
			Prod-bill
			Prod-hajj
			Prod-salam
			Prod-groc
			Prod-home
			Prod-ijarah
			Prod-moneych
	Problems faced by BMTs and BPRS	Prob	
			Prob-access
			Prob-compt
			Prob-capital
			Prob-mngr
			Prob-facl
			Prob-pers
			Prob-skill
			Prob-vehi
			Prob-busi
			Prob-others
			Prob-otherbmt
	Problem of lack of funds	Fund	
			Fund-lack
			Fund-handle
	Training provided for staff	Training	
			Traing-fund
			Traing-type
			Traing-inst
			Traing-dura
			Traing-times

Table 7.3a and Table 7.3b presents the codes derived for questions on the financing and non-financing services provided by BMTs and BPRS, including the most popular financing product and the profit-sharing ratio.

Table 7.3a: List of Codes for Research Question 3

Descriptive code		1st level codes	Pattern Code
FINANCING SERVICES		**FIN**	
	Financing approach	Appr-group	
		Appr-indv	
	Most popular financing product	Prod-mura	Prod-mura-easy
			Prod-mura-simple
			Prod-mura-dema
			Prod-mura-clear
			Prod-mura-safe

Table 7.3b: List of Codes for Research Question 3

Descriptive code		1st level codes	Pattern Code
FINANCING SERVICES		**FIN**	
			Prod-mura-conv
			Prod-mura-prod
			Prod-mura-cons
			Prod-mura-mang
			Prod-qard-bmt
			Prod-qard-bprs
			Prod-mudha-musya
			Prod-ijar
		Prod-qard-most	
	Profit sharing ratio	Prod-ratio	Ratio-other
			Ratio-40:60
			Ratio-50:50
			Ratio:60:40
	Financing evaluation	Fin-eval	
			Eval-proc
			Eval-5C
			Eval-char
			Eval-save
			Eval-capa
			Eval-collate
			Eval-BIcheck
			Eval-empl
	Collection of repayments	Coll-pay	
			Coll-NPF
			Coll-prev
			Coll-inte
			Coll-pers
			Coll-resc
			Coll-rest
			Coll-off
			Coll-other
	Social development services	Soci-serv	
			Soci-mana
			Soci-tech
			Soci-mark
			Soci-cons
			Soci-reli
			Soci-no
			Soci-other

Table 7.4 presents the list of codes used in analysing the interview material in response to the questions on outreach and maintaining the relationships with the clients.

Table 7.4: List of Codes for Research Question 4

Descriptive code		1st level codes	Pattern Code
RELATIONSHIPS		**REL**	
REL	OUTREACH	REL-OUT	
	How do you broaden the outreach?		Rel-out-new
			Rel-out-marketing
			rel-out-reference
			Rel-out-custnetwork
REL	CLIENTS	REL-CLIENT	
	How do you maintain relationships with clients?		Rel-client-visit
			Rel-client-relimeet
			Rel-client-gift
			Rel-client-annualevent
			Rel-client-social
			Rel-client-goodservice
			Rel-client-personappr

Table 7.5 lists the codes developed to analyse the interviewees' answers to the question on the role and impact of BMT/BPRS in economic empowerment and development of individuals engaging with these institutions.

Table 7.5: List of Codes for Research Question 5

Descriptive code		1st level codes	Pattern Code
ROLE IN ECONOMIC DEVELOPMENT		**ROLE**	
ROLE	BORROWERS	ROLE-BORR	
	Have you in general observed any change in individual life after the borrower completed the process with you?		
	Yes, because	Role-borr-yes	Role-borr-dev
			Roll-borr-free
			Roll-borr-vehicle
			Role-borr-target
	No, because	Role-borr-no	Role-borr-difficult
			Role-borr-limit
ROLE	SOCIETY	ROLE-SOC	
	Do you observe any development in the society due to the positive activities of Islamic Microfinance Institutions?		
	Yes, because	Role-soc-yes	Role-soc-help
			Role-soc-free
			Role-soc-service
			Role-soc-trust
			Role-soc-aware
			Role-soc-move
	No, because	Role-soc-no	Role-soc-difficult

7.4. RESEARCH FINDINGS

Based on the coding system explained in the previous section, this section presents the findings from the interview analysis and this empirical chapter is organised around the research questions, as follows.

7.4.1. Research Question 1: The Prospects for BMT, BPRS and Microenterprises in East Java, Indonesia

This section provides analysis of the responses given by the officials of BMTs and BPRS about future prospects of BMTs, BPRS and MEs in their areas. The responses were classified into two focus-coding groups: future prospects of BMTs and BPRS, and the future prospects of microenterprises. The summary of the coding analysis is shown in Table 7.6a:

Table 7.6a: Data Analysis for Research Question 1

Research Question 1	**What are the prospects of BMT, BPRS and microenterprises in East Java, Indonesia?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Pros-bmt-good	BMT and BPRS have good prospects
	Pros-bmt-compete	BMT and BPRS have to compete with other institutions
	Pros-bmt-changemindset	The BMTs and BPRS' customers should change their mindset, not holding the conventional banking mindset
	Pros-bmt-market	There is a potential market for *Shari'ah* microfinance
	Pros-bmt-skills	BMT and BPRS should improve their staff's skills in order to be able to compete and develop their services
2	Pros-me-good	Microenterprises have good prospects
	Pros-me-support	Microenterprises need support, particularly financial support
	Pros-me-consumptive	Microenterprises sometimes are consumptive in managing their funds
	Pros-me-empowerment	Microenterprises have potential if there is empowerment action by the related institutions.
	Pros-me-noidea	No idea on microenterprises' prospects
Concluding theme	BMT and BPRS have good prospects and potential markets. However, there are some challenges, including tough competition with other institutions that offer *Shari'ah* micro financing, the customers who still have conventional banking mindsets, and the staff's skills should be improved. Microenterprises also have good prospects, since they have potential. However, they need to be supported financially and empowered by the government and related institutions. However, microenterprises sometimes are consumptive in managing their funds.	

Table 7.6 shows coding analysis based on the interview responses, which indicate good prospects for both the institutions. However, some of the interviewees also stated that they faced some challenges in the market. Although the proportion of Muslim communities in East Java is very high (around 80%), these communities are very likely to have a conventional banking mindset and a low or poor level of understanding of the *Shari'ah* terms used in Islamic banking, as evidenced by the results presented in Chapters 6. Based on the interviewees' information, conventional and *Shari'ah* commercial banking has recently started to offer micro financing, thus constituting a potential competitor to BMT and BPRS, since they are all offering the same services to the same market. Another challenge is the requirement to improve the BMT and BPRS staff's skills, particularly in *Shari'ah*-oriented skills, as articulated by the interviewees.

In response to the questions on the prospects of microenterprises, as can be seen in Table 7.6, the interviewees generally believed that microenterprises have potential prospects. However, they need to be supported financially, in particular by being given access to financing, as the interviewees explained. Moreover, if the government and related institutions take real action to empower microenterprises, their potential cannot be neglected. On the other side, as articulated by the interviewees, microenterprises also display unconstructive characteristics in managing their funds, as a few microenterprises are likely to use the funds for consumptive rather than productive purposes. As stated by the interviewees, it should be noted that some customers tend to misuse the funds obtained from financing and from their businesses for consumptive purposes rather than productive purposes.

7.4.2. Research Question 2: The Major Issues and Problems Faced by BMT and BPRS in East Java, Indonesia

This subsection analyses the issues and problems from the institutional perspectives, using both descriptive statistics and coding analysis. Seven issues are discussed in this section: clients' understanding of Islamic terms, collateral required, development planning and authentic product development, risk and moral hazard, business problems, problem of lack of funds faced by other Islamic microfinance institutions, and training for staff.

As the results in Table 7.7 depict, all BMTs are structured as ‘cooperative legal types’, while 80% of the BPRS are structured as ‘bank legal types’ and the remainder were of ‘other legal types’, namely ‘limited companies’. It should be noted that BPRS’ are operated as banks and have formal legal bases as Limited Companies. Hence, the difference between the responses of ‘Bank’ and ‘Other’, which is a Limited Company, should not be treated as different forms. This difference arose during the interviews mainly due to the different perceptions of the interviewees in responding to the question. In addition, the majority of interviewees did not revise their objectives (75% of BMTs and 70% of BPRS), implying that only 25% and 30% respectively engaged with the revision of organisational objectives; this should be considered a source of concern in the face of a changing and dynamic environment.

Table 7.7: Legal Type and Revision of Objectives

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Legal type	Cooperative	12	100	0	0	12	54.5
	Bank	0	0	8	80	8	36.4
	Other	0	0	2	20	2	9.1
	Total	**12**	**100**	**10**	**100**	**22**	**100.0**
Objective revised	Yes	3	25.0	3	30.0	6	27.3
	No	9	75.0	7	70.0	16	72.7
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100.0**

7.4.2.1. Customers’ understanding of Islamic terms used in banking products

Concerning clients’ understanding of Islamic terms, as can be seen from Table 7.8, based on the interviewees’ opinions, half of their clients did not understand the Islamic terms used in the financing products, although they also claimed that the terms were clearly explained to them before they signed the contract. This finding seems different from the customers’ perception of the same question, as presented in the previous chapter (Table 6.14), as the percentage of clients who understand the Islamic terms was found to be lower in this analysis, which might be explained by the fact that the officers of BMT and BPRS have higher expectations in this matter.

Table 7.8: Clients' Understanding of Islamic Terms

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Clients' understanding of Islamic terms	Yes	6	50.0	5	50.0	11	50.0
	No	6	50.0	5	50.0	11	50.0
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100.0**

Table 7.9 shows the coding analysis of the major issues and problems, particularly on the specific issue of clients' understanding of the Islamic terms used in the banking products.

Table 7.9: Data Analysis for Research Question 2.1

Research Question 2.1	**In your opinion, do clients understand terms used in Islamic banking products?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Terms-yes	Client understood the Islamic terms used after explanations
	Terms-explain	Generally, society did not understand the Islamic terms used. However, clients received adequate and detailed explanations from the institutions when they made an enquiry and when they signed the contract; then they were assumed to have understood the terms
	Terms-no	Client did not understand the Islamic terms used
	Terms-educate	Society needs adequate education in order to understand the Islamic terms
	Term-notcare	The microenterprises are highly unlikely to understand the terms and did not pay attention to the terms used
Concluding theme	Initially, most of the customers did not understand the Islamic terms; however, they started to understand after they had received detailed information when they discussed with the institutions and when they signed the contract. More education and information are required, although it can be difficult to explain when the customers do not care about the terms.	

As the findings in Table 7.9 depict, since the terms used are not commonly used in society, the majority of the participants did not understand the Islamic terms used in the financing products when they first contacted the Islamic microfinance institutions. However, they would receive adequate and detailed information when they signed the contract, after which the interviewees assumed that they had begun to understand the terms of the account they were holding. The interviewees also stated that almost all new customers are highly unlikely to have understood; however the 'old customers' in terms of their period of custom with the institution usually have a higher understanding. It was identified that the customers need simple explanations that can easily be understood; thus, the institutions tried to explain the necessary concepts to them in simple terms and language.

However, some of the interviewees also reported that the customers still did not understand the terms after receiving detailed explanation. It is recognised that the customers need routine and adequate education and socialisation in order to understand the Islamic terms. It is also reported that the microenterprises are highly unlikely to understand the terms and do not care about the terms used. For the customers, the most important aim was to obtain the funds quickly, and they did not consider it important to understand the terms. They also tend to compare the *Shari'ah* financing products with the conventional products, and then choose those that provide more benefit for them. Thus, a pragmatic attitude, as can be appreciated, very much prevails among the borrowers. In facing such a reality, it is difficult for the institutions to explain the terms.

7.4.2.2. Collateral

Table 7.10 shows that all the interviewees required collateral for financing for safety reasons, and the types of collateral required by both institutions were quite similar: these include assets certificates (33.85%), car certificates (32.31%) and motorcycle certificates (15.3). Collateral in the form of group references was more likely to be required by BMTs (14.89%) than by BPRS (7.50%).

Table 7.10: Collateral

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Collateral required	Yes	12	100	10	100	22	100
	No	0	0	0	0	0	0
	Total	**12**	**100**	**10**	**100**	**22**	**100**
Types of collateral	Assets certificate	12	25.53	10	25.00	22	33.85
	Car certificate	11	23.40	10	25.00	21	32.31
	Motorcycle certificate	12	25.53	10	25.00	10	15.38
	Group reference/ Pressure	7	14.89	3	7.50	12	18.46
	Others	**5**	10.64	**7**	17.50		0.00
	Total	**47**	100.00	**40**	100.00	**65**	100.00

Table 7.11 shows the findings related with collateral required by the institutions. In general, as can be seen, all the representatives of the institutions interviewed stated that they required collateral. The amounts of collateral varied, however. For instance, one interviewee stated that they required the value of the collateral to be at least 70% of the amount of financing; another interviewee reported that the amount of financing would be a maximum of 75% of the collateral. It should be noted that, as explained by the interviewees, savings could also be used as collateral. Unlike the collateral required by commercial banks, it is stated that the collateral required by their businesses is probably just a kind of formality collateral, and it is not owned by the institutions. In other words, it is simply a proof of serious commitment by the customers to repay accordingly. The interviews evidenced that one institution also provided insurance for customers; thus, should they die, for example, the insurance company would pay the remaining unpaid financing. However, in some cases, collateral was not required; such as when the amount of financing was small, *i.e.* less than IDR 3 millions.

Table 7.11: Data Analysis for Research Question 2.2

Research Question 22	**Do you require collateral from the clients? If yes, what collateral do you require?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
2	Terms-yes	Nearly all institutions required collateral of various types and amounts
	Terms-explain	Collateral was not required in some cases
Concluding theme	Generally, all interviewees required collateral of various types and amounts. However, collateral was not required in some cases.	

7.4.2.3. Risk and Moral Hazard

In exploring various issues, risk and moral hazard is also considered in the analysis for their implications for Islamic finance as well. Table 7.12 shows the coding analysis on the risk and moral hazard faced by BMTs and BPRS as articulated by the interviewees.

As can be seen in Table 7.12a – 7.12c, there are some risks faced by BMTs and BPRS in their micro financing, including liquidity risk, default/unpaid debt and customers’ bad behaviour. Some interviewees from well-established institutions reported having no liquidity risks, because they have applied a more secure liquidity standard ratio, which is higher than the Central Bank's requirement. As identified, it seems that good coordination and cooperation among all the branches has been built up; thus, when financial problems arise, they may be able to communicate on how to deal with the issue through collaborative work. Besides, a certain amount of funding has been provided in a specific account to cover such risks. As the interviewees articulated, BMTs and BPRS usually need fresh money during the month of *Ramadhan* and *Eid* celebrations, as the customers are likely to withdraw their money to cover the cost of *Eid* celebrations. However, other interviewees admitted the occurrence of liquidity risk in the past due to the high level of fund withdrawals mainly for business-oriented reasons while, at that time, the BMT did not have sufficient funds to cover such large withdrawals. In order to handle the liquidity problems, one of the interviewees reported building links with Islamic Banks (Bank Muamalat, BNI *Shari'ah*, *etc.*). It was also articulated that high fund withdrawal might also occur due to high financing demand, as an interviewee from BMT reported having liquidity problems due to the limited funds available to cover the high financing demand.

Table 7.12a: Data Analysis for Research Question 2.3

Research Question 2.3	**a. What risks have you dealt with?** **b. What types of moral hazard problems have you dealt with?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
3	Risk	
	Risk-liquid-no	There was no liquidity risk, as the financial problems were solved through building good cooperation among branches and among BMT
	Risk-liquid-yes	There was liquidity risk due to the high fund withdrawal
	Risk-default	BMT have default due to customers' financing problems, which resulted in delay of repayment, loss of collateral, customers' personal financial problems or business failure, harvest failure, run away/dead, damage to the goods BPRS have problems due to mis-evaluation of the financing application and providing financing to family/friends
	Risk-defaullt-handle	BMT applies personal approach to handle default and never sell the collateral BPRS applies stages to handle debt, using reserve funds, selling the collateral, and writing off the debt
	Risk-bad-behave	BPRS had experiences with customers who behaved badly, who treated the bank poorly and were uncooperative

Table 7.12b: Data Analysis for Research Question 2.3

Research Question 2.3	**a. What risks have you dealt with?** **b. What types of moral hazard problems have you dealt with?**	
	Risk-collate-sold	Customer sold or rented the collateral
	Risk-bad-prevent	BMT should conduct surveys more carefully as part of the financing evaluation and improve group-based financing
	Moral Hazard	
	Hazard-misuse	BMT Customers used the funds for purposes other than the original intended purposes as stated in the contract, or the funds are used by other persons. Misuse of funds by the manager BPRS Misuse due to personal bad behaviour: drunk, re-married, used the money for other purposes; and misuse of funds by manager
	Hazard-handle	BMT The BMT should investigate and educate them to be honest customers Using a religious approach, and obtaining reference from respected person BPRS If clients refuse to repay, firm but not emotional action and family friendship approaches were applied
	Hazard-collateral	BPRS Clients used collateral belonging to other persons or used leader reference
	Hazard-character	BPRS Moral hazards rooted in clients' characters were difficult to see/predict in the beginning; it is not easy to judge whether one is trustworthy or not
	Hazard-sell	BPRS Clients sold the goods bought from the financing fund, because from the beginning one needs money rather than goods
Concluding theme	For some interviewees, liquidity risks did not exist since good cooperation and coordination among all branches and among BMT can be managed well. However, this risk occurred in some institutions due to the high fund withdrawal. Defaults are frequent risks that might happen mostly due to customers' financial problems which result in repayment delay and mis-evaluation of financing applications. To handle the default, BMT focus on personal approach rather than selling the collateral, while BPRS is more likely to sell the collateral if the stages applied to default do not work, and write off the debt. There were also at risk of having customers who behave badly and sell the collateral. To prevent risks of default, the survey as part of the loan evaluation should be conducted more carefully, and group-based financing should be improved. Moral hazards are usually caused by the unpredicted bad character, which are sometimes difficult to observe at first. The moral hazard cases included misuse of funds, providing collateral that was not owned, and selling the items obtained from financing to get cash.	

As identified by the interviewees, the risk of default or financing problems might occur for various reasons:

(i) Experience apparently shows that, for example, customers have financial difficulties, which might result in delay of repayment due to business failures, harvest failures or other personal financial difficulties. The interviewees stated that, although generally the customers are trustworthy, they are unlikely to be transparent in disclosing their financial problems.

(ii) As stated by some of the interviewees, this might also be caused by the customer's inability to manage the funds, particularly when the customers receive financing despite their situation precluding them from receiving financing, or when they receive more financing than they are capable of managing. In a very rare case, there was a business collapse after financing, as experienced by one interviewee.

(iii) There is a risk of difficulties in 'repayment collection'. One interviewee stated that it seems easier to arrange financing and to handle the problem of repayment with ordinary people rather than those with good religious knowledge or those with close relationships with BMT.

(iv) Default can happen due to the loss of assets (*e.g.* motorcycles) sold by badly behaved customers without the institution's consent.

(v) In some cases troublesome customers run away and cannot be found, thus leaving the debt unpaid. In other cases, the customer passes away but the children do not attempt to pay the debt; sometimes the value of collateral is less than the financing amount.

(vi) One interviewee reported having default cases because the collateral provided was simply a Legal Statement Letter from the office where the customers worked, without assets as collateral. Hence, the customers had low motivation to repay.

(vii) There were cases of misunderstanding among some customers, who assumed that the financing funds were grants that did not have to be repaid.

(viii) Finally, as explained by the interviewees, there were cases where the customer refused to repay because the goods bought through financing were damaged; thus, the customer assumed that he was no longer responsible for repaying, which was a truly incorrect assumption

The interviewees from BPRS reported that risk usually resulted from the misevaluation of financing applications. However, the banks usually take responsibility for mitigating the risk of profit-sharing by providing funds in a specific account. In addition, the interviewees of BPRS also reported the difficulty of handling financing problems of family/relatives/friends.

To handle the risk of default, the interviewees of BMTs stated that they prefer to apply a personal and friendly approach; therefore, they never sell the collateral to cover the default. It should be noted that the key to good repayment is routine weekly meetings, as experienced by an interviewee of BMT. BPRS applied some stages of action to handle default, starting with a first warning for customers who delay the repayment for three months. When this step does not work, the bank collects the repayment directly from the customer's premises. Should this step also fail to overcome the problem, the bank will sell the asset collateral (house) through an auction process. It was reported by one interviewee that, in one case, when the collateral came to be sold, the owner was found to have already sold the actual collateral; thus, the bank only held the certificate. Consequently, the bank started to conduct routine repayment collections direct from the customers' homes. However, some customers, who felt disturbed, reported the matter to the customer protection agency. The bank would then consider confiscating the house. Since the case could not be solved using a personal approach, it was then placed under the court's jurisdiction, as the interviewee explained.

Generally, nearly all the interviewees stated that, when the default occurred, the processes for handling it were not easy, as there was no proper procedure to follow. Some interviewees reported certain solutions to overcome this problem, such as using reserve funds to cover defaults, improving the amount of default reserve funds and writing off the debt. In order to reduce default, the interviewees realised the importance of maintaining routine monthly relationships to detect the problem in the early stages.

The risk of having badly behaved customers also arose, as explained by the interviewees from the BPRS, as the customers treated the bank in a bad and uncooperative manner.

In order to prevent the risk of default related to customers' bad behaviour, the interviewees stated that BMT should conduct surveys more carefully as part of the financing evaluation. Since individual financing problems often occur, the BMT is likely to increase group-based financing; hence, the group leaders will be responsible for handling the problems of group members.

Besides the risks discussed above, BMTs and BPRS have also experienced moral hazard problems, which usually include misuse of funds, presenting collateral belonging to other persons, undetected bad characters and the selling of items bought with the financing funds. The interviewees from BMT reported cases where the clients used the funds for purposes other than the originally intended purposes as stated in the contract, such as using them for consumptive purposes rather than productive purposes. There were also cases when the clients applied for financing for other persons. Unexpectedly, the interviewees also stated that the above cases would not be problems as long as the clients repaid the funds as scheduled, or used the funds for other *halal* businesses. However, misuse of funds did not occur in all institutions, as one interviewee stated that there was no misuse of funds because the customers received goods/items instead of cash. One BMT had had a bad experience of misuse of funds by the manager, which resulted in the institution having deep financial problems, as stated by one of the interviewees from the BMT. In many cases, despite the fact that clients were financially able to repay, they refused to pay for various reasons such as needing to use the funds for other more urgent purposes rather than using them to repay the loan. In such cases, as stated, the Accounts Officer went directly to their homes to collect the repayments; otherwise, the clients would not have repaid. It seems that the BPRS experienced similar situations. The interviewees reported that clients sometimes used the money for other purposes and sold the collateral.

Based on the experiences described, misuse of the funds might be due to individual personal bad behaviour, such as becoming alcoholic or even re-marrying. The interviewees stated that if the only cause of misuse was economic factors, there was still a chance that the client would repay the loan, as it is an economically circumstantial problem. In such cases of default and failure, the Accounts Officers were normally engaged directly in collecting the repayments. However, clients sometimes simply kept promising to pay, thus delaying the process or even trying to avoid the Accounts Officers by not being at home during the anticipated visit by the Accounts Officers. It should be noted that there have even been worse cases, such as clients disappearing after receiving the funds. It should be noted that the most common reason for failing to repay on time was business failure.

In tackling the above problems, as articulated by an interviewee from the BMT, various strategies were developed such as conducting investigations and spreading education among the clients. The latter, in particular, aims at helping the clients to become more honest people, as the purpose of BMT is not only to conduct business but also to encourage educational activities and spread Islamic values (*dakwah*). Some interviewees reported using a religious approach, such as saying *dua'* (supplication) together and religious *nasihah* or giving advice shaped by the Qur'anic verses and sayings of the Prophet after signing contract agreements in order to reduce the cases of misuse of funds and other financing problems through instilling Islamic values in the hearts and minds of the clients. As stated by the interviewees, this approach was able to improve the customers' repayment records. As part of such a person-to-person approach, the interviewees stated that they also encouraged the customers to be honest and open in explaining their problems, so that efforts could be made to find possible solutions to problems whenever they arose.

Some other strategies of BMT involved the intermediation of a respected community leader through referral in cases where clients who were able to pay refused to do so. It seems that the interviewees from BPRS applied similar approaches to customers who had the ability to pay but refused to do so, i.e. a firm rather than an emotional approach, as mentioned by one of the interviewees. In other words, a family friendship approach within the social network seems to work in certain cases.

The findings also suggest that, in addition to such a socially oriented approach, the legal department can also play a role by taking the required action, such as selling the collateral or preventing the collateral from being sold by the customers. This is considered helping as a mitigation source.

There are other moral hazard problems in the case of BPRS. As stated by the interviewees, there are cases where the clients provided collateral belonging to other persons or used their work supervisor's reference as collateral, although they tended to misuse the reference.

The interviewees from the BPRS also stated that moral hazard problems stemming from clients' personal character are difficult to predict in the beginning, as it is difficult to distinguish a non-trustworthy person from a trustworthy person. However, another interviewee stated that only a small number of problems related to misuse of funds could be traced to personal character. However, it seems that problems usually occur for economic or financial reasons. For example, in one case related to BMT, the clients sold the goods bought with the financing funds as it seemed that, from the beginning, the clients in question were in need of money rather than goods to be purchased with the financing. However, faced with the condition that the funds had to be used to purchase goods, they opted to buy the goods and then sold them in the market.

7.4.2.4. Development Planning and Development of Authentic Products

As discussed in the previous chapters, this research also explored and examined the issues related to development planning of the customers' businesses and the search by the fund providers to develop authentic products to respond to such needs. In the specific issue of development planning, as can be seen from Table 7.13, market outreach seems to be the most important issue, as 31.34% of the interviewees chose this option. This is followed by skills improvement (25.37%), capital increase (23.88%) and sustainability (14.93%).

Table 7.13: Development Planning

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Development planning	Capital increase	9	24.32	7	23.33	16	23.88
	Increase sustainability	6	16.22	4	13.33	10	14.93
	Market expansion (outreach)	12	32.43	9	30.00	21	31.34
	Skill improvement	9	24.32	8	26.67	17	25.37
	Others	1	0.00		0.00		0.00
	Total	**37**	100.00	**30**	100.00	**67**	100.00

Table 7.13 presents the results on the possibility of the institutions developing more authentic products to fulfil local needs. Based on the interviewees' statements, most interviewees have considered or offered new products, which include *rahn*, monthly bill payment services, *hajj* fund, *salam*, opening shops selling groceries, home financing, *ijarah*, money changing and *mudharabah*. A high number of interviewees stated their willingness to provide *rahn* (gold). However, to obtain authorisation to provide this service, the regulations from the Central Bank required them to have employees with certificates of assessment in terms of assessing the value of gold, which is put on *rahn*.

As Table 7.14 indicates, routine bill payment is also mentioned among the authentic services to be provided. This might include electricity, home telephone and mobile phone bill payments, *etc*. *Hajj* fund is another financial service mentioned; this is arranged by the BMTs and BPRS, which pays the whole amount to the bank to reserve places on the *hajj* for their clients. The clients then repay the amount throughout the year to ease the financial burden. Among the desired financial services, *ijarah* was also identified for multiple purposes; it can be offered not only for general purposes but also specifically for education and health. A large number of customers are aiming to go on the *hajj*, and they need to have Saudi Arabian currency, Riyals, in exchange for their Rupiahs. As identified, this creates another opportunity space for BPRS to provide money-changing services. One interviewee also reported that she prefers and hopes to provide *mudharabah* among the services provided, as she has thus far only offered *murabahah*.

Table 7.14: Data Analysis for Research Question 2.4

Research Question 2.4	**Have you considered developing more authentic products to respond to the local need and environment?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
4	Product	Development of new authentic product for local needs
	Prod-rahn	BMT/BPRS: rahn (*Shari'ah* gold pawn)
	Prod-bill	BMT : Routine monthly bill payment
	Prod-hajj	BMT/BPRS : hajj fund, the customers pay in one year
	Prod-salam	BMT : salam
	Prod-groc	BMT: open a shop selling groceries.
	Prod-home	BMT: home financing (leasing) sewa beli
	Prod-ijarah	BPRS: Ijarah Multi jasa (for general, education and health purposes)
	Prod-moneych	BPRS : money changer (Riyal to Rupiah) for hajj
	Prod-mudha	BMT: *mudharabah*, as now only offers *murabahah*
Concluding theme	Most of the interviewees have considered developing new product, such as *rahn*, bill payment services, hajj fund, salam, open shop selling groceries, home financing, *ijarah*, money changer and *mudharabah*.	

7.4.2.5. Business Problems

Table 7.15a and 7.15b shows the occurrence of ten problems faced by BMT and BPRS. In general, based on the total percentage of respondents reporting 'sometimes', 'often' and 'always', the rankings of the most frequent problems are as follows: (i) difficulty of assessing borrowers' financial flow (59.1%); (ii) managerial problems (52.4%); (iii) competition (50%); (iv) lack of capital (45.5%); (v) lack of staff skills (36.3%); (vi) lack of personnel (36.3%); (vii) lack of infrastructure (36.3%); (viii) inappropriate type of business organisation (31.8%); (ix) other problems; and (x) lack of vehicles to reach borrowers (9.1%).

It should be noted that separate analyses of BMT and BPRS problems show different figures. As can be seen in Table 7.15, the rankings of the most frequently occurring problems of BMT are as follows: (i) lack of capital (58.3%); (ii) difficulty of assessing borrowers' financial flow (41.7%); (iii) managerial problems (33.4%); (iv) competition (33.4%); (v) lack of personnel (33.3%); (vi) inappropriate type of business organisation (33.3%); (vii) lack of infrastructure (33.3%); (viii) lack of staff skills (25%); (ix) other problems; and (x) lack of vehicles to reach borrowers (8.3%).

On the other hand, the rankings of the most frequent problems of BPRS are as follows: (i) difficulty of assessing borrowers' financial flow (80%); (ii) competition (70%); (iii) managerial problems (70%); (iv) lack of staff skills (60%); (v) lack of infrastructure (40%); (vi) lack of personnel (40%); (vii) lack of capital (30%); (viii) inappropriate type of business organisation (30%); (ix) other problems; and (x) lack of vehicles to reach borrowers (10%).

Hence, by comparing these two types of institutions, it seems that the frequencies of the problems are different; while lack of capital is the main problem for BMT (58.3%), it is ranked only seventh for BPRS (30%), with 40% of the respondents reporting that they never have this problem. Moreover, difficulty in assessing borrowers' financial flow is the main problem for BPRS (80%), but this is ranked only second for BMT (40%), which may be due to the different number of profit-sharing contracts and the size of the financing. Competition is likely to be tougher in the BPRS environment (70%) as compared to BMT (33.4%); this might be due to the nature of BPRS as a bank which has to compete with other banks, considering that an increasing number of commercial banks are enter the micro financing market and offering the same products. Meanwhile BMT is a more community-based organisation, focusing more on its members. Besides, managerial problems are more frequent in BPRS (70%) than in BMT (33%), which may be due to the different sizes of the organisations, as BPRS is generally larger than BMT. Staff skill problems are greater for BPRS (60%) than for BMT (25%), possibly because BPRS has higher expectations in terms of staff skills than BMT, which usually has simple management.

Table 7.15a: Problems Faced by BMT and BPRS

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Lack of capital	Never	2	16.7	4	40.0	6	27.3
	Rarely	3	25.0	3	30.0	6	27.3
	Sometimes	5	41.7	1	10.0	6	27.3
	Often	1	8.3	1	10.0	2	9.1
	Always	1	8.3	1	10.0	2	9.1
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100.0**
Managerial problems	Never	4	33.3	0	0	4	19.0
	Rarely	4	33.3	2	20.0	6	28.6
	Sometimes	2	16.7	6	60.0	8	38.1
	Often	2	16.7	1	10.0	3	14.3
	Always	0	0	0	0	0	0
	Total	**12**	**100.0**	**9**	**90.0**	**21**	**100.0**

Table 7.15b: Problems Faced by BMT and BPRS

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Lack of infrastructure	Never	4	33.3	2	20.0	6	27.3
	Rarely	4	33.3	4	40.0	8	36.4
	Sometimes	4	33.3	3	30.0	7	31.8
	Often	0	0	0	0	0	0
	Always	0	0	1	10.0	1	4.5
	Total	**12**	**100**	**10**	**100.0**	**22**	**100.0**
Inappropriate type of business organisation	Never	8	66.7	5	50.0	13	59.1
	Rarely	0	0	2	20.0	2	9.1
	Sometimes	3	25.0	3	30.0	6	27.3
	Often	0	0	0	0	0	0
	Always	1	8.3	0	0	1	4.5
	Total	**12**	**100**	**10**	**100**	**22**	**100.0**
Competition	Never	7	58.3	2	20.0	9	40.9
	Rarely	1	8.3	1	10.0	2	9.1
	Sometimes	2	16.7	2	20.0	4	18.2
	Often	2	16.7	3	30.0	5	22.7
	Always			2	20.0	2	9.1
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100.0**
Lack of personnel	Never	6	50.0	3	30.0		40.9
	Rarely	2	16.7	3	30.0	5	22.7
	Sometimes	2	16.7	4	40.0	6	27.3
	Often	1	8.3	0	0	1	4.5
	Always	1	8.3	0	0	1	4.5
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100.0**
Lack of staff skills	Never	5	41.7	0	0	9	40.9
	Rarely	4	33.3	4	40.0	5	22.7
	Sometimes	2	16.7	4	40.0	6	27.3
	Often	1	8.3	2	20.0	1	4.5
	Always	0	0	0	0	1	4.5
	Total	**12**	**100.0**	**10**	**100**	**22**	**100.0**
Difficult to assess borrowers' financial flow	Never	6	50.0	0	0	6	27.3
	Rarely	1	8.3	2	20.0	3	13.6
	Sometimes	2	16.7	2	20.0	4	18.2
	Often	3	25.0	6	60.0	9	40.9
	Always	0	0	0	0	0	0
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100**
Lack of vehicles to reach borrowers	Never	10	83.3	7	70.0	17	77.3
	Rarely	1	8.3	2	20.0	3	13.6
	Sometimes	1	8.3	1	10.0	2	9.1
	Often	0	0	0	0	0	0
	Always	0	0	0	0	0	0
	Total	**12**	**100.0**	**10**	**100**	**22**	**100.0**
Others:	Never	1	16.7	0	0.0	1	14.3
	Rarely	0	0.0	0	0.0	0	0.0
	Sometimes	3	50.0	0	0.0	3	42.9
	Often	2	33.3	1	100.0	3	42.9
	Always	0	0.0	0	0.0	0	0.0
	Total	6	100.0	1	100.0	7	100.0

Based on the interviewees' perceptions, the next table shows the findings on the problems faced by the BMT/BPRS and how they solve these problems. This table is a continuation of Table 7.15a and 7.15b about BMT/BPRS problems analysed based on the descriptive statistics. Table 7.15a and 15b show ten types of problems faced by BMT/BPRS in managing their businesses, ranging from lack of capital to limitation of vehicles owned, while the next table further elaborates on these problems. The sequence of the problems presented in the following sections is based on the frequency of the problems, as resulting from the analysis in Table 7.15.

7.4.2.5.1. Access to Customers' Financial Reports

The most frequent problem faced is the access to customers' financial reports, which is essential in *mudharabah* financing. An interviewee of a BMT realised the importance of obtaining information on how much profit the customers made in a year in order to justify the profit-loss sharing, thus enabling the monitoring process to be conducted. Another interviewee reported the difficulty of accessing financial reports of the micro financing given to micro entrepreneurs; however, the same problem was not faced in larger financing to larger entrepreneurs. As stated by an interviewee, the customers were often less than honest in reporting their income when applying for *mudharabah* financing; they merely relied on rough predictions, due to their desire to obtain the funds rapidly. In such cases, the interviewee would consider checking other aspects as part of the financing evaluation, such as the business location. For another interviewee, this was not a problem, since the proportion of *mudharabah* financing was just a small part of the whole financing operation, as the customers mainly hold *murabahah* accounts for productive purposes. This statement was echoed by another interviewee; the proportion of *mudharabah* was very small in his/her operation, and it is handled directly by the director. As a way of overcoming such problems, one interviewee from BPRS even advocated a proactive attitude in terms of teaching the customers simple bookkeeping.

7.4.2.5.2 Managerial Problems

Second, managerial problems mostly refer to the difficulty of building a good management system, and an interviewee of BMT admitted that managerial problems occur in some other BMTs because the management systems are not well organised and do not run smoothly. He further asserted that this problem is more frequent than financial problems in BMT. An example of this problem was also provided by an interviewee of BMT, which has more than 130 branches on Java Island; the respondent stated that the head office sometimes loses control of the branches. Another interviewee from a small rural BMT reported that this problem is rare, and it mainly occurs due to different opinions on decision-making in regard to financing analysis; it is therefore necessary to build up closer relationships between the director/owner and the employees. Managerial problems in BPRS are mostly related to human resources, particularly the quality and personal characteristics of human resources; one interviewee stated that not every employee has a personality suitable for teamwork.

7.4.2.5.3. Competition

With regards to the problem of competition with other financing institutions was stated as an issue generally faced by all interviewees. Nevertheless, one interviewee from a successful BMT stated that, despite the on-going heavy competition from a large number of banks in its surrounding area, it dominates the market due to its strong community-based relationships. An interviewee from another very big and successful BMT stated that their institution is competing strongly with a conventional micro financing institution, BRI, and another conventional bank that provides small financing. However, they compete fairly. The interviews demonstrate that competition with other *Shari'ah* microfinance institutions rarely occurs, as within the 'co-operation' understanding of Islam they mostly help each other and build good cooperation among *Shari'ah* microfinance institutions. The interviewee further explained that the most important issue for them is the honourable purpose of the business in providing micro financing; thus, with their submission to God, it will be possible to resolve problems. He also reported the importance of maintaining the focal point of *Shari'ah*, moving or *hijrah* from *riba* to *Shari'ah*[2].

[2] As the interviewee explained, having a strong Islamic value rooted from the Islamic boarding school as based of establishment of this BMT, move from *riba* to *Shari'ah* means that BMT would like to educate the society to change their mindset and move from *riba* based financing to *Shari'ah* based financing.

An interviewee of a small BMT that has operated in the traditional market of a city for more than 15 years reported a similar situation, in which competition with the *Shari'ah* institutions rarely occurs, as there is only one local BMT operating in the same market with fewer customers than the interviewee's institution. However, in general the BMTs exercised good cooperation. The tough competition mostly came from the conventional microfinance institutions, such as a credit union owned by a Christian community, Teras BRI (BRI windows), and a local BPR, as identified by the interviewee. Based on the interviewee's observation, the credit union also offered a financing scheme similar to *qard hassan* for people in need, such as people who are sick and need to meet medical and educational expenses (school tuition). She further asserts that the competition only comes from the conventional institutions, not the *Shari'ah* ones. An interviewee from a BMT that operates in a rural area experienced the same problem - competition from a conventional bank (BRI) - as most of their customers have moved to the conventional bank. This occurred mostly because of the customers' misperception that conventional and *Shari'ah*-compliant solutions for their financial needs are just the same. In general, customers want to obtain funds easily, quickly and at low margins.

An interviewee from a BPRS in a suburban area stated that competition occurs naturally/fairly. However, the interviewee did not compete with *Shari'ah* institutions. Another interviewee from BPRS reported that, if they have to compete with BMT or BPRS, the competition would be properly equitable and fair. The real competitors are BRI and another two local BPRS. It was identified that fierce competition with conventional banks began in 2008 when new branches of well-established conventional banks (*e.g.* Bank Danamon Credit Union, BTPN) opened in the same area, as reported by an interviewee from a BPRS which operated in the traditional market in a town centre. Competition also comes from two BMTs and another BPRS. However, the interviewee believed that the demand for financing remains high. To handle this problem, the interviewee stated that his/her institution considered applying the conventional banks' strategy in order to appear attractive, such as offering gifts for new savings accounts (umbrellas, pens *etc*), namely *tabungan berhadiah* (savings with gift). The other solution considered is based on the idea of providing trustworthy services, such as mobile printers[3] and offering higher profit-sharing for customers in order to be able to compete with other *Shari'ah* institutions, as he realised that BMT has an advantage in terms of speedy approval and providing the funding on the same day that the financing application is made.

An interviewee from a BPRS in a suburban area stated that competition was not a problem if it occurred at the same level of micro institutions. In other word, competition with the same BPRS rarely occurs, as the local BPRS' cooperate well in the form of informal organisations. They also often share their ideas, realising that they have the same vision and mission. However, trying to compete with Islamic windows could create problems. This is because, as he explained, they also offer micro financing and they have entered the same market and offer their products to the same customer base as the interviewee's customers. The interviewee further explained that there is no regulation and protection of micro financing, and all banks can enter the same market. Therefore, many banks enter the micro financing market attracted by its great potency, although the cost associated with providing micro financing services is considered high; as he sadly reported, this cannot be avoided. The problem that might occur in this situation is that the banks will not understand the character of micro financing and the micro market, which is a source of 'worry'.

7.4.2.5.4. Lack of Capital

As the fourth problem, lack of capital is one of the most challenging problems for some of the interviewees, although an interviewee from a mature BMT stated that the BMT has not experienced capital shortage, as funding from the public can be gathered easily due to the community's high level of trust in this BMT. When the required fund is considered large, the partner of an Islamic commercial bank can be contacted and the funds can usually be provided promptly due to the trust in this BMT and the large amount of assets owned by the BMT. An interviewee from the most reputable BMT even stated that the banks have approached and offered funds directly to the BMT. Thus, as a whole, the

[3] This is a new small mobile electronic device that can provide print out of the payment to customer on the spot.

organisation never lacks funds, although there are sometimes funding problems in some of the 130 or more branches.

Some of the interviewees stated that problems of high seasonal withdrawals sometimes occur, such as during *Ramadhan and Eid* celebrations and at the start of the new school year. This problem often observed due to large withdrawals accompanied by high financing demand, as admitted by an interviewee from a small BMT operating in a traditional market in the city centre. However, this can be anticipated using pre-allocated funds.

As the interviewees identified, linked programme with the Islamic banks seems to be one of the solutions to lack of capital, as many respondents utilise this solution when they need fresh money. The banks that usually have a linked programme with BMT/BPRS are Bank Muamalat Indonesia, BRI *Shari'ah*, BTN *Shari'ah*, Bank *Shari'ah* Mandiri, and Bank Jatim *Shari'ah*. These Islamic banks also sometimes distribute government funds under the micro financing programme. The contracts utilised in this linked programme were mostly *murabahah* contracts. The government provided Dana Bergulir *Shari'ah*,(Shari'ah Revolving Funds) although two interviewees explained that there are difficulties in accessing the funds; therefore, they have never obtained the government funding. Another solution is to obtain short-term loans from other BMTs that have idle funds.

An interviewee from a BMT in the capital city reported building networks with members of the BMT Association, namely Absindo (Asosiasi BMT Indonesia/The Association of BMT in Indonesia), Inkopsyah (Induk Koperasi *Shari'ah*), Microfin and the BMT Centre, in order to gain access to a linked programme with the bank (BNI) when fresh funds are required, although, thus far, the BMT has not applied for the funding. The only funds received by the interviewee were from Bank *Shari'ah* Mandiri, in the amount of IDR 850 millions to be repaid in 3 years, using a *mudharabah* contract based on the profit-sharing ratio of 80:20.

An interviewee from a rural BMT, which is a member of a local BMT Association, reported sometimes having a lack of funds. The interviewee has applied for more funds from BTN *Shari'ah*, although the process had not yet been finalised during the interview period. While waiting to receive the funding, they can only operate the business using the limited funds available. This new proposal was for an additional fund to top up the original fund of IDR 300 millions received previously when the BMT was first set up. It was based on a *mudharabah* contract with the ratio of 60:40, which the BMT repaid through the Association, rather than directly to the bank.

A problem related to this issue is the distribution of financing funds to the financing applicants. However, an interviewee from the most reputable BMT in East Java stated that it had never faced problems in allocating the funds. Another interviewee from a small BMT admitted sometimes having difficulty in allocating the funds, because there were too many financing applications, although very few were feasible. When the BMT has idle funds, it usually offers them to other BMTs to utilise. However, she further explained that it is sometimes much easier to offer financing rather to attract savings. Some interviewees claimed they never had problems in this regard.

As revealed in the interview process, BPRS had the same problems, although they had a better chance of obtaining external funds than BMTs as they have many linked opportunities with Islamic Banks, such as Bank Muamalat, Bank Danamon *Shari'ah* and BTN *Shari'ah,* based on *murabahah, mudharabah and musharakah* contracts with pre-agreed profit-sharing ratios. Thus, BPRS might choose which institutions are more suitable for them based on certain criteria, such as close relationship, lowest rate of return required and easy procedures. For example, an interviewee of BPRS obtained funds from BTN *Shari'ah* and Bank Muamalat. A severe financial problem, admitted by a BPRS due to the misuse of capital by the previous director in 2008, resulted in the capital decreasing by 50%. This problem has been resolved gradually since 2009 through the appointment of a new director. The linked programme is not always attractive to BPRS, as one interviewee stated that, although he often lacked capital, he has not utilised the fund through the linked programme due to the high return required by the bank; hence, the profit margin for BPRS is not sufficient. The interviewee also admitted that the cheapest funds that should be considered are public funds (savings and deposit), and the funds from the stakeholders (owners). Further, he reported that the financing distribution sometimes proceeded on a seasonal basis, such as *Ramadhan*, when there is a high level of fund withdrawals and a high financing demand, thus causing a lack of funds.

7.4.2.5.5. Lack of Staff Skills

Fifth, lack of staff skills was reported as occurring frequently in both BMTs and BPRS. Based on the information from interviewees, the skills most lacking include knowledge of *Shari'ah* contracts, as most of the staff were familiar only with *murabahah*, financing evaluation/analysis, and computer and administrative skills.

8.4.2.5.6. Lack of Personnel

Sixth, in general the lack of personnel is not a big issue, as most of the interviewees reported no problems in this regard. Besides, there are abundant human resources available in the job market; an interviewee of a highly reputable BMT even claimed that they often reject job applications. This BMT has a total of 670 male employees and no female employees; most of them are recruited after graduating from an Islamic boarding school, a school led by the initiators and original owners of the BMT. Holding the belief of "*man jadda wa jadda*" (he who has worked hard will be able to reach success) and realising the importance of long-life learning based on good intentions (*niat*) and hard work hard. It is believed, therefore, that even staff with no formal education in running the business will be able to manage it successfully. An interviewee from a BPRS that had previously suffered serious financial problems reported sometimes having personnel problems. However, since it is still in the recovery process, it has not been ready to recruit new staff. An interviewee from BPRS in the capital city reported a high rate of staff turnover.

7.4.2.5.7. Lack of Infrastructures

Seventh, it seems that the problem of lack of infrastructure did not generally occur, as most of the respondents claimed not being faced with such a problem. Only one interviewee from BMT reported having computer error problems, whereas an interviewee from BPRS reported constant infrastructure problems; for example, the office building currently being used was merely rented rather than owned, the office rooms were uncomfortable and the computers were unable to support the business operation efficiently. Computer-related problems, particularly in terms of information technology and business software, were also reported by an interviewee of a BPRS operating in a suburban area.

7.4.2.5.8. Inappropriate Type of Business

Eighth, the cooperative legal basis of BMT was not acceptable to some interviewees of BMT. They also stated that the cooperative regulations have not provided sufficient support for BMT development. However, one interviewee stated that, as long as BMT can help society and maintains this as the main goal, this issue would not be considered urgent. An interviewee of BMT provided an example: when BMT applies for funds from the Ministry of Cooperatives, the regulations require that the proposed funds be of a certain amount, and a certain amount of interest rates are applied; this is not suitable for BMT because of its *Shari'ah* scheme. She further explained that the purpose of a cooperative is to improve its members' wealth/prosperity, but the purpose of BMT goes beyond that aim. Until now, the involvement of the Ministry of Cooperatives has been limited to attending the members' Annual General Meeting. Another interviewee was concerned, since BMT is not regulated and protected by the Central Bank, about what might happen when financing risks occur; where can BMT go for help?

In addition to legal problems resulting from inappropriate type of business organisation, an interviewee of a BPRS reported problems of a lack of personnel in certain positions in the management; hence, some persons in certain positions occupied multiple jobs, although the jobs were still manageable.

7.4.2.5.9. Other Problems

As articulated by interviewees from BMT, the other problems might include lack of *tabligh* (ability to do *dakwah* or delivering religious education to society) and *fathonah* (developing intelligence). Since these BMTs were built by the leader of the Islamic boarding school, the fulfilment of four of the Prophet's characteristics, namely having *fathonah*, *amanah*/trustable, *siddiq* (trustworthy) and *tabligh*, is necessary, as expressed by the interviewees. Moreover, other problems were emphasised by interviewees, including: (i) customers' honesty; (ii) customers' bad behaviour, which might sometimes tend towards violent behaviour; (iii) problem of poor maintenance of financing documents and payment records by the customers; (iv) the wrong perception of BMT which treats it as similar to a conventional institution; (v) misleading information about the BMT, suggesting that the BMT is not trustworthy; (vi) the customers failing to notify the BMT of their financing problems explicitly; (vii) recording transactions in incorrect accounts in the accounting system due to the lack of accounting skills among the boarding school graduates; (viii) suspicion from colleagues in relation to fund management; (ix) reluctance to offer *mudharabah* financing due to past bad experiences of default and bankruptcy; and (x) difficulty of educating people to be better customers who have the responsibility to repay the loan in full in accordance with the pre-agreed contract and schedule.

An interviewee from BMT reported other problems in the early days of the institution's establishment; those problems are lack of discipline, lack of skills and carelessness in managing the funds. However, the interviewee then added that the most important resource is religious spirit (*Islamic ghirah*); thus, they bravely opened the new BMT and organised it using simple management.

Finally, some interviewees reported lack of vehicles, particularly motorcycles, to reach customers. A solution reported by an interviewee from BPRS was to rent motorcycles for the staff. However, most of interviewees did not have this problem.

Table 7.16a: Data Analysis for Research Question 2.5

Research Question 2.5	**How often do you face the problems?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
5	Problems	
	Prob-access	Difficult to assess borrowers' financial flow BMT • It is often difficult to access the customers' financial report. • Customers often not honest in reporting their incomes • No problem, because *mudharabah* is just a small part BPRS • It is often necessary to teach them how to do simple bookkeeping

Table 7.16b: Data Analysis for Research Question 2.5

Research Question 2.5	**How often do you face the problems?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
	Prob-mngr	Managerial problems. BMT • No problems • Management systems are not well organised, systems are not running well; this is a bigger problem than financial matters • Sometimes, loose control over branches • Rarely, different opinions in decision-making about financing analysis BPRS • Problem in relation to human resources and their quality
	Prob-compt	Competition BMT • Rarely compete with Islamic counterparts, as they even build good cooperation • Competition with conventional banks, mostly BRI windows. • Competition is fair BPRS: • Rarely compete with Islamic banks • Fair, however sometimes tight, competition with conventional banks
	Prob-capital	Lack of capital BMT • No problem with capital, easy to get public funds and funds from the bank • To handle linked programme with banks and cooperate with other BMTs • Difficulty in accessing government funds • Difficulty in allocating financing fund: never, rarely, often. Problem of high withdrawals during June/July, holiday season and new school academic year
	Prob-capital	BPRS • Lack of capital: rarely provided linked programme, often having lack of capital, although there is linked programme with bank; however those funds required high return • Capital decreased by 50% in 2008 due to misuse of funds by the director • Problem in allocating the funds: never, rarely, sometimes on seasonal basis (*Ramadhan* and *Eid*)
	Prob-skill	Lack of staff skills BMT • No problem, however sometimes occurred BPRS • Sometimes, and often need to improve skills on how to decide the most appropriate contract (*akad*), financing analysis, computer skills, accounting and administration

Table 7.16c: Data Analysis for Research Question 2.5

Research Question 2.5	**How often do you face the problems?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
	Prob-pers	Lack of staff BMT • No problems in number of staff BPRS • Sometimes and rarely having lack of staff • Staff turnover is quite high
	Prob-facl	Lack of infrastructure BMT • No problem, sometimes, never • Computer often has errors BPRS: • No problem • Always problem: building, rooms, computers are not efficient • IT not online due to high cost • Rarely, most problems related to computer programme (financial software)
	Prob-busi	Inappropriate type of business organisation BMT • Regulations do not really support the development of BMT • The cooperative legal basis is not appropriate • No problem with cooperative legal base BPRS • The management positions not filled with enough staff; some positions are occupied by the same person
	Prob-others	Other problems BMT • Lack of *tabligh* (ability to do *dakwah*) and *fathonah* (clever/smart/intelligent) • Customers' honesty • Customers with bad behaviour (violence) • Many customers do not record or keep the financing documents • Society's perception: BMT = conventional • Misleading information (wrong news) about BMT in society • The customers did not report their financing problems explicitly • Errors and mistakes (inaccuracy) in bookkeeping • Suspicion from colleagues • Based on bad experiences (default and bankruptcy) with *mudharabah*, *mudharabah* is now neglected; prefer group (in an institution) financing • Problem and challenge to educate and develop the characters of customers

Table 7.16d: Data Analysis for Research Question 2.5

Research Question 2.5	**How often do you face the problems?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
	Prob-vehi	Lack of vehicles to reach borrowers BMT • Sometimes, there is no vehicle provided by BMT BPRS • Sometimes, rent staff motorcycles
	Prob-otherbmt	Problems of • BMT in the early days usually had problems of lack of discipline, lack of skill, and carelessness
Concluding theme	BMT and BPRS have some common problems, namely difficulty in assessing borrowers' financial flow, competition with conventional banks which offer micro financing, lack of capital particularly in seasonal circumstances, managerial problems due to improper management system, infrastructure problems mainly in computer and software-related issues, lack of personnel, lack of staff skills particularly in understanding the *Shari'ah* contracts, lack of vehicles to reach borrowers, inappropriate type of business legal basis as cooperative legal basis does not fully reflect the BMT character, and other problems such as lack of intelligence, customers' bad behaviour, high level of default *etc*.	

7.4.2.6. Lack of funds

The results from the analysis of interview data on the problem of lack of funds among Islamic microfinance institutions are presented in Table 7.17.

As the findings indicate, in general, some of the BMT/BPRS had problems with lack of funds, although some BMTs reported that they had no funding problems. Most of the interviewees stated that other Islamic microfinance institutions also experience the same problem. Lack of funds in BMT/BPRS may occur for various reasons, namely personal ownership, seasonal high fund withdrawals, funds management failures, and high financing demand. First, one interviewee reported that the personal ownership of a BMT is likely to bring financial problems, such as misuse of funds by the owner or manager for their personal purposes. The misuse of funds by the director was reported by one BPRS interviewee, who claimed that it resulted in deep financial problems in the institution. Second, as stated by some interviewees, there are seasonal fund withdrawals, such as during the fasting month (*Ramadhan)*, *Eid* celebration and when the new school academic year commences, usually in June. These are the times when the customers require a large amount of funds. Third, fund management failures might occur when the funds are not managed properly, including failing to exercise good control over funds, inability to obtain extra funds in urgent situations, and failing to attract public savings. One interviewee of BPRS stated that, compared to other conventional microfinance institutions that were able to provide interesting gifts and rewards for their customers, BPRS was lagging behind in providing such services due to the limited funds provided for this purpose. The interviewee also stated that offering the *Shari'ah*-based financing products was not interesting enough for the public, as they tend to be more interested in material benefits. Besides, another interviewee of BPRS stated that gathering public funds was not easy due to the central bank regulations, which limit the operational area of BPRS and the range of products that might be offered by BPRS to the public. Fourth, some interviewees claim to have high financing demands with insufficient available funds to cover the demand.

To handle these problems, most of the interviewees came up with similar solutions; these were to apply for funds through linkage programmes and build solid cooperation among similar Islamic microfinance institutions. However, the interviewees also stated that it was not easy to obtain funds through linkage programmes with Islamic Banks, as they have many requirements and some banks even require a quite high rate of return. Linkage programmes might also be built up with non-banks, such as PNM (Permodalan Nasional Madani, a government institution focusing on micro financing). Solid cooperation among similar Islamic microfinance institutions was also considered as a quick solution when an institution experiences funding problem, as a wealthier institution could provide funds for short-term purposes, which can usually be returned within a month. In general, the interviewees realised that the best solution was to gather public savings, as this is the cheapest fund, although it is a challenge to achieve this, as discussed above. A solution proposed by some interviewees was the interbank call, in which the *Shari'ah* microfinance institutions might enjoy the same pattern as the conventional banks. Unfortunately, such a facility does not exist for *Shari'ah* microfinance institutions.

Table 7.17: Data Analysis for Research Question 2.6

Research Question 2.6	**Would you consider that your organisation in particular and the microfinance institutions in general have experienced lack of funds?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
6	Fund-lack	Lack of funds caused by personal ownership, seasonal high fund withdrawals, fund management failure, and high financing demand
	Fund-handle	Linkage programme with Islamic banks and other financial institutions, good cooperation with similar *Shari'ah* microfinance institutions, gathering public fund and proposing interbank call
Concluding theme	In general, the Islamic microfinance institutions experience lack of funds problems, caused by personal ownership, seasonal high fund withdrawals, fund management failure, and high financing demand. To handle this problem, they usually get the funds through linkage programmes with Islamic banks and other financial institutions, building strong cooperation with similar *Shari'ah* microfinance institutions, gathering public funds and proposing interbank call, as usually applied among the conventional banks.	

7.4.2.7. Training for Staffs

With regards to 'training for staff', as the findings in Table 7.18 shows that training for staff was perceived important for all interviewees, as all of the interviewees provided training.

Table 7.18: Training for Staff

		BMT		**BPRS**		**Total**	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Trainings for staffs	Yes	12	100	9	100	21	100
	No	0	0	0	0	0	0
	Total	**12**	**100**	**9**	**100**	**21**	**100**

In addition, findings depicted in Table 7.19 shows the importance of training for BMTs and BPRS' staff. One interviewee of BMT even stated that the BMT provided a high amount of funding (IDR 300 million) per year for training; these funds must be fully allocated and usable in a year. The type of training provided by BMT and BPRS was quite similar, namely management, marketing, *Shari'ah* banking products, customer service excellence, general accounting, *Shari'ah* accounting, leadership, business development, taxation, *fiqh muamalah*, financing analysis, how to handle financing problems, and *rahn*. This training might be provided in the form of in-house training where the institutions invite trainers from other institutions, such as Islamic banks. The institutions also send the staff/managers for training provided by Islamic banks, such as BTN *Shari'ah*, Bank Muamalat Indonesia and other related institutions. Those institutions providing training for BMT were Islamic universities with *Shari'ah* departments (UIN Malang, Unair, UMM, Widyagama University), the Ministry of Cooperatives and Small and Medium-Sized Enterprises (Depkop), Dekopin, Microfin and Pinbuk. The training providers for BPRS were Asbisindo, the Central Bank, LPPI and Perbarindo. The information provided by the interviewees shows that the duration of the training varied, from just 2 hours to 3 days. The frequency of training provided also varied, from once a year to once a month.

Table 7.19: Data Analysis for Research Question 2.7

Research Question 2.7	**Trainings for staff** **- Have you provided training for officials in order to keep them updated with their knowledge and skills? ☐ Yes ☐ No** **- What training have you delivered?** **- How often do you provide training for your staff?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
7	Training	Yes, all of the interviewees provided training
	Traing-fund	BMT MMU provides Rp 300 million/year for training
	Traing-type	Management, marketing, *Shari'ah* banking products, customer service excellence, general accounting, *Shari'ah* accounting, leadership, business development, taxation, *fiqh muamalah*, financing analysis, how to handle financing problems, and rahn
	Traing-inst	Islamic banks, Depkop, Dekopin, Pinbuk, University, the Central Bank, LPPI, Asbisindo
	Traing-duration	1 day, 2 day, 3 days, 1 year
	Traing-times	Varied from once/year to once/month
Concluding theme	All of the respondents provided training for their staff and also for managerial level, such as: management, marketing, *Shari'ah* banking products, customer service excellence, general accounting, *Shari'ah* accounting, leadership, business development, taxation, *fiqh muamalah*, financing analysis, how to handle financing problems, and *rahn*. The training might be provided by Islamic banks, Depkop, Dekopin, Pinbuk, University, the Central Bank, LPPI, Asbisindo.	

7.4.3. Research Question 3: The financing and non-financing services provided by BMT and BPRS for developing MEs.

This subsection presents analysis on the provision of the financing and non-financing services for developing microenterprises through the data collected by interviews. Detailed analysis and discussion is provided in the following sections:

7.4.3.1 Financing Approaches

Table 7.20 shows that both group (59%) and individual (36.4%) financing approaches are adopted, and in most of the cases both approaches were employed. It should be noted that BMT interviewees prefer group financing (58.3%), while BPRS focuses more on the individual approach (80%).

Table 7.20: Financing Approach

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Financing approach	Group	7	58.3	1	10.0	8	36.4
	Individual	5	41.7	8	80.0	13	59.1
	Others	0	0	1	10.0	1	4.5
	Total	**12**	**100.0**	**10**	**100.0**	**22**	**100**

Table 7.21a shows the coding analysis of financing and non-financing services conducted by BMT and BPRS to develop microenterprises. As stated by the interviewees, the group approach might be applied to religious gatherings, businesses groups, groups of staff in certain institutions, groups of school teachers (for financing) and groups of students in schools, mostly primary schools (for group savings). However, the interviewees reported that not all of the groups applied joint responsibility; only three interviewees from BMT reported using joint responsibility, while the group approach was mostly utilised for socialisation and educational purposes, not for the group collateral. The BMT, which applies both approaches, normally utilises the individual approach when the customers' characters can be tracked directly through relatives and friends, or there may be an appropriate recommendation/reference from relatives, friends or work leaders/supervisors in certain urgent circumstances. The advantage of this individual approach is that it may

make it possible to observe directly whether the money is utilised appropriately/correctly as per the original intention.

The group-based approach is applied for various reasons, as articulated by a number of interviewees: (i) it assures safety for the BMT by preventing default since the contract (*akad*) is between BMT and the target institutions, not with the person directly; (ii) it is also more secure because the repayments are collected by the treasurer of the institutions by deducting the specific amount of repayments from monthly salaries, after which the BMT collects the money from the treasurer; (iii) it is easier to maintain since there is a group leader responsible for controlling the repayments of the group members; (iv) it embraces/involves the wider community from all types of societies.

On the other hand, the individual approach seems to be more favourable for some interviewees, based on the reasons stated by interviewees from BMT as follows: (i) it is easier to evaluate, monitor and control, particularly in terms of repayment; (ii) using a group-based approach which relies on the leader's/guarantor's recommendation might lead to the wrong financing decision, particularly when the real character of the recommended person is not as good as the guarantor's reference; (iii) as the customers are from the low-to-medium level of society, the individual approach is more appropriate for this level as the interviewees need to observe their capacity to repay; and (iv) the responsibility is more obvious and transparent when the financing is given individually. Moreover, the interviewees from BPRS also prefer the individual approach and they reported similar rationales, such as the following: (i) the risk of default might be reduced when the customers are more widely spread across a broader community; (ii) the equal distribution reasoning is likely to reduce the risks of default (iii) it is more effective and efficient due to direct relationships with the individual customers; (iv) the financing demands are more personal/individual than group-based, an approach which is also preferable to BPRS; (v) the individual responsibility is more obvious than the group responsibility; (vi) it is more difficult to manage group financing, since it requires longer to process the financing application and monitor the repayments; it also needs human resources who have the ability to handle group financing; thus, none of the interviewees' customers is group-based; and (vii) it is easier to handle personal financing and offer the financing products individually, and the interviewees can observe more details about the customers' characters and capabilities.

Table 7.21: Data Analysis for Research Question 3.1. Financing approach

Research Question 3.1	What type of Financing approach have you applied? ☐ Group ☐ Individual ☐ Others, please specify Why do you choose that approach?	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Appr-group	BMT/BPRS (i) it assures safety for the BMT because the contract is between BMT and the institution (ii) it is also more secure because the repayments are collected by the treasurers of the institutions (iii) there is a group leader who are responsible for controlling the repayments of the group members (iv) it embraces/involves the wider community from all types of societies
	Appr-indv	BMT (i) it is easier to evaluate, monitor and control (ii) guarantor recommendation might lead to the wrong financing decision, particularly if there is an incorrect reference (iii) the customers are from the low/medium level of society (iv) the responsibility is more obvious and transparent BPRS (i) reducing the risk of default by having broader customer base and equal distribution to all society (ii) it is more effective and efficient (iv) the financing demands are more personal/individual rather than group-based (v) the individual responsibility is more obvious than group responsibility (vi) it is more difficult to manage group financing (vii) it is easier to handle personal financing
Concluding theme	The group and individual approaches are common approaches applied by both BMT and BPRS, although most BMT/BPRS prefer individual approach due to its simple evaluation and monitoring. Group approach is mostly conducted with no joint responsibility, and applied when BMT/BPRS have contracts with groups of people in certain institutions.	

7.4.3.2. Financing Products

As regards to financing products available, Table 7.22 shows that the most popular product was reported as *murabahah* (86.4%), due to its simple and easy procedure compared to other financing products, followed by *qard hasan* (9.1%).

Table 7.22: The Financing Products

		BMT		BPRS		Total	
		Freq.	Percent	Freq.	Percent	Freq.	Percent
The most popular Financing product	Musharakah	0	0	0	0.0	0	0.0
	Mudharabah	0	0	0	0.0	0	0.0
	Bai'bitsaman ajil	1	8.3	0	0.0	1	4.5
	Murabahah	10	83.3	9	90.0	19	86.4
	Ijarah	0	0	0	0.0	0	0.0
	Salam	0	0	0	0.0	0	0.0
	Qard Hasan	1	8.3	1	10.0	2	9.1
	Total	**12**	**100.**	**10**	**100**	**22**	**100**

Table 7.23, 7.24a and 7.24b show the findings on how the financing and non-financing services are conducted by BMT/BPRS. Based on the interview results, the most popular mode of financing is *murabahah*, as presented in Table 7.22, followed by *qard hasan* and *bai'bitsaman ajil*.

Three interviewees stated various reasons for the popularity of *murabahah*. First, this is the simplest and easiest financing mode to manage and explain to the customers since it is based on the margin set by the institutions above the purchase price. Hence, the customer is likely to have a better understanding of this product as compared to other products. Second, the customers, who mostly have low levels of education, prefer this product due to its simplicity in calculation and further repayment procedure. This is a sell-and-purchase contract; hence, they do not need to provide annual financial reports as required by the profit- and loss-sharing financing (*mudharabah* and *musharakah*). Third, there is a very high demand for this financing product, much higher than other products. Fourth, the instalments are clearly set up in the beginning and are fixed throughout the financing period; hence, the costumers are likely to feel secure knowing the exact amount they must allocate each month for repayment instalments. Fifth, from the bankers' perspective, it is also the safest mode but is still *Shari'ah*-based, since the risk is lower as compared to profit- and loss-sharing financing. An interviewee from a BMT who had default experience in the past stated that, in the case of *mudharabah* of *musharakah*, customer bankruptcy is troublesome and creates the risk of losing the funds. Sixth, it is in some ways similar to conventional financing products: the products are well known and are familiar to most of the customers and public.

Murabahah could be used for productive and consumptive purposes, as reported by the interviewees. However, an interviewee from a highly reputed BMT stated that all items required in *murabahah* were for productive purposes, and none were used with consumptive intentions; otherwise the financing application was likely to be refused. In this case, the most suitable types of financing were *mudharabah* or *musharakah*; however, due to the complexity of profit- and loss-sharing calculations and repayment procedures which require regular financial reports declaring the profits obtained over certain periods, the customers are likely to avoid them. Examples of items purchased for productive purposes include sewing machines, Land Rover engines, wood and other materials for furniture as the customer's main business was furniture production, working tools, ovens, meatball carts/wagons, motorcycles for taxi services, and small goats to be raised and sold when they grow bigger. Items bought for consumptive purposes might include laptops/notebooks, motorcycles, and electronic goods; these were generally in high demand and were very popular among the customers.

In terms of the operational aspects of *murabahah*, the interviewees stated that, in most cases, the BMT/BPRS bought the items required by the customers from the suppliers' who had partnerships with the institutions. Then, the items were distributed to the customers. However, in some cases the customers received cash instead of products, as articulated by the interviewees, which they called *wakalah*. Hence, the BMT/BPRS deputised or authorised the customers to buy the items themselves due to the difficulty of purchasing the specific products, such as when the merchandise was sold by small traders in traditional markets (*e.g*. vegetables, traditional food materials, chickens, daily essential goods *etc*). Then, the customers paid the instalments as stated in the pre-agreed contracts. An interviewee from a small BMT stated that discounts were sometimes offered to encourage the customers to pay instalments as scheduled; this ensured the cash flow and guaranteed repayment.

Besides having *murabahah* as the most common product, the above interviewees also provided *qard hasan, mudharabah, musharakah* and other products. An interviewee from a mosque-based BMT reported having good cooperation with YDSF (Zakah Fund Foundation) in distributing *zakah* funds to the needy for productive purposes based on pure *qard hasan* financing repayment in full as the original amount of financing. However, this BMT had difficulty in collecting the funds and experienced defaults as some customer did not repay the money. Another interviewee from a rural BMT reported good experience and achievements dealing with *qard hasan* financing. The BMT started the programme in 2009 to educate a group of female small traders in a weekly religious gathering by offering weekly voluntary savings without specifying a particular amount. Then, *qard hasan* financing was gradually introduced, allowing the group members to have financing of between IDR 250,000 and IDR 500,000 to be utilised for productive purposes (small trading) and to be paid back in weekly instalments in around a year. The weekly savings continued, and the instalments were paid separately. As identified by the interviewees, this mode has been sustained over the last 3 years, gaining more groups with around 80 members.

It should be noted that in the implementation of this particular mode, there was no joint responsibility among members, and financing was provided on an individual basis. According to the information gathered, it is likely that the key success of such a programme depends on maintaining routine meetings with members; thus, the institutions are able to monitor the customers' repayment performance. Despite the success achieved by one BMT in the sample, some of the interviewees articulated that they did not have charity and *qard hasan* funds. Hence, based on the interview results, it seems that the function of *baitul maal* has not been operating fully or has been to some extent neglected by BMTs, although some of them are mosque-based institutions.

The *qard hasan* financing was also offered by BPRS, mostly to the needy, although it may sometimes be distributed to employees in amounts between IDR 500,000 and IDR 1,000,000, which should be returned between 3 to 5 months. However, the application of *qard hasan* may appear surprising, as one interviewee stated that it was applied for *hajj* (pilgrimage) financing, since the customers required temporary loans to pay a large amount to book a secure seat for the *hajj* organised by the government. In fact, there is a long waiting list for the *hajj*; therefore, anyone wanting to go on the hajj has to secure a place, which could be anytime over the next 5 years. These short-term *hajj* loans were provided by some institutions using *qard hasan* funds. In this case, the demand inspired some creativity in utilising *Shari'ah* contracts. This interviewee also stated that *qard* for productive purposes did not exist. Another interviewee reported that *qard* could also be offered or distributed to customers who had financing problems for rescheduling purposes; the maximum amount offered was IDR 5 millions.

Other products offered were *ijarah, salam, murabahah* and *musharakah.* An interviewee from BPRS reported that *musharakah* financing was mostly utilised for working capital, such as providing funds for customers who won procurement competitions in an institution, with the bank then receiving a certain percentage of profit-sharing. *Musharakah* had been distributed to school cooperatives to develop their businesses, as stated by one interviewee; however, this product had been discontinued. A problem pointed out by some interviewees in relation to *musharakah* and *mudharabah* was lack of honesty among customers. Therefore, some interviewees stated that they were not planning to offer or develop these products. During the interviews, it was revealed that *ijarah* was utilised for wedding ceremonies and educational purposes.

Some interviewees reported that *qard hasan* was the most popular financing product. According to information gathered from an interviewee from BPRS, *qard hassan* is considered an easy, simple and quick procedure, as no collateral is required for financing of less than IDR 2,5 millions, and the cash can be used for any purpose, while there is only a one-page contract. Further, an interviewee explained that the financial contract utilised in this product was *ujroh* (charging an administration fee); therefore it is also called multi-service financing. This interviewee started to offer this product in 2010, and it has since produced an adequate amount of profit and attracted large numbers of customers, becoming a favourite product of both customers and institution. As explained by the interviewee, to be eligible to apply for this product, an applicant must be a good, long-term, loyal customer with a good savings and financing record. It is likely that the other BPRS offer a similar product due to its simplicity, and because it offers potentially high profits and low risk. This product was created due to the strong competition with a number of conventional banks that have entered the micro market in the last 5 years. This product appeared an interesting product for customers; it is *Shari'ah*-based, competitive and attractive.

Table 7.23: Financing Products

<table>
<tr><td>Research Question 3.2</td><td colspan="2">Financing product:
Please rank the popularity of the following modes of financing product in your institution (1 is the most popular, 5 is less popular) :
_____Musharakah
_____Mudharabah
_____Bai'bitsaman ajil
_____Murabahah
_____Ijarah
_____Salam
_____Qard Hasan
In your opinion, why is it the most popular mode?
For PLS-based, what is the share of the profit ratio with the clients (bank : clients) ?
☐ 40: 50 ☐ 50 : 50 ☐ 60 : 40 ☐ Others :………………….</td></tr>
<tr><td>Focused Coding</td><td>1st Level Coding</td><td>Sub-Themes/Remarks</td></tr>
<tr><td>1</td><td>Prod-mura</td><td>Prod-mura-easy</td></tr>
<tr><td></td><td></td><td>Prod-mura-simple</td></tr>
<tr><td></td><td></td><td>Prod-mura-dema</td></tr>
<tr><td></td><td></td><td>Prod-mura-clear</td></tr>
<tr><td></td><td></td><td>Prod-mura-safe</td></tr>
<tr><td></td><td></td><td>Prod-mura-conv</td></tr>
<tr><td></td><td></td><td>Prod-mura-prod</td></tr>
<tr><td></td><td></td><td>Prod-mura-cons</td></tr>
<tr><td></td><td></td><td>Prod-mura-mang</td></tr>
<tr><td></td><td></td><td>Prod-qard-bmt</td></tr>
<tr><td></td><td></td><td>Prod-qard-bprs</td></tr>
<tr><td></td><td></td><td>Prod-mudha-musya</td></tr>
<tr><td></td><td></td><td>Prod-ijar</td></tr>
<tr><td></td><td>Prod-qard-most</td><td></td></tr>
<tr><td></td><td>Prod-ratio</td><td></td></tr>
</table>

Table 7.24a and 7.24b explains further the reasons behind the popularity of each product.

Table 7.24a: Data Analysis for Research Question 3.2. Popular Financing Mode

Research Question 3.2	Financing product: Please rank the popularity of the following modes of financing product in your institutions (1 is the most popular, 5 is less popular) : _____Musharakah _____Mudharabah _____Bai'bitsaman ajil _____Murabahah _____Ijarah _____Salam _____Qard Hasan In your opinion, why is it the most popular mode?	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Prod-mura	The most popular product
	Prod-mura-easy	Easiest to manage and explain to the customers
	Prod-mura-simple	Simplicity in calculation and further repayment procedure
	Prod-mura-dema	Demand is higher than other financing modes
	Prod-mura-clear	Fixed and clear instalments
	Prod-mura-safe	The safest mode, low risk, but still *Shari'ah*-based
	Prod-mura-conv	Similar to the conventional banking financing products
	Prod-mura-prod	To buy productive items, such as sewing machines, Land Rover engines, wood and other materials for furniture when the customer's main business was furniture production, working tools, ovens, meatball carts/wagons, motorcycles for taxi services and small goats to be raised and sold as they get bigger
	Prod-mura-cons	To buy goods in high popular demand, such as laptops/notebooks, motorcycles and electronic goods.
	Prod-mura-mang	BMT/BPRS bought the required items and distributed them to the customers. Otherwise, customers received cash instead of products (*wakalah)* for certain items, such as merchandise sold by small traders in traditional markets. Then, the customers paid fixed instalments
	Prod-qard-bmt	Cooperate with *Zakah* Fund Foundation to distribute *zakah* funds for productive purposes, although some customers did not repay Good experience in successful *qard hasan* based on a women's weekly religious gathering, combining weekly voluntary savings and small financing for productive purpose No *qard hasan*.
	Prod-qard-bprs	Distributed to the needy, also to employees, at amounts between IDR 500,000 and IDR 1,000,000 It was also applied for temporary short-term loans for *hajj* No *qard* for productive purposes existed *Qard* for rescheduling of problematic financing, maximum IDR 5 millions
	Prod-mudha-musya	*Musharakah* for working capital Lack of honesty by customers BMT/BPRS are reluctant to offer these products (according to the interviewees)
	Prod-ijar	*Ijarah* was utilised for wedding ceremony and education purposes

Table 7.24b: Data Analysis for Research Question 3.2. Popular Financing Mode

Research Question 3.2	Financing product: Please rank the popularity of the following modes of financing product in your institutions (1 is the most popular, 5 is less popular) : _____Musharakah _____Mudharabah _____Bai'bitsaman ajil _____Murabahah _____Ijarah _____Salam _____Qard Hasan In your opinion, why is it the most popular mode?	
	Prod-qard-most	*Qard Hassan* (multi-purpose service based on *ujroh* contract) is new, attractive and competitive product as it is an easy, simple, quick procedure, no collateral is required for financing of less than IDR 2,5 millions, the cash can be used for any purposes, and there is only a one-page contract
Concluding theme	The most popular financing is *murabahah* due to its simplicity, high demand and safety reasons. It is followed by *qard hasan*, *mudharabah*, *musharakah*, *ijarah* and *salam*. Other than common application of *qard* for the needy, *qard hasan* is also applied in newly developed products called multi-services. It is a competitive product and attractive to customers, and is also applied for short-term loans for *hajj* (pilgrimage).	

7.4.3.3. Ratio of Profit and Loss Sharing

In general, as shown in Table 7.25, the profit share ratio between banks and customers is mostly applied on a personal case-by-case basis (36.4%), followed by 60:40 (31.8%) and 40:60 (27.3%). However, the common ratio varies between BMT and BPRS, at 60:40 (41.7%) and 40:60 (40%) respectively. Thus, it seems that BMT have imposed higher share for institutions than BPRS. On average, the financing duration was longer in BPRS than in BMT: the maximum duration of financing was 34.42 months for BMT and 33.60 months for BPRS; minimum durations were 2.95 months (BMT) and 5.3 months (BPRS); the average durations were 16.42 months (BMT) and 18 months (BPRS).

Table 7.25: Profit Ratio Share

		BMT		**BPRS**		**Total**	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Profit ratio share	40:60	2	16.7%	4	40.0%	6	27.3%
	50:50	0	0.0%	1	10.0%	1	4.5%
	60:40	5	41.7%	2	20.0%	7	31.8%
	Others	5	41.7%	3	30.0%	8	36.4%
	Total	**12**	**100.0%**	**10**	**100.0%**	**22**	**100.0%**
Duration of the loan (months) (N and mean value)	Maximum	12	34.42	10	33.60	22	34.01
	Minimum	12	2.95	10	5.30	22	4.13
	Average	12	16.42	10	18.00	22	17.21
	Total N	12		10		22	

Further interview results on ratios of profit- and loss-sharing are presented in Table 7.26. The ratio varies according to each institution, and might be decided on a case-by-case basis, 40:60 and 60:40. Some interviewees stated that the fixed ratio could not be applied for profit and sharing financing as it is against the *Shari'ah*. Hence, the ratios are calculated and evaluated on an individual basis, as they vary according to business productivity, the customers' ability to manage funds, gross profit and net profit. Thus, the determination of ratios was a case-by-case process as ratios are negotiated after considering and analysing all the above aspects; as a result, the ratio can be 40:60, 25:75, 70:30, 45:55, *etc*. There is no fixed standard ratio, as stated by the interviewees, and the reference for the BMT profitability is the margin of the usual selling and purchase price. An interviewee from BPRS stated that, as it is decided case by case, the ratio might be 20:80, on condition that the bank made a profit from this PLS-based financing. For this product, a financial report is required; therefore, only larger enterprises that can provide financial reports might negotiate for this product. The interviewee also reported that the same condition was offered to micro and small enterprises, but they refused to provide financial reports. Other interviewees reported having ratios of 40:60 and 60:40. Based on the interview results, it seems that the ratio-sharing of BMT is lower than the ratio-sharing offered by BPRS.

Table 7.26: Data Analysis for Research Question 3.2. Ratio of Profit and Loss Sharing

Research Question 3.2	Financing product: For PLS-based, what is the share profit ratio with the clients (bank : clients) ? ☐ 40: 60 ☐ 50 : 50 ☐ 60 : 40 ☐ Others :………………….	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Ratio-other	Case-by-case calculation and negotiation
	Ratio-40:60	Profit sharing is 40% for the bank and 60% for the customers
	Ratio-50:50	None
	Ratio-60:40	Profit sharing is 60% for the bank and 40% for the customers
Concluding theme	The ratio varies by institution; some decide the ratio on an individual basis after analysing all related aspects while some have standard ratio sharing of 40:60 and 60:40.	

7.4.3.4. Financing Evaluation and Repayment

The findings related as to how the interviewees conducted the financing evaluation and repayment are shown in Table 7.27. Generally, the financing evaluation is based on a number of criteria: 27.9% of the interviews stated annual revenue, collateral owned (25%), credit limit (16.2%), other criteria (16.2%) and number of workers (14.7%). In terms of loan application purposes, all interviewees admitted that they know the original financing purposes.

As the findings in Table 7.27 shows, on average, 3 days are required for the interviewees to evaluate the financing requests, although it could sometimes take only 2 days (8.3%) 6 days (in BMT) or even 1 day (20%) in BPRS. Monthly repayment (52.4%) seems to be the most common repayment for both types of institutions, followed by daily (23.8%), weekly (11.9%) and bi-weekly repayments (7.1%). The repayment rate appeared to be very high in general (above 90%), although it varied in the last five years.

Table 7.27: Financing Evaluation and Repayment

		BMT		BPRS		TOTAL	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Criteria to give loan (respondents might answer more than one)	Assets owned (collateral)	9	25.7	8	24.2	17	25.0
	Annual revenue	11	31.4	8	24.2	19	27.9
	Number of workers	5	14.3	5	15.2	10	14.7
	Credit limit	6	17.1	5	15.2	11	16.2
	Others	4	11.4	7	21.2	11	16.2
	Total	**35**	**100**	**33**	**100**	**68**	**100**
Do you know the purposes of loan application?	Yes	12	100	10	100	22	100
	No	0	0	0	0	0	0
	Total	**12**	**100**	**10**	**100**	**22**	**100**
Time required to evaluate the credit request	1 day	0	0.0	2	20.0	2	9.1
	2 days	1	8.3	0	0.0	1	4.5
	3 days	8	66.7	6	60.0	14	63.6
	4 days	0	0.0	1	10.0	1	4.5
	5 days	1	8.3	1	10.0	2	9.1
	6 days	2	16.7	0	0.0	2	9.1
	Total	**12**	**100**	**10**	**100**	**22**	**100**
	Mean	3.58		2.90			
Collection of repayment (respondents may answer more than one)	Everyday	6	23.1	4	25.0	10	23.8
	Every week	4	15.4	1	6.3	5	11.9
	Every two weeks	3	11.5	0	0.0	3	7.1
	Every month	12	46.2	10	62.5	22	52.4
	Others	1	3.8	1	6.3	2	4.8
	Total	**26**	**100**	**16**	**100**	**42**	**100**
Repayment rate in percentage (N and mean value)	2007	8	89.75	6	96.54	14	93.15
	2008	9	92.61	8	90.25	17	91.43
	2009	9	92.32	8	89.03	17	90.68
	2010	11	91.43	9	90.39	20	90.91
	2011	11	92.90	10	89.99	21	91.45

Table 7.28a and Table 7.28b show the coding analysis on loan evaluation. The general financing evaluation process started with the submission of the completed financing application form along with the required administrative documents, which might include a copy of an ID card (sometimes both husband and wife), a copy of the family card *etc*. A mosque-based BMT providing mostly group financing for employees of certain institutions stated that other documents are required, such as a report for the last 6 months; for school procurement financing, annual reports for the last 2 years are required.

Then, as most of the interviewees reported, an interview and an on-the-spot survey are conducted to check the correctness of the information on the form. The interviewees stated that the survey focuses more on the business performance/feasibility, how busy the enterprise is, assets owned, number of family members under the applicant's responsibility, personal references and, possibly, the applicant's religious life. After that, the complete application is forwarded to the relevant person for approval, which depends on the size of the financing application, which varies at each institution. An interviewee of BPRS reported that financing of less than IDR 10 millions required approval from the head of the marketing department, and for between IDR 10 millions and IDR 20 millions it required the director's approval. Financing above IDR 30 must be approved by the commissioner; while another BPRS has a IDR 50 millions financing limit to be approved by the commissioner. A different threshold is set by BMT, as an interviewee reported that, for financing of more than IDR 25 millions, approval from the local BMT association is necessary. An interviewee of BMT stated that the maximum limit for financing is IDR 25 millions. Obviously, as reported by the interviewees, the higher the financing, the tougher the financing evaluation has been conducted in order to prevent unexpected defaults.

Generally, there is some common ground in terms of how BMT and BPRS conducted financing evaluations, in that they apply conventional financing evaluations based on the 5 Cs, namely character, capital, capacity, collateral and condition, as revealed by nearly all the interviewees. An interviewee of BMT further explained that applicants should also have been operating their businesses for more than 3 months. As part of a group of Islamic microfinance institutions owned by a large Islamic boarding school, this BMT provides further enlightenment on the relationship between BMT and BPRS in the same group environment, in that the BPRS, as a bank, acts as a benchmark for what the bank does and what BMT should do. In this case, BMT would like to manage and maintain operations in the same way that the bank operates, in terms of more professional accounting, administration *etc*; however, at the same time they maintain cooperative approaches to customers, which is a more ‘humanist’ approach than a bank. An interviewee from a successful BPRS reported that the evaluation process for multi-service financing products is conducted by an Accounts Officer in a simple process. However, some technical aspects are required for evaluation of *mudharabah* and *murabahah*, such as economic, marketing, collateral, and business performance (5Cs), although the most important criterion is considered as character.

Based on the interviewees’ statements, it should be noted that, among others, character seems to be the most important factor in financing evaluations, followed by capacity, which refers to the adequacy of annual income to repay the loan. Character was evaluated based on reference or personal guarantee, as most interviewees from BMT and BPRS emphasised the importance of references from friends, colleagues, relatives, neighbourhood, managers or even local religious leaders (*ulama)* who live in the surrounding areas. Hence, references or personal guarantors are essential for financing approval, as articulated by most all interviewees. This reference provides insightful information on the trustworthiness of a certain customer. An interviewee of a BMT that is now focusing on group financing stated that, because of previous bad default experiences, the Accounts Officer’s evaluation is still insufficient even though he has been trained to assess the customer’s character; hence, personal references are compulsory. Considering the importance of the personal reference, a survey is sometimes not necessary when there is a personal guarantor, as explained by an interviewee of BMT.

The characters of existing customers might also be traced from the frequency of savings deposits (savings track record), as admitted by an interviewee of a BPRS; this institution has a much-favoured multi-service product, and it relies on this indication as assets collateral is not required for financing below ID 2,5 millions. An interviewee from a BMT operating in a traditional market in the middle of a city reported that character is evaluated through daily observation as the Accounts Officer meets customers daily in the market to collecting savings and repayments. Accounts Officers are the ones who directly and regularly meet with the customers; therefore, they are well trained in how to assess the customers' characters and behaviour, as articulated by some interviewees. Some interviewees who provide group financing stated that it is sometimes easier to evaluate group financing as the character guarantee is provided by the manager of the customer's office and repayments are collected through salary deductions by the treasurer, which are then forwarded to the BMT/BPRS monthly; hence they could be considered low-risk.

Capital and capacity often refer to annual or monthly income, which is essential for financing evaluation as BMT/BPRS would like to reduce the risks of default. The importance of all these measurement is emphasised by an interviewee of the biggest BMT, who stated strongly that, without these two measurements, namely character and capacity, it is impossible to approve a financing application. An interviewee of BPRS further explained that there is also a certain pattern of evaluation based on the type of business, in which micro enterprises usually obtained 10% profit/day. He also added that most of the customers obtained financing from more than one bank. The challenge in tracking the capacity is to ascertain the customers' cash flow, as most customers do not have proper bookkeeping and cash flow records. Hence, this requires the banks to carefully examine the applicants' raw cash flow data.

Overall, collateral is required by all BMT and BPRS as an essential part of the evaluation requirements. This varies by type of financing institution, size of the financing, income and number of employees, as articulated by an interviewee of BPRS. Besides, the amount of collateral is adjustable based on customer capacity and the BMT/BPRS requirements. However, for small financing under a certain threshold, collateral could be waived. For example, an interviewee of BMT has a threshold of IDR 500,000, equal to GBP 35, while an interviewee of BPRS has IDR 2.5 millions as the threshold. An interviewee of BMT, which rely mostly on group financing, stated that collateral is not usually required as repayments are deducted directly from customers' monthly salaries by the treasurer; hence, the collateral is the monthly/annual income. Collateral might be necessary when the customers purchase a motorcycle; in such cases, the BMT holds the certificate until the financing is fully repaid.

Another form of collateral is savings, as articulated by an interviewee of a BMT operating in a traditional market. A financing applicant is required to have had savings for a minimum of 3 months. This savings track record provides necessary information on customer capability, habitual attitude and discipline to save and repay the loan, as the amount one saves is the excess after daily living costs. The interviewee is usually required to provide around 40% savings as collateral. The amount of daily savings is voluntary, sometimes negotiable, and is on average IDR 15,000/day. In addition, to apply for financing, one must be a BMT member, providing a copy of ID, opening a savings account and regularly saving the voluntary amount, a minimum of IDR 5,000/day. A statement by an interviewee from a mosque-based BMT illustrated that this has the same pattern as the previous BMT in using savings as part of the collateral. In addition, he also obtains suggestions from the *zakah* foundation, which is in the same environment, on who deserves to receive financing.

A new screening criterion, which provides a unique insight, is the application of *Shari'ah* screening, where the business activities and the products/services must be *halal* and *Shari'ah*-compliant, as some interviewees stated. An interviewee from a mature, well-established BMT admitted that, in addition to 5Cs, an S (*Shari'ah*) is added; thus, the new formula becomes 5C+S.

An interviewee of BPRS provided an example from the past, when the financing application for wig (artificial hair extension) production had been approved by the marketing team; however, when the application was forwarded to the director, this application could not be approved since wig production is not a *halal* activity. Another example of the importance of *Shari'ah* compliance was provided by an interviewee of BPRS; some cases in the past had involved non-*Shari'ah*-compliant businesses, the products sold were not *halal*, the person's behaviour was not good, *riba* was applied *etc*. Thus, in this case, the *Shari'ah* screening is mostly based on the use of funds in the business, not the application of *Shari'ah* in personal daily life.

Complementary to the above evaluation, the database provided by the Central Bank (commonly called Bank Indonesia checking) is also useful for obtaining information on the financing track records of the applicants. However, it took time to obtain data from the affiliated Islamic bank, as these data could not be accessed online directly by the BMT.

Finally, employment is unlikely to be important in financing evaluations, as articulated by some interviewees. However, two interviewees of BPRS reported considering the number of employees as part of the evaluation process.

Table 7.28a: Data Analysis for Research Question 3.3. Financing Evaluation

Research Question 3.3	Loan evaluation How do you evaluate clients before distributing loans to them? What are your criteria to give loans? ☐ Assets owned (collateral) ☐ Annual revenue ☐ Number of labourers ☐ Credit limit ☐ Others	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Eval-proc	Process • Application form and completeness of administrative requirements • Interview and survey • Approval from certain relevant person in authority
	Eval-5C	Character, capital, capacity, collateral and condition • All institutions use 5C • Business must have been operating for a minimum of 3 months • Simple evaluation for very small financing • Tougher evaluation for larger financing
	Eval-char	Character • Considered the most important factor • Based on reference or personal guarantee and direct observation by Accounts Officers
	Eval-save	Savings as character and collateral evidence • Savings track record is necessary • Savings must be around 40% of financing
	Eval-capa	Capital and capacity • Important to examine cash flow
	Eval-collat	Collateral • The amount varied by type of institutions and size of financing. • No collateral for small financing
	Eval-halal	*Shari'ah* screening • The business and products/services sold must be *halal*.

Table 7.28b: Data Analysis for Research Question 3.3. Financing Evaluation

Research Question 3.3	Loan evaluation How do you evaluate clients before distributing loans to them? What are your criteria to give loans? ☐ Assets owned (collateral) ☐ Annual revenue ☐ Number of labourers ☐ Credit limit ☐ Others	
	Eval-BIcheck	Bank Indonesia checking • Additional information on credit track record provided by central bank
	Eval-empl	Number of employees • Considered not really important in evaluation
Concluding remark	The process of financing evaluation started with submission of administrative documents, followed by interview, survey and references to obtain further information on the customers' character and capability, then forwarded to certain person for approval. All institutions use 5C, emphasising the importance of trustworthy character and capability to repay. Collateral is required but can be waived for very small financing. Savings is also considered as collateral and character evidence. There is a unique evaluation that differs from conventional, that is *Shari'ah* screening, in which the business activities and products must be *halal*. Additional information to track the creditworthiness is the Central Bank checking.	

7.4.3.5. Strategies to Reduce Non-Performing Financing

Non-performing loan is known to be a major problem in micro financing, which, is, therefore, is also explored in this section. Table 7.29a and Table 7.29b show coding analysis of strategies to reduce non-performing financing and to improve the repayments.

Overall, based on information provided by the interviewees, the non-performing financing (NPF) rate is around 5% of the total financing; however, some interviewees reported a higher NPF. Interviewees of very reputable BMTs reported having an average 5% NPF mostly due to customers' inability to repay as a result of business failures. He further explained that the customers' problems are the BMTs' problems too; hence, BMTs should help customers. The lesson learnt from these cases is the need for accurate financing evaluations. The average NPF of 5% was also reported by another interviewee from BMT, who further explained that, out of 300 customers, only between 2 and 5 did not repay. An interviewee of BMT reported an NPF of only 2% in the last 4 years, which was due to the customer's inability to repay the IDR 20 millions loan and the damage caused by the purchase of an item bought through the financing fund in the amount of IDR 7 millions.

Other interviewees reported a high NPF, reached 20%; however, it was stated that this high rate was declining year by year, which indicates a good improvement. An interviewee of BPRS provided detailed information on NPF; it increased gradually from 2007 to 2010 due to fierce competition from other banks. He also pointed out other problems related to repayments, such as the limited number of Accounts Officers available to handle the repayment collection, resulting in some new Accounts Officers being recruited. Another interviewee from a BPRS, which was still struggling to recover from its harsh financial problems caused by the misuse of funds by a previous director in 2008, reported that the NPF in 2009 was 32%, which is considered very high. Then, the NPF was reduced to 26% in 2010 and 21% in 2010. To mitigate this high NPF, he further asserted that some actions have been taken, such as appointing a new director in 2009 with the mission to resolve the previous financing problems, adding new capital and aiming to reduce NPL to 10% in 2011.

To prevent the occurrence of NPF, the financing evaluation process must be improved and the real intention behind the financing must be correctly observed, as stated by some interviewees. An interviewee of a BMT operating in a 'traditional' local market stated that NPF mostly occurred due to poor financing evaluation; financing applications were approved for customers who did not deserve to obtain financing, or customers obtained financing beyond their ability to manage the funds. Another interviewee of BPRS also emphasised the importance of conducting qualified financing analysis to prevent NPF. The real intention must be correctly observed; hence, any possibility of NPF could be predicted, as articulated by an interviewee of BPRS in a suburban area. Customers with bad financing track records must be placed on a blacklist with the aim of improving capital and repayment rates, as strongly stated by an interviewee of a BMT in a traditional market. An interviewee of BPRS also added that BPRS should manage a good and healthy financing coordination among all staff and customers, in which financing can only be approved for good customers who can cooperate with the bank. An anticipation of NPF might also be conducted by monitoring customers with 'call 1' (customers with repayment delays for a certain duration) in their financing reports, as reported by a BPRS in the city centre. An alternative way of preventing NPF is to ask for assets collateral for high-risk applications, as experienced by an interviewee of BMT.

When customers have unexpected NPF, in general all interviewees resolve this problem by using intensive monitoring and collection. Monitoring financing records is necessary to locate customers with potential problems. An interviewee of BMT reported that a regular monthly monitoring organised on the 24th of each month, in which all the staff focus on collection of repayments; as there were only 3 staff members, and therefore the director was stated being directly involved in collection. All the interviewees reported applying the common stages including phone calls, distributing warning letters in three stages from 1st warning to 3rd warning, direct visits to homes/premises and, finally, confiscation. An interviewee of BMT stated that, when confiscation in necessary, the BMT and the customer sell the item together; the funds received are partly used to repay the loan, and any excess funds are given to the customer. Another small BMT stated that, following the phone calls, the Accounts Officer visits the customer for *silaturahim* (informal gathering/meeting) and collection but, in such an approach, Accounts Officer never forces the customer to pay. As a result, customers come voluntarily to the BMT office to repay after the visit. Another interviewee reported calling the customer before the maturity date; hence, any potential late payment can be avoided. Moreover, intensive routine collections, warnings and compromising when the customers offer to sell collateral was reported by an interviewee of BMT. Direct visits for collection are conducted when the delay in repayment goes beyond 90 days, as articulated by an interviewee of BMT.

The interviewees of BPRS made similar comments: routine and intensive collection by phone, warning letters, direct visits and sale of the collateral if necessary. An interviewee of BPRS reported referring to a customer’s worksheet to monitor the meeting between the Accounts Officer and the customer; such reports and visits are useful to detect and monitor the actual use of the funds. A specific team was set up in a BPRS with the tasks of making routine weekly collections, writing and sending warning letters, making direct visits to customers, and carrying out confiscations, as reported by interviewees. An interviewee of BPRS stated that, when there is no good response from the customer in regard to repaying, the director directly visits the customer. From this visit, he can investigate whether there had been any deliberate intention not to repay; if there is, sanctions were, then, imposed. An interviewee of BPRS also emphasised the importance of effective collection by phone calls and direct visits. In addition, it is necessary to resolve previous financing problems first before resolving new cases, as articulated by an interviewee of BPRS.

The personal approach seems to be the most common approach used when there are NPF cases, as reported by nearly all interviewees. An interviewee of BMT /BPRS believed that a persuasive and intense personal approach is the key to solving financing problems, together with a religious approach and routine collections. The personal approach might also be conducted together with group leader, treasurer, head of school *etc.* Maintaining good relationships through *silaturahim* is also important, as stated by an interviewee. Besides, by maintaining a good personal approach, the real intention of financing can be assessed; hence, if there is an indication of negligence, collateral can be obligatory from the beginning.

Of other approaches, rescheduling and restructuring might be pointed out when necessary, as some interviewees of BMT and BPRS believed this might be the best solution in some cases. Rescheduling means extending the duration, while restructuring means setting up a lower margin for BMT. The best solution is determined on a case-by-case basis.

The last option for resolving financing problems is to write off the debt by utilising a prepared fund in a specific account (DP3/Dana Penghapusan Piutang) and a *zakah* fund, as some interviewees reported. This specific fund is prepared for use in cases of default; however, this fund is sometimes not fully absorbed, as stated by an interviewee of a well-established BMT. He further commented that BMT educates customers to pay on time through religious approaches. Such approaches have been heavily operated in this BMT due to its strong religious background. This interviewee believes that: “When we help others, then God (Allah) will help us; when we are honest to others, then others will also be honest to us; when we deceive others, then others will also deceive us”. Further, he asserts that no staff members are allowed to accept bribery; if the customers want to pay *sadaqah* (charity) after obtaining funds, there is a charity box provided in the office for distribution to other charity institutions. Hence, this is considered as an evidence of honesty. Moreover, no BMT staff or customers are allowed to betray/defraud each other.

In order to prevent fraud, after the staff distributes the financing funds directly to the customers, they pray (recite *du'a*) together with the customers; considering that the fund is *amanah* (trust), it is expected that this *amanah* will be honourably utilised. He further illustrated that the fund is like a useful 'hook' to develop customers' businesses. An interviewee from a mosque-based BMT reported that the *zakah* fund is used to write off the debt, if necessary.

In addition, as articulated by an interviewee of BPRS, other approaches to reduce NPF might include providing marketable financing products, good quality of services, quick financing process and good negotiation skills. Another interviewee of BPRS stated that, thus far, there has been no national arbitrage body to help BPRS when there are defaults in financing, and no binding with civil law in cases of dispute in Islamic microfinance; hence, this BPRS never exercises its right in district court. An interviewee reported that, when this problem occurs, the BPRS applies for more financing funds.

Table 7.29a: Data Analysis for Research Question 3.4. Strategies to Improve Collection Rate

Research Question 3.4	**What are your strategies to improve collection rate?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Coll-NPF	Non-performing financing • Average NPF of 5%/year • NPF can be higher in some institutions • Reasons for not repaying: customers' inability due to business failures • Increased NPF is due to tight competition with other banks
	Coll-prev	Prevention of non-performing loan (NPF) • Improvement of financing evaluation • The real intention of financing must be correctly observed. • Blacklist of customers with bad financing track records
	Coll-inte	Intensive monitoring and collection • Monitoring of repayment records • Stages: warning letters, phone calls, direct collection from premises, confiscation
	Coll-pers	Personal approach • Persuasive personal approach combined with religious approach • Through group leader/treasurer/head of school or individual • Maintain *silaturahim* (informal gathering/meeting)
	Coll-resc	Rescheduling • Extend the duration

Table 7.29b: Data Analysis for Research Question 3.4. Strategies to Improve Collection Rate

Research Question 3.4	**What are your strategies to improve collection rate?**	
	Coll-rest	Restructuring • Reduce the margin
	Coll-off	Writing off • Using specific fund in certain account (account receivable writing off fund) • Using *zakah* fund
	Coll-other	Other approaches to reduce NPF • Marketable financing products • Good quality of services • Quick process • Good negotiation skills • There is no National arbitrage body, no binding with civil law, BPRS never uses its right in district court • Propose to get more funds for financing
Concluding theme	NPF mostly occurs due to business failures. To reduce NPF, the efforts made by BMT/BPRS are preventing NPV based on improvement of financing evaluation, intensive monitoring and collection, persuasive personal and religious approach, rescheduling, restructuring, writing off and implementing other approaches.	

7.4.3.6. Social Development Programme/Services

The findings from the interview data provided by BMTs and BPRS in relation to in relation to social services are shown in Table 7.30. Generally, the most common service was 'consultancy services', which are usually conducted by the Accounts Officers when they visit the customers for collection of repayments. This is followed by 'religious training related to business ethics' (22%), 'marketing services' in the form of providing networking among customers (16%), 'management training' (8%), 'technical training' (4%) and 'no social services' (2%).

Table 7.30: Social Services

		BMT		**BPRS**		**Total**	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Social services (respondents might answer more than one)	Management training	3	10.00	1	5.00	4	8.00
	Technical training	2	6.67	0	0.00	2	4.00
	Marketing	4	13.33	4	20.00	8	16.00
	Consultancy services	10	33.33	12	60.00	22	44.00
	Religious training related to business ethics	8	26.67	3	15.00	11	22.00
	No social services development programme	1	3.33	0	0.00	1	2.00
	Others	2	6.67	0	0.00	2	4.00
	Total	30	100	20	100	50	100

Table 7.31a and Table 7.31b show social development services provided by BMTs and BPRS. As can be seen from Table 7.30, overall the number of social development services delivered to customers is limited. An interviewee of BMT reported providing entrepreneurship training in the past, but this is not provided currently. An interviewee of BPRS expressed his intention to provide management training, as he is also a *Shari'ah* trainer. However, there is no proper room for training in the office due to its small size. Consultation, mostly provided by Accounts Officers, seems to be the most popular development service, as most of the interviewees admitted. This may be due to the close relationship between Accounts Officers and the customers, as they meet everyday; hence, they often discuss their business problems to obtain possible solutions/suggestions. An interviewee of BMT even reported that, when the customers wish to apply for higher financing that is beyond the BMT's ability to provide (as the limit of financing in this BMT is IDR 3 millions), they consult BMT on this intention to obtain their comments and suggestions. Besides, religious meetings are common social services, as part of the culture in the local community is to have regular gatherings. Marketing services are conducted by promoting network building amongst members, as reported by some interviewees. Therefore, it is expected that such a cooperation and synergy would improve customers' businesses.

Table 7.31a: Data Analysis for Research Question 3.5. Social Development Services

Research Question 3.5	What type of enterprise and social development services do you provide to customers (borrowers/microenterprises)? (you may choose more than one option) ☐ Management training (organisational management and bookkeeping *etc*) ☐ Technical training (production process, *etc*) ☐ Marketing ☐ Consultancy services ☐ Religious training related to business ethics ☐ No social services development programme ☐ Others:……………………	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Soci-mana	Management training • Entrepreneurship training • There is intention, but there is no proper room in the office
	Soci-tect	Technical training

Table 7.31b: Data Analysis for Research Question 3.5. Social Development Services

Research Question 3.5	What type of enterprise and social development services do you provide to customers (borrowers/microenterprises)? (you may choose more than one option) ☐ Management training (organisational management and bookkeeping *etc*) ☐ Technical training (production process, *etc*) ☐ Marketing ☐ Consultancy services ☐ Religious training related to business ethics ☐ No social services development programme ☐ Others:……………………	
	Soci-mark	Marketing • Promoting networking amongst customers, usually facilitated by Accounts Officers • Promoting to build synergy and cooperation amongst customers.
	Soci-cons	Consultation • Consultation mostly provided by Accounts Officers. • Consultation on business problems, simple solutions are suggested, sometimes through religious meetings.
	Soci-reli	Religious • Regular religious meetings
	Soci-no	No social services
	Soci-other	
Concluding theme	The most popular services are religious meetings, consultation on business problems provided by Accounts Officers, and promoting networking amongst customers.	

7.4.4. Research Question 4: Maintaining relationship between BMT, BPRS and MEs

The analysis of interviewees' responses on how BMT/BPRS maintain relationships with their clients is reported in Table 7.32a and Table 7.32b The responses were classified into two focus-coding groups: how they broaden their outreach and how they maintain relationships with their existing customers.

Table 7.32a: Data Analysis for Research Question 4

Research Question 4	**How have the relationships between BMT, BPRS and microenterprises been maintained?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Rel-out-new	BMT/BPRS open new branches/cash payment points/outlets to reach new customers and to get closer to the existing customers
	Rel-out-market	BMT/BPRS conduct marketing approach to other institutions, community leaders, *etc*
	Rel-out-ref	BMT/BPRS approach is to get references from community leaders, existing good customers and to get new customers
	Rel-out-custnet	BMT/BPRS create networking among members

Table 7.32b: Data Analysis for Research Question 4

Research Question 4	**How have the relationships between BMT, BPRS and microenterprises been maintained?**	
2	Rel-client-visit	BMT/BPRS directly visit customers
	Rel-client-relimeet	BMT/BPRS arrange routine religious meetings with their customers
	Rel-client-gift	BMT/BPRS provide gifts to their customers
	Rel-client-annualevent	BMT/BPRS arrange routine annual/biannual events to meet their customers
	Rel-client-social	BMT/BPRS provide social services to orphans
	Rel-client-goodservice	BMT/BPRS always try to offer the best services
	Rel-client-personappr	BMT/BPRS maintain personal approach by taking up their customers' invitations on special events/occasions
Concluding theme	To broaden their outreach, BMT/BPRS conduct efforts to get new customers by opening new branch(es)/cash payment office(s)/outlets, marketing their products and services through personal approach to other institutions *(e.g.* schools, local government offices) and community leaders, continuing to get recommendation/references on new customers from existing good customers, and creating networking among members. To maintain relationships with their customers, BMT/BPRS are actively directly visiting and maintaining friendship/*silaturahim* with their customers, arranging routine religious meetings, distributing gifts to customers, arranging annual events, providing social services to orphans, offering the best services and maintaining personal approach by accepting customers' invitations to special events.	

Table 7.32a and Table 7.32b show the coded data analysis based on the interview responses on how BMT/BPRS have broadened their outreach. First, in general, BMT/BPRS have opened or plan to open new branch(es)/cash payment point(s)/outlet(s), depending on their businesses development requirements. A newly-opened branch must be located in another town/city, according to the Central Bank's regulations for BPRS. Opening a new cash payment point is easier and simpler than opening a new branch, since the procedures and infrastructure requirements are less complicated. The requirement to open new branches imposed on BMTs is more flexible, since they do not come under the Central Bank's regulation. Second, BMT/BPRS have undertaken marketing processes through personal approaches, such as personal approaches to teachers in schools, local (village) government offices and local community leaders, and by distributing brochures to the public. Third, to reach new customers, BMT/BPRS have managed to stay in touch with their existing customers and community leaders to obtain their references/recommendations on new customers. This recommendation is necessary to ensure that new customers are trustworthy. Lastly, BMTs and BPRS have created

networking among their customers; hence, the customers' businesses can be developed faster by improving collaboration among them.

As articulated by the interviewees, BMTs and BPRS have sufficient awareness of the importance of maintaining relationships with their customers; therefore, certain actions are taken, which are, as reported, as follows:

First, most of the BMTs and BPRS, through the Accounts Officers, directly visited (*silaturahim*/informal gathering) in their houses or their places of business. The aim of these visits is to get closer to them; thus, should the customers have problems to discuss, Accounts Officers will be able to provide alternative solutions.

Second, BMT/BPRS have conducted routine and regular religious meetings to discuss various themes including motivation to maintain good financing track records, business topics, children's education, psychology and health; these meetings have been held in mosques, in BMT/BPRS offices or in their customers' homes, with the aims of meeting members directly and supporting their businesses.

Third, gifts were distributed to customers, particularly depositors and good financing customers. These are tokens of appreciation from the institution to their good, loyal customers and are intended to motivate the customers to continue their relationships with BMTs and BPRS.

Fourth, routine events (annual, biannual and quarterly) have been conducted in the form of annual members' meetings, celebrations of institutions' anniversaries, *Ramadhan* fasting breaks and *Eid Fitr* celebrations. In these events, certain activities were arranged, such as religious speeches. Fifth, social activities were also arranged to support those customers in need, such as selling cheap, subsidised groceries and giving funds to orphans through *zakah* distributions.

Sixth, provision of the highest-quality services to their customers cannot be neglected, as this is the core of relationship maintenance. Lastly, BMTs and BPRS always accept the customers' invitations to special events/occasions, such as religious meetings, weddings and funerals *etc*.

7.4.5. Research Question 5: Exploring the role of BMT and BPRS in economic development

The role of BMTs and BPRS in economic development from the institutional perspectives is analysed in this subsection; as grass-roots organisations, they are expected to contribute to capacity development on the periphery. The descriptive analysis is shown in Table 7.33, while the coding analysis of interviewees' responses is shown in Table 7.34. The responses were classified into two focus-coding groups; whether they observed any change in the individual lives of their customers after financing and any change in society. The details are as follows:

Table 7.33: Observation of Development after Financing

		BMT		BPRS		Total	
		Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
Have you observed any change in individual life after the borrower completed the process?	Yes	11	91.7	7	77.8	18	85.7
	No	1	8.3	2	22.2	3	14.3
	Total	**12**	**100.0**	**9**	**100**	**21**	100.0
Do you observe any development in the society due to the positive activities of Islamic Microfinance Institutions?	Yes	7	58.4	6	66.7	11	57.8
	No	5	41.6	3	33.3	8	42.2
	Total	**12**	**100.0**	**9**	**100.0**	**19**	100.0

Table 7.33 shows that the majority of the interviewees (85.7% in total) reported observing changes in the lives of the customers after financing. As the breakdown in the table indicates, the percentages reporting a change are 91.7% in the case of BMT and 77.8% in the case of BPRS. BMT appears to be having more developmental consequences than BPRS. In substantiating this finding, interview analysis is also utilised: more that half of the interviewees (57.8% in total) also reported that they observed community development resulting from the positive activities of BMTs and BPRS.

The coding analysis of the role of the BMTs and BPRS in economic development is shown in Table 7.34a and 7.34b. The impacts of BMTs and BPRS on the economic development of the borrowers are easier to observe than the impact on society in general, since the institutions maintain direct and close contacts with their customers. A number of indicators were used to determine the impact:

First, as reported by the interviewees, it was easy and straightforward to note the development of the customers' business incomes. These are monitored by Accounts Officers when they regularly visit the customers directly in their places of business or their homes to collect repayments and daily savings. In addition, in some institutions, the monitoring process is recorded on Customer Visiting Forms (Lembar Kunjungan Nasabah), which are used to track each customer's business improvement in detail from time to time.

Second, it is also monitored from the improvement of products sold, other assets in their shops and their harvests. The improvements vary from case to case: some can achieve great improvement while others have to come to terms with average improvement. Unfortunately, when the customers' businesses improve, they sometimes move to other banks.

Third, another indicator is the improvement in savings, which are not withdrawn on *Eid*, thus indicating that the customers have enough funds to pay for the *Eid* celebration.

Fourth, Accounts Officers also monitor the businesses' development through the improvement of financing track record and the ability to complete repayments on time, after which they apply for a new, higher amount of financing. The customers with improved businesses are usually those of good character, who follow the bank's suggestions. On the basis of their businesses' improvement, the customers may be offered higher financing.

Fifth, another indicator of the positive impact was the institutional success in limiting the role of moneylenders. The customers who were under pressure from moneylenders in the past are now in a better situation; they are free from moneylenders and are able to develop their businesses in a better environment.

Sixth, as reported by the interviewed officers, the customers' transportation tools have improved, from bicycles to motorcycles, which have a positive impact on their mobility and hence contribute to their economic activities. Seventh, by utilising the financing funds, customers can meet their production targets, which can be difficult to achieve without financing. Hence, in general, their quality of life has gradually improved.

However, despite such positive changes were observed, some interviewees admitted the difficulty of observing the impact on borrowers. The impact could not be seen easily, because their customers lived in areas far from the interviewees' offices. The financing amount is also just a small amount compared to the total funds required for the business. Thus, for the business owner, the financing received from the *Shari'ah* micro financing institutions was just a small supporting fund. In fact, the interviewees realised the importance of impact monitoring of the borrowers after financing; but due to the limited number of staff, this process could not be conducted. However, in some cases, the customers told the account officers about their business improvement after financing, which was useful for helping the interviewees to observe the impact in general.

As mentioned above, observing the impact on micro financing in society is a difficult and complicated matter; hence, the interviewees briefly explained the general conditions based on the following indicators. First, the institution helped society through distribution of *zakah* funds. Second, the institutions noticed that the power of moneylenders was gradually eliminated, leaving society free from the pressures exerted by moneylenders. Third, the customers might enjoy a new service (bill payment centre) based on automatic debits to pay school tuition fees and electricity, water and phone bills *etc*. Fourth, society is beginning to trust and use *Shari'ah* micro financing institutions' services to pay household monthly bills and utilise other services (savings). Fifth, the awareness of *Shari'ah* financing has improved, which was made possible through routine religious meetings, *silaturahim* and other forms of socialisation, in mosques or in other places. Thus, as customers change their mindsets, they choose to obtain financing from the *Shari'ah* microfinance institutions rather than from the conventional ones. As society gains a better understanding of *Shari'ah*, people will move their funds to the *Shari'ah* microfinance institutions. However, some interviewees stated that it was difficult to observe the impact on society, as this could not be seen directly. It is also difficult to observe, since there are far more conventional micro financing institutions than *Shari'ah* institutions.

Table 7.34a: Data Analysis for Research Question 5

Research Question 5	**What is the role of BMT and BPRS in economic development?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Role-borr-yes	Role-borr-dev
		Roll-borr-free
		Roll-borr-vehicle
		Role-borr-target
	Role-borr-no	Role-borr-difficult
		Role-borr-limit
2	Role-soc-yes	Role-soc-help
		Role-soc-free
		Role-soc-service
		Role-soc-trust
		Role-soc-aware
		Role-soc-move
	Role-soc-no	Role-soc-difficult

Research Question 5	**What is the role of BMT and BPRS in economic development?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
1	Role-borr-yes	
	Role-borr-dev	Positive role in economic development based on the direct observation of the development of the customers' businesses, income, savings and assets
	Roll-borr-free	The customers who were under moneylenders' pressures now have a better situation, free from moneylenders, and can develop their businesses.
	Roll-borr-vehicle	The customers' transportation tools have been improved, from bicycles to motorcycles
	Role-borr-target	By utilising the financing fund, customers could meet their production targets
	Role-borr-no	
	Role-borr-difficult	The impact could not be seen easily
	Role-borr-limit	The institution realises the need for impact monitoring; however due to limited number of staff, this process could not be conducted properly
2	Role-soc-yes	
	Role-soc-help	The institution helps society through distribution of *zakah* funds
	Role-soc-free	Moneylenders' power/influences are eliminated/reduced, society is now freed gradually from moneylenders' pressures
	Role-soc-service	The customers might enjoy a new service (bill payment centre) based on the automatic debit account, e.g. school tuition fees payment, electricity bills, phone bills *etc*

Table 7.34b: Data Analysis for Research Question 5

Research Question 5	**What is the role of BMT and BPRS in economic development?**	
Focused Coding	**1st Level Coding**	**Sub-Themes/Remarks**
	Role-soc-trust	Society is starting to trust and use *Shari'ah* micro financing institutions' services to pay the household monthly bills and other services (savings)
	Role-soc-aware	The awareness of *Shari'ah* financing is higher, built through religious meetings, *silaturahim* and other forms of socialisation, in mosques or in other places Then, as they change their mindsets, they choose to get financing from *Shari'ah* rather than conventional institutions
	Role-soc-move	Society has a better understanding of *Shari'ah* and people move their funds to the *Shari'ah* microfinance institutions
	Role-soc-no	
	Role-soc-difficult	The impact on society could not be seen directly, it is difficult to observe since the number of conventional micro financing institutions is greater than the *Shari'ah* institutions
Concluding theme	BMT and BPRS have made a positive contribution to economic development for both borrowers and society. The contribution to the borrowers is observed directly through the business development, income, savings, assets, improvement of transportation vehicles and the ability to meet the production targets. However, some interviewees stated that, although they realise the importance of impact observation, the contribution could not be seen easily and the institutions have staff limitations. The role in society's economic development is not obvious as compared to the borrowers' development. However, positive contributions are noticed through reducing the influence of moneylenders, helping society using *zakah* fund, provision of new services (bill payment center), improvement of awareness of *Shari'ah*-based financing, improvement of trust in the *Shari'ah* micro financing institutions and transferring the funds to *Shari'ah* microfinance institutions. It should also be noted that there are more conventional micro financing institutions than *Shari'ah* ones; thus the impact on society is difficult to observe.	

7.5. CONCLUSION

This chapter presents the analysis of data assembled through face-to-face interviews with twenty-two directors/managers of BMTs and BPRS regarding their perception of the actual issues in the prospects of BMTs and BPRS, their role in economic development, businesses problems, provision of financing and non-financing services to MEs and maintaining the relationships with customers. The aim of the chapter is to complement the quantitative analysis method presented in the previous two empirical chapters.

In terms of prospects, both institutions are likely to have good prospects; however, there are some challenges, particularly competition with other financial institutions that provide

Shari'ah micro financing. In addition, MEs also have good prospects, although many need financial support and empowerment actions by both government and other related institutions.

The actual issues in the field include clients' lack of understanding of the Islamic terms used in financing products, collateral requirements in all BMTs and BPRS for financing above a certain threshold, seasonal high fund withdrawals, high risk of default mostly due to customers' financial problems, risk of dealing with badly behaving customers, and moderate consideration of the development of new products. The business problems experienced by BMTs and BPRS are mostly due to difficulty in assessing borrowers' financial flows, managerial problems, competition and lack of capital. The provision of training has been fulfilled by all BMT/BPRS, ranging from management training to technical training, such as training on *Shari'ah* banking products, accounting, customer services excellence *etc*.

The financing approach is mostly based on the individual approach with *murabahah* as the most popular product. In terms of financing evaluation, all BMTs and BPRS have record of the original intended use of funds. The most popular evaluation criteria are annual revenue/income and collateral together with wide use of 5Cs, with the addition of a new criterion of *halal* or *Shari'ah*-based business, emphasising the importance of trustworthy character and ability to repay. On average, three days are required for financing evaluations, and most customers repaid monthly. To reduce non-performance financing, BMT/BPRS focus on preventing this from happening, intensive monitoring and collection based on the personal approach, rescheduling and restructuring, writing off and other approaches. Non-financing services are also provided by BMTs and BPRS: religious meetings are the most popular service, followed by consultations with Accounts Officers and promoting networking amongst customers.

In the effort to broaden their outreach, BMTs and BPRS prefer to open new branch(es) or cash payment office(s)/outlet(s) and market their products through personal approaches to other institutions and community leaders. In order to maintain relationships with the customers, BMT/BPRS actively maintain good friendships and directly visit the customers. Other related activities are conducted, such as routine religious meetings, distributing gifts to customers, arranging annual events *etc*.

Although it is not an easy task to assess the economic impact, BMTs and BPRS believe that they contribute to local economic development by supporting microenterprises' development in terms of improving their incomes, savings, assets, transportation vehicles and the ability to reach production targets. In addition, their role in local society includes reducing the influence of moneylenders, providing bill payment centres and improving trust in and awareness of *Shari'ah*-based financing.

Chapter 8
CONTEXTUALISING THE FINDINGS: AN INTERPRETATIVE DISCUSSION

8.1. INTRODUCTION

This chapter aims to contextualise the findings of this study, which are presented in the empirical chapters (Chapters 6 and 7), and also aims to locate the findings within the existing body of knowledge as presented in the foundational chapters (Chapters 2 to 4) but also within the larger body of literature. The interpretative approach adopted in this chapter aims, therefore, to present an integrated discussion with the intention of deriving further meaning by linking all those findings together, hence providing a broader understanding of the issues. This chapter also specifically discusses the gap analysis between two main literature resources of this research, namely 'Financing Microenterprises' by Ahmed (2002) and 'Islamic Microfinance in Indonesia' by Seibel (2008).

As it is a discussion chapter, the organisation of this chapter is based on the research questions set out in the introductory chapter (Chapter 1); it starts with an introduction, discusses the findings, identifies the contribution of the research by contextualising the existing literature, and ends with a conclusion.

8.2. SUMMARISING AND REFLECTING ON THE FINDINGS

The discussion presented in this section focuses on the eight research questions, which are related to the potential and prospects of BMT, BPRS and MEs, their major issues and problems, the financing services and non-financing-related services provided for developing MEs, the perceptions of MEs towards the financing and non-financing services provided by BMT and BPRS and, finally, the role of BMT and BPRS in economic development, including their economic and social impacts. The summary of the findings within these categories obtained by both quantitative and qualitative analysis is presented in Appendix 8.1.

8.2.1. Research Question 1: The Potential and Prospects of BMT, BPRS and MEs

This section discusses the potential and prospects of BMT, BPRS and MEs through the institutional perspective; it is based mainly on the findings from interviews with BMT and BPRS. In general, despite the fact that the competition between Islamic microfinance institutions and other conventional financial institutions has been more challenging, this research has found that BMT and BPRS have good prospects and are able to support the development of MEs, particularly by providing financial access.

Previously, the entry of conventional banking into the microfinance market was driven by the great potential of this market, mainly due to the large number of MEs in Indonesia; these accounted for more than 95% of total number of businesses in 2008 as compared to the SMEs and large enterprises (see Table 4.1). However, there are no regulations on protecting microfinance institutions, particularly BMT, as revealed by the interview findings (Table 7.1). While BPRS are under the Bank Indonesia's regulations, supervision and monitoring, BMT have experienced harder circumstances, in which proper regulation and supervision by the Cooperative and SME Ministry was not established until 8 January 2013 (Government Act. No.1/2013 on Microfinance Institution, which will be applied in 2015).

Another challenge revealed by this research is the difficulty of promoting Islamic financing products in a society that mainly has a conventional banking mindset. Hence, efforts by all parts of society will be required to overcome this challenge, since it is not the responsibility of BMT and BPRS alone to educate society. Thus far, nationwide socialisation through audiovisual media has only been heavily conducted during the holy month of *Ramadhan*, and has been largely dismissed during the other eleven months. This type of socialisation will not be effective, as it is easy for society to forget the information obtained during this short timeframe.

Similarly, MEs are also considered to have good prospects due to their potential in terms of numbers and capability, considering that they are looking for financial access/support and empowerment programmes, as discovered by this research. In this case, the government has made substantial efforts to support the development of MEs, particularly through programmes under the Ministry of Cooperatives and SMEs, as has been discussed in detail in Chapter 4 (see section 4.5.1). The potential business prospects are also admitted by MSMEs in the Bank of Indonesia survey (2007), particularly for businesses in individual/household services; hence, they are making business expansion plans (Ascarya and Sanrego, 2007: 16).

8.2.2. Research Question 2: The Major Issues and Problems of BMT, BPRS and MEs

This section elaborates the findings on major issues and problems of BMT, BPRS and MEs from the customers' perspective (quantitative analysis) and the institutional perspective (qualitative analysis).

8.2.2.1. MEs Perspectives

This section focuses on quantitative findings, including problems of MEs, level of understanding, intention of borrowing, collateral and arrears.

(i) Problems of Microenterprises

The problems of MEs discussed in this section include five types of business problems: production, financial, bookkeeping, management and marketing problems. The findings suggest that financial problems are likely to be the toughest problems (Table 6.7). Financial problems are most likely to be found among respondents in urban areas, BMT respondents, employees in government-owned companies and businesses with between 11 and 20 workers in total, as can be seen in Table 6.34.

Overall, the findings reveal that the respondents who have the most problems are living in urban areas; this may be a result of the tough business environment and the fact that there are more businesses challenges in urban areas compared to rural areas. In relation to type of financing sources, it is indicated that the BMT clients have more financial problems than the BPRS respondents, a problem that may be rooted in their lower economic background. However, the clients of BPRS experienced more marketing problems than BMT respondents, which may be attributed to the larger size of their businesses, which is likely to lead to greater marketing challenges. In general, the respondents who have other income sources as employees in government-owned companies have the most problems, except for those with management problems. A possible reason for this may be the long working hours and tough working environment in government-owned companies, which limits the time they are able to allocate to managing their businesses.

Moreover, the field of business is significantly related to some problems, such as: (a) production problems are faced by food production businesses, (b) management problems are faced by transportation businesses, and (c) marketing problems are faced by agricultural businesses.

Business age is also significantly related to production and bookkeeping problems, as respondents with businesses aged between 41 and 50 years faced the most problems. This may indicate that having long years of experience does not significantly reduce the problems as, despite the rapid improvements in technology and new production methods, old businesses may fail to respond to these improvements. It may also indicate that old businesses are likely to have low awareness of the importance of maintaining proper bookkeeping. In addition, the total number of workers in a business is significantly related to production, financial and management problems. It is highly likely that having between 11 and 20 workers will cause financial problems, as the manager/owner must prepare a proper cash flow and funds for salaries and other employee benefits. This may lead to management problems, as the challenge of managing the above high number of workers is not easy, compared to managing a smaller number of workers.

As compared to previous research, it is likely that the financial problems faced by MEs are commonly recognised, as the Bank Indonesia (2007) survey also reveals that the main source of MSMEs' capital is their owned capital and additional capital from family and friends, when bank loans are limited (Ascarya and Sanrego, 2007: 9). This indicates that there is a potential demand for microfinance in the market. MEs in particular will appreciate wider financing access, while microfinance will also challenge financial institutions to serve this potential demand.

Concerning marketing problems, the reason why a large majority of respondents claim ‘never’ to have marketing problems, as can be seen in Table 6.7, may be the fact that most of the respondents (61%) are in retail businesses and operate their businesses from home (39%). In other words, MEs are likely to sell their products in local markets through individual sales; hence, marketing is not part of their concern in selling their products, as also reported by Ascarya and Sanrego (2007: 10). In addition, Ascarya and Sanrego (2007: 11) also indicates that marketing assistance is only needed by a small percentage of MSMEs (22.4%).

(ii) Level of Understanding of Islamic Terms Used in Financing Products

In general, the findings on the level of understanding show a very low level, as more than 84% respondents have a poor understanding of the Islamic terms used (see: Table 6.14), except for the popular term *riba*, of which only 30% of the customers had a poor understanding. The findings of a study by Seibel (2008) based on a survey conducted around the year 2000 suggest that only 11% of respondents living in provinces with a 97% Muslim population understand the benefit of *Shari’ah* banking. Hence, compared to previous research, the percentage of respondents with a good level of understanding in this research could be considered slightly higher, thus indicating an improvement. However, the finding of Seibel indicates that there is a gap between needs and knowledge of *Shari’ah* banking products (Seibel, 2008). Another study in West Java reveals that a majority of respondents have a low level of understanding of the Islamic concept in the BMT products, as 41% of the respondents claimed a poor knowledge of *Shari’ah*, 47% of the respondents ‘knew nothing about *Shari’ah*’, and 12% stated that they knew about the BMT system (Widyaningrum, 2002: 78). Similarly, a survey in Bandung, West Java, found that, in general, the respondents did not understand the Islamic banking products, with the percentages of those not understanding and understanding as follows: *murabahah* (73%:27%), *mudharabah* (8%:91%), *musyarakah* (86%:14%), and *ijarah* (86%:14%) (Masyita, 2011: 16).

The same question was put to the Directors/Managers of BMT and BPRS in this study. The findings show a substantial difference; while most of the respondents admit they do not understand the Islamic terms, the institutions believe that 50% of the customers get to know the terms after obtaining sufficient explanation during the financing application process. This gap may reflect an excessively high level of confidence among the institutions in assuming that the customers fully absorb the information given by the institutions. This misleading assumption may lead to a disregard for the importance of more thorough socialisation and promotional/educational activities.

Overall, this study established that it is likely that female respondents are more knowledgeable, possibly because they are more active in religious gatherings, usually weekly Islamic circles. It should also be noted that teachers/lecturers have amongst the lowest levels of understanding of little-known Islamic terms. This may be a result of the spread of secularism among the middle class, who do not have any interest in Islamic banking terms that are not related to their businesses.

(iii) Intention of Borrowing

The findings in this study, as depicted in Table 6.44, show that 23.6% of the respondents changed the actual use of funds; instead of using them only as working capital, as set out in the financing agreement, the funds are used for both working capital and consumption purposes. It should be noted that the change in the use of funds occurs because cash is given instead of goods, a reality that seems to contradict real *Shari'ah*-based financing, due to technical problems and difficulties in applying the Islamic financing perfectly; this was also noted in previous research (Ahmed, 2002: 40). This tendency may be caused by the economic/financial instability of the MEs; in some cases, there are urgent expenses that have to be paid immediately, such as school tuition for children, health expenses, repayment of financing from other sources, *etc* (see section 6.7.5). In addition, 22% of the respondents, who plan to use the funds for fixed capital as originally intended, change the actual use to both fixed and working capital. This may imply that working capital is more important than fixed capital for MEs. On the other hand, it was also noted that the customers who apply for consumptive purposes do not actually use the funds entirely for such purposes, rather, they invest part of the funds for productive purposes, although the percentage of borrowers who do so is very small. This is a good indication that the MEs are highly inclined to use the funds productively.

A significant relationship between 'change of use of fund' and type of micro financing source has been found in this research, in which the respondents from BMT are more likely to change the use of funds compared to BPRS respondents (see: Table 6.45). A possible reason for this may be the general character of BMT respondents, who are likely to require more flexibility in using the funds, as compared to BPRS respondents, who are in a better economic condition, having more mature businesses and more discipline in utilising the funds for productive purposes.

The interview findings confirm this change or misuse of funds, which is perhaps mainly caused by unpredicted bad behaviour by customers and unforeseen financial difficulties (see section 7.4.2). In general, BMT and BPRS have maintained good relationships with their customers; hence, mitigating this issue should not be very difficult. The Account Officers could monitor the use of funds based on their daily/monthly observations while visiting the customers to collect repayments and savings. However, it seems that they do not pay real attention to this problem, since timely repayments are more important than monitoring the use of funds. In addition, the findings indicate that only a small percentage of respondents have arrears, while the interview findings suggest a high repayment rate. Hence, this indicates that, although the respondents change the actual use of funds, they are able to maintain good and timely repayments as scheduled.

This issue has been addressed in previous research in Bangladesh by Ahmed (2002: 41), through a field survey of three IsMFIs found that 12% of the respondents in one institution had misused the funds for consumption purposes. However, the findings also reveal that the officers were aware of this occurrence and did not consider it a serious problem, since it was mitigated by the joint responsibility of both husband and wife, who signed the contract together (Ahmed, 2002: 42); the same solution and mitigation applied in BMT and BPRS. Related to this finding, Paul and Mosley (1998) and Zaman (2004: 12) points out that poorer households are more likely to use larger portion of the fund for consumption purposes, compared to non-poor households.

Similarly, a survey of both conventional and Islamic MFIs in Bandung, West Java, by Masyita (2011: 14) suggests that the respondents used the funds for working capital and fixed assets (50%), working capital only (23%), fixed assets (14%) and consumption (13%). Although the latter study does not provide information and analysis on whether there were changes in the use of funds, it can be assumed that, considering the percentage of consumption intentions, some of the respondents needed cash financing for consumptive purposes.

Furthermore, in relation to decision-making on using the funds, Ahmed (2002: 43) points out that males are the main decision-makers and users of the funds (determined from the hours spend in business activities). This finding is contrary to the findings of this research, in which 77% of the respondents (the total number of respondents is balanced between males and females) are the decision-makers in terms of how to use the funds (see: Table 6.16). Moreover, the users of the funds are largely the respondents (63.5%), followed by spouses (21.8%) (see: Table 6.27). This may indicate that the respondents in this research are more independent in both decision-making and using the funds, as compared to the previous research.

It should also be noted that the respondents of this research (and the customers of BMT and BPRS in general) are not predominantly female. Unlike the Islamic MFIs in Bangladesh, BMT and BPRS are not specifically oriented to female customers; they treat males and females as equal and tend to target the family rather than females. Targeting women as recipients often occurs in conventional microfinance with the aim of empowering women. In some cases, however, males are behind the financing applications; they force women to obtain credit but then often use it themselves, which is likely to lead to tensions in the family (Ahmed, 2002: 30). Although Islam encourages the targeting of families rather than specifically women (Obaidullah, 2008; Ahmed, 2002), the predominance of women as customers still occurs in other Islamic microfinance institutions in other Asian countries, such as Bangladesh (Ahmed, 2002: 34). Therefore, this research may indicate that BMT and BPRS have done well in terms of family targeting.

(iv) Collateral

Provision of collateral is necessary for financing above a certain small threshold, and all the interviewees agree on this issue (see section 7.4.3.4). This is also confirmed from the customers' perspectives, as almost all of the respondents admitted that the amount of the collateral should be higher than that of the financing (Table 6.16). This might be acceptable since BMT and BPRS need a security back-up when there is a potential for default and the previous bad experience of high default rate really affects how they operate now (see section 7.4.2.3). However, this heavy dependence on collateral seems to contradict the underlying model of mosque-based BMT. Does it imply that there is a low level of trust in the members/customers, and that being a mosque-based and community-based organisation does not necessarily mean having sufficient trust in their community members?

A good model has been produced by some BMT, which require savings as collateral, a strategy that seems to be able to reduce the default rate (see section 7.4.2.2). Further research on this aspect may be worth undertaking, particularly on how to create a model of collateral substitution, such as creating a national credit guarantee board complemented by a savings guarantee board specifically for Islamic microfinance institutions. This form of protection might also contribute to the further rapid development of the Islamic microfinance industry. Similarly, the Bank Indonesia survey (2007) emphasises that 'the most needed' action to smoothen financing access for MSEs is the establishment of underwriting institutions that act as credit guarantors for collateral substitution (Ascarya and Yumanita, 2007: 16). It should be noted that such institutions have been operating successfully in Turkey (Obaidullah, 2008a: 30).

(v) Arrears

The findings suggest that almost a quarter of the respondents experienced being in arrears, which was mainly due to business failures and distress/urgent consumption needs (Table 6.17). There was a significant finding on the relationship between arrears and type of micro financing source, in that the BMT respondents had more arrears problems than BPRS respondents (see: Table 6.48). There may be several reasons for this, such as lower level of financial/economical background of the BMT respondents in general as compared to BPRS respondents (see: Table 6.60). Furthermore, BMT respondents are likely to change the actual use of funds from investment to consumption purposes, which may lead to arrears since the funds will not produce any income (see section 7.4.2.3 and Table 6.45). Moreover, the businesses of BMT respondents are likely to be less efficient than BPRS respondents' businesses (see section 6.9.1.2 and 6.9.1.3), hence producing lower net incomes. The findings also indicate that arrears are a general problem faced by all micro and small enterprises, regardless of the above factors.

In regard to the reasons for arrears, Ahmed (2002: 43) shows that 10% of the respondents (from one of three institutions in the research) have arrears, which are mostly due to business failure, natural disaster, family and other troubles; such explanations are similar to those found in this research. Besides, the Bank Indonesia survey findings reveal that arrears and financing problems are usually due to business failure (55.52%); this is supported by the fact that almost 100% of financing is for productive purposes, although moral hazard can still occur in certain cases, especially deliberate default (26.91%) (Sakti, 2011: 11). To reduce cases of arrears, the suggestion to use peer monitoring could be considered, which has been successfully applied by Grameen Bank (Stiglitz, 1990: 353).

8.2.2.2. BMT and BPRS Perspectives

This section discusses another approach in responding to the above research question, through interview findings.

(i) Risk and Moral Hazard

Risk and moral hazard in relation to the provision of micro financing services have occurred regularly in the interviewees' institutions. Risk includes liquidity risks, default and bad customer behaviour. First, some interviewees claim that liquidity risk does not exist since a collaborative approach can be managed by maintaining good cooperation and coordination among all branches of BMT. This good networking is likely to be part of a strong culture built up among Islamic microfinance institutions, particularly BMT, and it may be rooted in their nature as mosque- and community-based organisations that maintain strong personal relations. Hence, this culture seems have an effect on how they maintain relationships with their colleagues. On the other hand, some interviewees reported high fund withdrawals, particularly on seasonal occasions such as *Ramadhan* (the fasting month) and the *Eid* celebration. During these occasions, Muslims usually need more money than in other months to cover the cost of food; this is a phenomenon that seems to contradict the spirit of *Ramadhan*, which encourages Muslims to spend less on food and other household expenditure during that period. This raises a question: does the fasting month of *Ramadhan* fail to encourage Muslims to fast? In addition, during the *Eid* celebration, as part of the culture, most people go back to their home towns for family reunions (*silaturahim*) and stay for several days in the villages. The findings in Table 6.3 shows that almost two thirds of the respondents (67%) live in urban areas. Therefore, they usually need more money to cover public transportation costs, which are always more expensive than in other months, new clothing, gifts, and donating a share of annual incomes to families and relatives. Usually, savings have been made during the year to cover these high costs. In this case, it is not possible to judge whether this is good or bad culture since some people can only go back home once a year, that is on *Eid*. Moreover, the longest holiday period of the year for both students and workers is also available only during *Eid*.

With regard to this liquidity problem, Sakti (2011: 12) points out that BMT has potentially large liquidity problems because of the large number of micro and small enterprises that comprise its membership. These types of businesses, largely run by families, tend to display similar general behaviour in managing their funds; hence, it is highly likely that they will all withdraw their funds during seasonal religious events, which could lead to high liquidity risks.

Second, the risk of default is highly likely to occur due to the respondents having both personal and business financial problems that lead to repayment delays, as 20% of the respondents reported having arrears (see: Table 6.17). These financial problems normally occur among MEs, as most of the respondents (88%) rely on their MEs as their main source of income (see: Table 6.2); almost 80% of them have MEs (see: Table 6.18) and they mostly come from low economic backgrounds (see: Table 6.21).

To handle this default, BMT focus on the personal approach rather than selling the collateral, while BPRS are more likely to sell the collateral, if the stages applied to deal with default do not work, and write off the debt. Hence, it might be assumed that, in this case, BMT take a more humanist approach than BPRS, which is likely to act like other larger banks. It should also be noted that an important way of managing good repayments is routine weekly meetings, a culture that can only be fostered by BMT as a community-based institution.

Third, there is moral hazard risk, including misuse of funds, presenting collateral belonging to another person, undetected bad characters, and selling the items bought from the financing funds; these mainly occur due to failure to predict customers' bad behaviour. This implies that it is not an easy task to judge a personal character in a short time during the financing application process, as a good personal appearance does not fully guarantee truly trustworthy behaviour. Although some good solutions to handle this problem were found (see section 8.2.4), it also suggested that institutions give more consideration to personal guarantors/referees, who could be existing trustworthy customers, local community/religious leaders, group leaders, or employees of related BMT and BPRS. Since the personal guarantor is assumed to have had a long relationship with the new applicant, the risk of moral hazard might be reduced. This approach has actually been taken in some cases; however, the occurrences of moral hazard cases should impel BMT and BPRS to consider this approach more seriously.

(ii) BMT and BPRS Business Problems

BMT and BPRS have some common business problems: (a) Difficulty in assessing borrowers' financial flow, (b) competition with conventional banks that offer micro financing, (c) lack of capital, particularly in seasonal circumstances, (d) managerial problems due to improper management systems, (e) infrastructure problems, mainly computer- and software-related issues, (f) lack of personnel, (g) lack of staff skills, particularly in understanding *Shari'ah* contracts, (h) lack of vehicles to reach borrowers, (i) inappropriate type of business legal foundations since cooperatives' legal basis does not fully reflect the BMT character, and (j) other problems such as lack of intelligence, customers' bad behaviour, high level of default *etc*. Although BMT and BPRS have some common problems, their most frequent occurrences may differ between the two types of institutions. A summary of the BMT and BPRS problems is presented in Appendix 8.2.

Hence, a comparison of these two types of institutions seems to reveal that the frequencies of the problems are different. For example, while the lack of capital is the main problem for BMT (58.3%), it is ranked just seventh for BPRS (30%), with 40% of the respondents reporting that they have never had this problem. This clearly indicates that BMT need more capital than BPRS and that financial access for BMT is likely to be more limited than for BPRS, which are fully supported by the Central Bank. This should prompt the government and other related institutions to provide financial support for BMT in order to provide more financing to MEs. Moreover, BPRS' main problem is the difficulty of assessing borrowers' financial flow (80%), but this is only the second most important problem for BMT (40%) (see: Appendix 8.2).

It should also be noted that competition is likely to be tougher in BPRS environment (70%) than in BMT (33.4%); this may be due to the nature of BPRS as a bank that has to compete with other banks, bearing in mind that an increasing number of commercial banks are entering the micro financing market and offering the same products. BMT, however, is more of a community-based organisation, focusing on their members rather than trying to attract new customers, a strategy dictated somewhat by the small scope of their operations.

Besides, managerial problems are more frequent in BPRS (70%) than in BMT (33%). This may be due to the different sizes of the organisations, in that BPRS are generally bigger than BMT and thus have more problems in managing a greater number of human resources. Generally, BMT managerial problems are likely to be related to management systems, which are not well organised and do not run smoothly. Moreover, BMT usually tend to be operated with a simple management system.

Staff skills are a more frequent problem in BPRS (60%) than in BMT (25%), probably because BPRS expect higher staff skills than BMT, which usually apply a simple management system. Besides, BPRS is under the Central Bank's supervision; hence, it requires proper, regular financial reporting and capable staff to handle it.

Similarly, Bank Indonesia (2011) survey findings by Sakti (2011: 16) also show that the majority of BMT staff have relatively low-level skills; their educational levels can be broken down as follows: Graduates from Senior High School (36.86%), Undergraduates/Sarjana (32.60%), Junior High School (15.54%), Diploma (13.21%) and Postgraduate/Master's (1.38%) (Sakti, 2011: 15). The survey also reveals that the second major problem in the BMT operation is human resources with lower competency (15.24%). They generally have low competency in operational skills and management, and there are limited funds allocated for training, only IDR 3,5 million per year on average (Sakti, 2011: 16). This seems to be the reason for the low salaries paid - only IDR 1 million on average, around one fifth of commercial banking staff salaries (Sakti, 2011: 16). To improve the human resources quality, the common types of training provided are BMT operations training (46.54%), accounting training (31.38%) and BMT marketing training (15.69%) (Sakti, 2011: 17). Although, in general, BMT do not have problems with the staff's integrity, certain activities are regularly organised to maintain close relationships among the staff and to improve the working conditions, such as routine religious meetings (76.67%), internal meetings (9.44%0, outbound training (5.83%), staff promotion to higher positions (5.83%) and demotion (2.22%) (Sakti, 2011: 18). The findings of difficultly in accessing the borrowers financial flow contradict with the findings of a survey in northern Nigeria which finds that information asymmetry is not a problem (Udry, 1990: 267-268).

(iii) Lack of Funds

It seems that a common problem faced by Islamic microfinance institutions in general is lack of funds, which can be caused by (a) personal ownership of an institution, (b) seasonal high fund withdrawals, (c) funds management failure, and (d) high financing demand. Personal ownership might lead to personal misuse of funds by the owner/manager due to weak internal financial control and fund management failures. Therefore, considering this risk, it is suggested that an institution should not be owned by a single person; it would be better if a group of people owned the institution collectively in order to maintain adequate financial control. This is the true spirit of a cooperative, where a group of local people set up a business together; sharing the initial capital, the ownership, the decision-making power and the financial control. However, it should also be noted that, in reality, the existence and the future of cooperatives in general is not entirely as expected by the founders of cooperatives due to personal mistakes in managing cooperatives, as experienced by some rural cooperative units.

Lack of funds could also be caused by high seasonal fund withdrawals and high financing demand without adequate funds to support that demand.

To handle this problem, the Islamic MFIs usually obtain funds through linkage programmes with Islamic banks and other Islamic financial institutions, building strong cooperation with similar Islamic microfinance institutions, gathering public funds and proposing interbank call, as usually applied among the conventional banks. Based on the Bank Indonesia survey findings, 70% of the BMT have conducted linkage programmes (Sakti, 2011: 11); which indicates good networking and cooperation between BMT and Islamic commercial banks, Islamic windows, local government and non-banking financial institutions. However, it is also revealed that there is an obstacle in the linkage programme, particularly in the requirements to be fulfilled by BMT due to the fact that there is limited or no relevant information related to the financial health of BMT (Sakti, 2011: 16). Furthermore, the findings of the Bank Indonesia survey also reveal the BMT expectations of having flexible liquidity sources, which the government is expected to provide, linkage with local BMT associations and linkage with Islamic banks, as only 55.5% of BMT are able to solve their liquidity problems independently (Sakti, 2011: 13). In this issue, it is suggested that the financial institution to consider that raising capital should not be the main objective, distributing capital to the needy should also be the main focus of operation (Stiglitz, 1991:35).

8.2.3. Research Question 3: The Financing Services and Financing-Related Services Provided for Developing MEs

In serving MEs, BMT and BPRS provide not only financing services but also financing-related services in the form of social development programmes. The summary of findings from both qualitative and quantitative methods is presented in Appendix 8.3.

(i) Financing Approach

It seems that BMT and BPRS differ slightly on which financing approach is preferable; some BMT apply group-based financing for security assurance reasons, while BPRS focus more on the individual approach due to the simplicity of financing evaluation, and repayment monitoring and control (see: Table 7.21). BMT, as community-based institutions that maintain closer relationships with their members, have more capability to manage group-based financing. It should be noted that only three interviewees from BMT reported having group-based joint responsibility. This may be because BMT and BPRS perhaps prefer to maintain direct individual responsibility for easy monitoring and collection. They do not rely on groups to impose obligations on members to repay as the role of the group is not strong enough, and most customers are not members of specific groups who can take responsibility for managing the members in terms of financing.

Overall, the individual approach is more popular. The findings of quantitative analysis also show that 97.7% of the respondents use the individual approach (see: Table 6.11). This finding is similar to the findings of the Bank Indonesia survey in 2011, which revealed that 96% of financing proceeds on an individual basis (Sakti, 2011: 10).

(ii) Financing Products

As regards to the findings related to financing products, the results indicates that the most popular financing mode is *murabahah* due to its simplicity, high demand and safety; meanwhile, the core financing products of profit- and loss-sharing financing (*mudharabah* and *musharakah*) are lagging behind (see: Table 7.24). The findings from quantitative analysis also confirm this phenomenon, showing that *murababah* is the most widely held contract (40%) among the respondents, while *mudharabah* financing is used by only 15% (see: Table 6.13).

Compared to the previous findings, (Ahmed, 2002: 46) found that around 75% of financing contracts were *bay muajjal* (sale on deferred payment), which is quite similar to *murabahah*. Besides, the Bank Indonesia survey by Sakti (2011: 10) ralso reveals that *murabahah* financing accounts for 63% of the total financing of BMT in three provinces; however, the figure shows a balance between *murabahah* and *musyarakah-mudharabah* in Central Java. It should be noted that heavy reliance of *murabahah* as the largest Islamic microfinance product also remains to be a global problem, as there are 672,000 customers and approximate total portfolio assets of USD413 million (El-Zoghbi and Tarazi, 2013: 4). Hence, it is a challenge for the IsMFIs to promote profit and loss sharing micro financing mode.

(iii) Ratio of Profit and Loss Sharing

The findings in Table 7.25 shows that the ratio of PLS varies in each institution and is mostly determined on an individual-case basis considering certain business related aspects such as business productivity, customer's ability to manage the fund, gross and net profit *etc*. Generally, BMT imposed lower profit-sharing on customers (60:40) than BPRS (40:60) (see: Table 7.25).

(iv)Financing Evaluation and Repayment

BMT and BPRS apply a simple procedure and quick approval as key elements of success in micro financing. The financing procedure includes submission of administrative documents, interview, survey and collection of personal guarantee/references, followed by approval by an authorised manager (see: Table 7.28). The evaluation criteria are mostly based on annual income and assets owned as collateral (see: Table 7.27). On average, this process takes three days before the fund can be disbursed, although in some cases it can take as little as one day or as much as one week, varying case by case depending on the amount of financing (see: Table 7.27). The financing is mostly repaid on a monthly basis, although daily and weekly repayments are also applied by BMT and

BPRS. In the last five years (from 2007 to 2011), repayment rates above 90% were maintained by BMT and BPRS. The findings of the Bank Indonesia survey show high discrepancies among three provinces in Java; among others, the NPF of BMT in Central Java is the lowest (4.97%) while BMT in West Java has the highest NPF (10.86%); on average, the figure is around 4-5% (Sakti, 2011: 11).

In general, all institutions apply 5% as an evaluation criterion, emphasising the importance of trustworthy character (which can be observed mainly based on the interview, survey and personal reference) and capability to repay. Although collateral is required, it can generally be waived for very small amounts of financing, thus reflecting the flexibility and humanity of BMT and BPRS in serving poor local communities. It should also be noted that savings are considered as collateral and character as evidence of discipline. A unique evaluation is applied, which differs from conventional micro financing; this is *Shari'ah* screening, in which the business activities, products and services must be *halal* (permitted in Islam). This screening is applied through simple observation during interviews and surveys in order to ensure that the funds are used for *Shari'ah*-compliant activities. Additional information to track the creditworthiness is obtained from Central Bank checking (see Table 7.28 for details).

(v) Strategies to Reduce Non-Performing Financing

Non-performing financing (NPF) seems to be a common problem for BMT and BPRS, although, on average, repayment rates above 90% can be achieved (see: Table 7.27 and Table 7.29). NPF mainly occurs due to customers' businesses failures, which are common. As this research explored, institutions seek to reduce NPF by prevention (pre-financing) through more rigorous evaluation processes, and post-financing through improvement of monitoring and collections, persuasive personal and religious approaches, rescheduling, restructuring, writing off *etc*. It should be noted that, by applying Islamic values and servicing MSEs, BMT and BPRS believe in the importance of the religious approach in dealing with problems of NPF. Besides, since around 90% of Indonesians are Muslims and 100% of the customers are Muslims, who seem to have above-average religious backgrounds and quite strong bonding to Islamic values, this approach is quite effective, particularly when it is supported by the involvement of the local religious leaders. Moreover, as has been discussed previously, BMT and BPRS manage to have close relationships with their customers; hence, these personal approaches and close monitoring could also be maintained more intensively to reduce NPF. Similarly, Ahmed (2002) points out that, in dealing with default, the Islamic microfinance institutions have advantages in terms of the spirit of brotherhood and mutual help that encourages the institutions to handle this problem based on a humanist approach and assistance, while at the same time emphasising the importance of paying the debts, as failure to pay debts is sinful.

(vi) Social Development Services Programme/Services

The results in Tables 7.30 and 7.31 shows that the most popular social service is consultancy services (44%) and religious meetings (44%). Consultancy services are provided in the form of a short informal consultation with Account Officers when they come to visit customers to collect repayments. It should be noted that BPRS provided more consultancy services (60%) than BMT (33%). However, BMT provided more religious training (26.67%) than BPRS (15%). This might be explained by the different characters of BMT and BPRS. As discussed previously, BMT is a community-based (mostly religious) institution; hence, it is part of the culture to hold religious meetings. However, BPRS, as a bank, does not have the same culture. On the other hand, BPRS rely mostly on their Account Officers, as frontline workers in direct contact with the customers, to provide social services in the form of short simple consultancies.

In particular, the popularity of religious meetings may be rooted in the local culture of Muslim communities, which hold regular social and religious gatherings as part of maintaining local community relationships. There are many forms of gatherings, usually combinations of ROSCA (rotating savings and credit), religious speeches and lunch/dinner among females in small local areas, which might be conducted weekly or at least monthly. Moreover, the customers may feel more comfortable with this service as it is considered part of belief and worship and encourages the feeling of brotherhood (Ahmed, 2002: 40) among customers and staff of BMT and BPRS.

It should be noted that, according to the interview findings, only 2% of the institutions have not provided social services (see: Table 7.30). However, in comparison to the quantitative findings, more than half of the respondents (52.5%) have not received social services (see: Table 6.28). This might indicate that the distribution and outreach of this programme is not very wide. This should prompt BMT and BPRS to provide more social services over wider areas to reach more customers in order to achieve higher impact. In comparison, Ahmed (2002: 46) found that outreach was low in Bangladesh (Ahmed, 2002: 46) .

8.2.4. Research Question 4: The Perceptions of MEs about the Financing and Non-Financing Services Provided by BMT and BPRS

This section discusses the findings on the factors affecting the decision-making in choosing BMT and BPRS. Overall, the findings of quantitative analysis indicate that the respondents chose the financing services from BMT and BPRS mainly based on the simple procedure, location, good service and flexible collateral. Unfortunately, the *Shari'ah*-compliant factor was found to be less important than these five factors. This indicates that the respondents were still heavily affected by direct self-benefiting factors. This should impart a sense of duty to all parts of society, not only the BMT and BPRS but also all related organisations such as Islamic microfinance institution associations, to educate and socialise people into appreciating the true benefits of Islamic micro financing through more regular and effective publicity, using simple and comprehensible terms, to make them fully understand the underlying principles of Islamic banking products.

The findings show that BMT respondents displayed the greatest agreement on the five variables in question that had statistically significant differences, including *Shari'ah* compliance, easy procedure, cheaper cost, flexible and easy collateral and proper location (see: Table 6.50). It should be noted that this sequence is based on the questions in the questionnaire; it does not represent the importance level. This might indicate that BMT, in general, have provided better services to customers than BPRS. However, why is the impact lower than in BPRS? Does it relate to the ability of their customers to manage the funds efficiently to achieve higher income?

A further test using factor analysis suggests the same trend. The most important factors found include the following: the procedure to obtain funds is not complicated, flexible and easy collateral, cost-related financing products are cheaper, *Shari'ah*-compliant, and good service and location (labelled internal/personal benefit factor). Meanwhile, socialisation by particular parties, advertisements in printed and electronic media, provision of social services and influence from/following particular people (labelled an external factor) are less important.

The findings also show that BMT and BPRS respondents had different views on which factors were important. The findings on BMT respondents reduced the ten factors to two factors, which is similar to the findings on the respondents overall (see: Table 6.55 and Table 6.56) in which the factor two is also more important. Meanwhile, the findings on BPRS respondents show three factors consisting of: (a) four external factors (least important); (b) four internal/personal interest factors: flexible collateral, cheaper cost, good location and easy procedure (second most important); (c) two factors related to good service and *Shariah*-compliant (the most important) (see: Table 6.57). This might lead to the assumption that the BMT respondents' views may have more substance than BPRS respondents, who tend to be more self-oriented. The BMT respondents' views may have more substance because they are mainly mosque-based communities and they still maintain close relationships with the local spiritual leader through religious meetings; hence, they are more attached morally to *Shari'ah*.

Overall, these findings are no different to those of the previous research. The Bank Indonesia survey of 386 BMT shows, as stated by Sakti (2011: 10), in order of importance, the reasons why the respondents choose BMT: simple procedure (52.77%), *Shari'ah*-compliant (18.73%), attractive price (margin and share) level (16.09%), easy to reach (9.5%) and safety (2.90%). The safety reasons are the least important factor in choosing BMT, thus raising the issue of savings security in BMT. Does this indicate that the security level offered by BMT is low because there are no guarantor institutions for BMT, compared to Lembaga Penjamin Simpanan (Deposit Guarantee Agency) for banks, including BPRS? It seems that, were there to be a guarantor institution for BMT, they would probably be more attractive to customers as the safety would improve.

Moreover, the findings of a survey study by (Widyaningrum, 2002: 81) among customers of BMT under Yayasan Peramu Bogor suggest that the factors in choosing BMT were easy procedure, easy requirements, quick service, system of 'pick up the ball' or direct approach to customers; only 10% of respondents clearly stated a religious motivation for choosing BMT. In addition, a survey study by Hamidi *et al.* (2008) on an Islamic boarding school communities in East Java suggests that the main factors in choosing Islamic banking products are, in order of importance, (a) the suitability of banking products for fulfilling the respondents' needs, (b) reliability and security of the bank, (c) product variations, (d) banking staff's attitude aligned with *Shari'ah* values, (e) relating to religion (Islamic), (f) the speed of the process, (g) the female employees dressing in a manner compliant with *Shari'ah*, (h) level of strength of the bank, (i) strategic location, (j) speed of services, (k) offering more benefits than other banks, and (l) location being easy to reach. Further, a survey study in 2010 by Masyita (2011: 19) of 581 customers of BRI, BPR, BPRS and BMT in Bandung implies that the economic reasons (ease of process, speed, low interest rate, proximity, low collateral) are more important than religious reasons. Furthermore, Amalia (2008) could not locate any religious reasons, pragmatic reasons are revealed in relation to factors in choosing BMT in six cities in Java (mostly Jakarta, West Java and Yogyakarta) as part of selection criteria. These include easy and quick procedure for funds disbursement (63.8%), convenience (53%), pleasant/good services (50.1%), within easy reach (47.2%), low administration costs (46.6%), fulfilling the customers' requirements (35.1%), high profit-sharing (11.2%), having many branches (6.7%) and others (2%) (Amalia, 2008: 7). However, Amalia (2008: 8) provided details on unfavourable factors in dealing with BMT, such as difficulty in managing to obtain the official required documents (ID, family card and other official letters from local authority) (21.5%), limited networking (19%) and slow and complicated services (12.5%).

It should be noted that different findings were obtained by Adnan *et al* (2003: 27); they point out that, based on a survey of 47 BMT in Java, customers' motivations to become members of BMT could be expressed in the following percentages: in accordance with Islamic values (36%), helping poor people (23%), free from *usury* (14%), and good services (9%). The finding of a survey study by Karim (2010) on 649 Islamic bank customers suggests that the most important factor is religiosity/Islamic identity, followed by physical services and financial/product services. The question is: how can this difference in motivation be explained? There are several possible answers; for example, it may have been affected by the demographic backgrounds of the customers or by how the questions were formulated.

8.2.5. Research Question 5: The Maintenance of the Relationship between BMT, BPRS and MEs

Generally, there are two types of activities that help to maintain relationships with the customers. First, in relation to prospective new customers, BMT and BPRS have broadened their scope to reach wider areas by opening new branches/cash payment offices/outlets, marketing their products and services through a personal approach to other institutions (*e.g*. schools, local government offices) and community leaders, continuing to obtain recommendations/references on new customers from existing good customers, and creating networking among members. In terms of regulations on opening new branches, it should be noted that BMT have less complicated requirements (see section 7.3.4). The findings suggest that BMT tend to have more branches than BPRS are able to have. Therefore, BMT are likely to be more popular with and closer to local communities than BPRS. In addition, it seems that the key marketing strategy of BMT and BPRS is personal approaches to potential customers who are not directly approached by larger banks, such as teachers in schools, local (village) government offices and local community leaders. These people have the potential to influence people around them. This personal approach is a powerful and effective tactic that distinguishes Islamic MFIs from larger banks.

Second, to maintain close relationships with existing customers, BMT and BPRS actively visit and maintain informal gathering (*silaturahim*) with their customers, arranging routine and regular religious meetings, distributing gifts to customers, arranging annual events, providing social services to orphans, offering the best services and maintaining a personal approach by accepting customers' invitations to special events (see section 7.3.4). Again, personal approaches by Account Officers to the customers are the strong points of BMT and BPRS in maintaining customer relationships, a practice hardly likely in larger banks.

However, it should also be noted that, according to the quantitative analysis, more than half of the respondents (52.5%) received no social development programmes and 28% of them responded ‘don’t know/don’t remember’ when asked about such programmes. Thus, in total, around 80% of the respondents neither received nor knew/remembered about such programmes (see: Table 6.28). This might indicate that the religious meetings, the most popular social services development programmes, have not reached as many customers as expected. In a comparison of frequencies, BMT have provided more social programmes than BPRS (Table 6.70). Hence, these programmes should be conducted more regularly in the wider community in order to maintain a wider and better relationship with the customers. However, the improvement of these programmes will require more funds, efforts and human resources to maintain them regularly, a capability usually lacking in BMT and BPRS.

This issue has also been addressed in the existing literature. As community-based organisations whose managers and officials are generally from the surrounding areas, as reported by Sakti (2011: 7) BMT are able to maintain close relations with members through regular visits to customers (particularly borrowers) (66.58%), members’ coaching/development through members’ meetings (15.53%), ‘socialisation’ products (9.47%) and business consultations (5.53%). However, it is also acknowledged by Sakti (2011: 17) that there are some challenges to maintaining this relationship, such as dispersed locations of customers (44.71%) resulting in the need for additional funds, low human resources quality (27.78%) and limited budgets (18.52). In addition, as reported by Ascarya and Sanrego (2007: 11), the previous Bank Indonesia survey (2007) findings also reveal that only 14% of MSMEs have received support/facilities, particularly credit, management and workshops, throughout 11 provinces covered in the survey. (Ascarya and Sanrego, 2007: 11).

8.2.6. Research Question 6: The Role of BMT and BPRS in the Economic Development Process

This section discusses the findings on the economic development role of BMT, BPRS and MEs from the customers' and institutional perspectives, including the economic and social impacts and the economic development role from BMT and BPRS perspectives. The summary of the findings on economic and social impacts is presented in Appendix 8.4.

8.2.6.1. Economic Impacts

The discussion on economic impact is divided into impact on sales, business expenditures, net income, household expenditures, assets, economic activities and employment.

(i) Impact on Sales

Overall, the findings show a significant improvement in annual sales (almost 50% higher) after financing compared to before financing (see: Table 6.59). This might indicate a positive role played by BMT and BPRS financing in improving the sales. Compared to BPRS respondents, the BMT respondents performed 50% better in terms of sales improvement. This might indicate that the BMT respondents are managing their funds more productively. This sales improvement could be considered higher than that reported in the research findings on BMT in 7 cities in Java (Tangerang, Depok, Jakarta Selatan, Jakarta Barat, Jakarta Timur, Wonosobo and Yogyakarta) by Amalia (2008: 13), as it is reported that the average sales improvement was IDR 1,417,769, which is 21.36% higher after the customers had built partnerships with BMT. However, compared to a study by Widyaningrum (2002: 131), who found an improvement in sales of around 60%, these findings could be considered lower, possibly because there was a larger number of respondents from a larger number of institutions participating in this study.

(ii) Impact on Business Expenditure

The annual business expenditures were significantly higher after financing than before financing, thus indicating that the funds have been utilised productively (see: Table 6.61).

Both types of clients from BMT and BPRS found to have performed at almost the same level of improvement, although BPRS respondents' businesses expenditures are slightly higher than BMT respondents. This might be due to the different sizes of businesses among the respondents, in that the BPRS respondents generally have larger business expenses and more business costs.

Although a large majority of the respondents reported no impact on specific monthly expenditures (Table 6.22), the findings also suggest statistically significant differences among different types of financing institutions in terms of the following monthly business expenses: stock, utilities, transport, and financing repayments (see: Table 6.62). These expenses are likely to be those most related to business and directly attached to daily expenses. In this case, in general, the BPRS respondents reported the least impact, apart from on financing repayments. In other words, the BMT respondents are likely to benefit more from the financing and have more respect in response to improvements.

However, this study could not find any significant differences among types of financing institutions in the variables of tools and minor equipment, rent, and wages (see: Table 6.62). This indicates that neither BMT nor BPRS respondents report any differences in spending funds on these businesses expenditures. This is possibly because the respondents of both BMT and BPRS are likely to retain the same premises after financing; hence, there are no additional rental costs. It was found that wages, in particular, also remain the same for the respondents of both institutions. This contrasts with the finding on the improvement in number of workers (discussed in the next section), which shows a positive impact. This might imply that an increase in the number of workers does not affect the wage bill, which is unusual.

Comparing the above two findings, it should be noted that the difference in the findings is caused by the application of two different tests. This raises a question: Why, in terms of quantitative perception (value of money), are the business expenditures of BPRS respondents higher while, in contrast, in terms of the qualitative range of perceptions on expenditures, those of BPRS are lower? A possible reason may be the high expectations of BPRS respondents; although their expenditures are higher, they are apparently not high enough for them to claim a good impact.

(iii) Impact on Net Income

The results show the annual net incomes of all respondents were significantly higher after financing (50%) than before financing (see: Table 6.59). The improvement in annual net incomes of BPRS respondents was around three times higher than those of BMT respondents. This might indicate that the BPRS respondents, who are more mature in running their businesses, may operate their businesses more efficiently than the BMT respondents, which may a consequence of the size of businesses.

In comparison to previous findings, a study comparing incomes before and after financing by Amalia (2008: 7) shows an average monthly income improvement of IDR 472,328 (19.58%). Further analysis using a different approach based on a model of path analysis with three variables presented by Beik and Purnamasari (2011: 13) suggests that the daily income level after financing is positively affected (81%) by daily business profit, monthly consumption and proposed financing application. These positive findings provide evidence that BMT and BPRS are likely to play a positive role in real income improvement. In addition, Rahman (2010: 177) shows that the average improvement in customers' incomes reached 33% after they had joined RDS IBBL, especially clients who run small businesses as compared to other types of businesses. Furthermore, the improvement of income is in line with the findings of Noipom (2013). However, with particular regard to variables related to impact on net income, the findings in this study contradict Noipom's (2013: 303) findings, as he suggests that gender and occupation are strong predictors of the impact. In this research, the variables correlated to impact on net income were assets owned, the length of membership and borrowers, frequency of borrowing, total loans, and total workers (see: Table 6.68). Hence, this implies that the respondents in this study have a more pragmatic and 'technical' way of thinking.

The positive findings established in this study on income improvement support the previous findings on conventional microfinance by Abou-Ali (2009), Latif *et al.* (2011) and Hulme *et al.* (1996), among other studies. As the findings suggest that the number of workers correlates to the impact on income, this was in line with the findings of Hulme *et al.* (1996).

(iv) Impact on Household Expenditure

The findings suggest that annual household expenditures of total respondents were significantly higher after financing than before financing (see: Table 6.64), and the BPRS respondents showed more than double the improvement of the BMT respondents. This may indicate that the BPRS respondents achieve better development in their personal lives. However, it may also imply that the BMT respondents are more efficient in managing their funds and less consumptive than BPRS respondents.

A further test showed statistically significant differences between types of financing institution in terms of transport expenditures, furniture and electrical purchases per year (see: Table 6.64). No statistically significant differences were found in household expenditures on food, health and medical expenses, education, clothing, and household utensils. Overall, the BPRS respondents reported less effect than the BMT respondents, which may indicate that they spend more money on transport expenditure; it may also indicate that they buy better transportation tools, probably new motorcycles or cars, and spend more on furniture/electrical goods.

The same question is raised here: why, in terms of value, did the BPRS clients report a higher impact but a lower perception? A possible explanation for this may be that there are different ways of thinking between the respondents of these two types of Islamic financial institutions: the BPRS respondents probably come from higher economic levels than the BMT respondents; thus, they have higher expectations, which affect the way they respond to the qualitative perception question.

In comparison to previous research, the findings of this study is in line with the findings of Rahman and Ahmad (2010: 178), who found that through micro financing, household expenditures increase, of which food expenditure is the largest improvement, followed by house repairs and maintenance, and medication expenditure (51%). In addition, this supports the findings of Shirazi (2012: 20), who suggests that household consumption expenditure by the poor grew by 10% after financing. In addition, the findings of this study support the previous findings by Abou-Ali *et al.* (2009) and Pitt and Khandker (2002) in terms of consumption smoothing.

(v) Impact on Assets

Generally, the findings suggest that a large majority of the respondents reported ‘no effect’ on assets; however, with particular regard to productive assets, 60% of the respondents reported a positive impact (see: Table 6.24). These findings support the findings established by Ahmed (2002: 45) in the case of Bangladesh, who found a significant increase in assets, showing that the respondents of an IsMFI increased their assets by 68%, while the other two IsMFI saw 15% and 24% asset improvements after financing. Further, Ahmed (2002: 45) also established that the premises also improved more than the assets, with respondents of one IsMFI improving premises by 88%, while those of the other two IsMFIs improve premises by 17% and 28%.

In addition, the findings support the result of a survey in Bangladesh by Rahman and Ahmad (2010: 178) indicating that all types of assets, for instance house, land, furniture, radio, television, cycle and cart, increased after the respondents joined RDS IBBL. Moreover, in terms of assets improvement and the initial amount of assets correlating to impact, the findings of this study are consistent with the findings by Noipom (2013: 304). Furthermore, the findings of this study on productive assets improvement are also in line with the previous research on microfinance by Kondo *et al.* (2008), Hulme *et al.* (1996) and (Nader, 2008).

With regard to the type of IsMFI, non-significant differences in almost all variables in assets and types of financing institutions are found, including buildings, private cars/motorcycles, cattle, productive assets, electronic goods and jewellery; savings (see: Table 6.65). Overall, the group reporting least effect on assets improvement is the BPRS respondents. This might imply that BPRS respondents have higher levels of expectation regarding improvement of their assets, possibly due to their higher economic status. A possible reason for the significance of the above variables is the character of these assets, which have less value than land/buildings. It should be noted that changes in the savings found to be insignificant, however, as the p=.053 seems very close to the confidence level of p=.050, hence, it may be considered as significant. As compared to other assets, savings are easy to measure since they are obviously value-based, hence, by looking the amount of saving, it can be easily recognised when there is any improvement.

(vi) Impact on Economic Activities

The findings in Table 6.25 show the highest impacts on economic activities which are demonstrated on improvement on volume of goods/services (reported by a large majority of the respondents, 75%), quality of goods/services (half of the respondents), and diversification into new goods/services; meanwhile, production technology and bookkeeping do not really seem to be affected. This high impact could be considered an indication that the funds are directly utilised for business development in terms of volume, quality and new products. Improvement in volume of goods/services has the highest impact, possibly because of the simple and direct approach to utilising the funds.

These findings are in line with those of Ahmed (2002: 45), as an improvement in volume of goods/services is also revealed in Bangladesh, showing that the respondents of one IsMFI achieved more than 50% improvement in volume of goods/services after receiving IsMFI funds, while the other two IsMFIs produced an improvement of around 10%. The findings of this study also demonstrate that diversification into new goods/services seems to be less affected (37%) than the improvement in volume and quality of goods/services, which is similar to the findings by Ahmed (2002: 45), Noipom (2013) and Rahman and Ahmad (2010) in terms of improvement in production opportunities. In addition, the finding of this study in terms of having no changes in production technology is in line with the findings of Hulme *et al.* (1996).

Although technology and bookkeeping are likely to be neglected in this regard, it should be noted that this study established that the majority of the respondents (60%) are in retail businesses (see: Table 6.4), where technology improvements are less likely to be required. Unfortunately, lack of awareness about maintaining proper bookkeeping still seems prevalent, which is a common trend among MEs. Hence, based on the regression analysis findings, BMT and BPRS are recommended to provide more training on how to maintain simple, proper bookkeeping, an initiative that could be conducted in cooperation with universities under the higher education community service (development) programmes. This is supported by the finding that the respondents who reported a high impact on economic activities are highly likely to have done so because of the social development programmes they receive.

The findings also show that the BPRS respondents report significantly higher impacts on volume of goods/services, quality of goods/services, production technology and premises than the BMT respondents (see: Table 6.66). This may be because the BPRS respondents have utilised their funds more productively. However, no significant differences are found in diversification into new goods/services and bookkeeping. This may imply that diversification is probably not a priority for micro entrepreneurs among both the BMT and BPRS respondents, as they concentrate more on improving the volume and quality of existing products. The bookkeeping deficiency may result from a lack of awareness of the importance of proper bookkeeping, which applies to both the BMT and BPRS respondents.

(vii) Impact on Employment

The findings in this study show that the number of workers (both male and female) is significantly higher after financing than before, which may indicate a real positive impact on employment (see: Table 6.67). Overall, the improvement in total number of workers found to be slightly higher among the BPRS respondents than among the BMT respondents. This may indicate that BPRS have created more job opportunities for new workers than BMT for various reasons, such as the scope and size of the BPRS businesses being larger than the BMT businesses. However, the BMTs respondents seem to show more improvement in the number of female workers than the BPRS respondents, which may indicate that BMT focus more on women’s empowerment.

The positive impact on employment has also been pointed out by Ahmed (2002: 45), who showed that the time spent in business (by both respondents and other family members) significantly increased after they received IsMFI funds in Bangladesh. Rahman (2010: 178) also points out the average improvement in the number of family members involved in the business after joining RDS IBBL, from 1.96 to 2.1 family members. In addition, Noipom (2013) suggested a positive impact on self-employment in clients' households in his study on Muslim communities in Thailand. However, this was contradicted, to some extent, when Noipom (2013: 305) suggested that the level of impact depended on gender, membership length, occupation and land holding; the findings in this study, however, suggest that the impact on employment was related to religious education, assets owned, the length of time as members and borrowers, total loans, frequency of borrowing, total number of workers and technical training received (see: Table 6.68). Again, this implies that demographic factors are not the best predictors of impact in Indonesia. In comparison to previous studies on conventional microfinance, the positive findings on employment established in this study support the findings of Kondo (2008).

Overall, the findings suggest that there are statistically significant correlations between all economic impacts and land assets, private cars/motorcycles, productive assets, electrical goods, jewellery, membership length, length of time as borrowers, frequency of borrowing, total loans, male workers, female workers and total workers, in which the higher values of the above variables relate to high impacts. These variables relate to capital owned, financing received and duration of relationship with BMT and BPRS. Therefore, this may indicate that, to improve the impact, BMT and BPRS should provide higher financing and maintain long relationships with the borrowers.

The regression models of economic impact on business activities suggest that the strongest predictors were social services development programmes/services provided to the customers (see: Table 6.69). This highlights the importance of such programmes in improving the economic impact. Hence, BMT and BPRS should provide more frequent social development programmes, possibly in cooperation with other institutions, such as universities, under the community development programme. Overall, it should be noted that the findings of this research generally contradict to Stiglitz's argument (1991: 25) that role of financial market is limited in development process.

8.2.6.2. Social Impact: Social, Religious and Other Impacts

Analysis of the social impact could not be entangled from the social services provided by BMT and BPRS, in that half of the respondents have not received any social service development programmes (see: Table 6.28). The findings also show a significant relationship between type of micro financing institution and social services provided to respondents, particularly in the following services: 'consultancy services', 'religious training on business ethics' and 'don't know/don't remember' (see: Table 6.70). Despite the BMT low fund allocation to social services, the BMT respondents receive more social services than BPRS respondents. Similarly, as compared to BMT respondents, BPRS respondents recorded a higher response to 'received no social services' and 'don't know/don't remember', compared to BMT respondents. Hence, BPRS should provide more social services, as they have relatively more capability to conduct this service, in terms of available funds and human resources. However, a question arises in regard to the negative correlation: Why do the BPRS respondents, having received fewer social development programmes, still report higher social impacts than the BMT respondents? This outcome may be rooted in the independency of the BPRS respondents, since they have better economic conditions; hence, they are not really affected by the social development programmes, of which the BPRS provide fewer anyway. In other words, it can be assumed that the BMT respondents have a greater demand for social service development programmes, as they may have less access to other similar programmes compared to the BPRS respondents, who have more opportunity to access similar programmes from other related institutions; such programmes are also likely to have more impact on BMT respondents. Alternatively, the social impact on the BPRS respondents might be caused by other factors, such as development of local economic conditions, and not just by social development programmes provided by BPRS.

A further test in this study found that relationships with spouse/family members and having women as decision-makers were the most important components (see: Table 6.74). This may indicate that having a healthy family relationship and allowing women to make decisions are most important, which may be rooted in the local culture of holding maintaining relations with the family.

In addition, this finding is rather discouraging in the sense that religious belief, which offers valuable source for positive prospects, is the least important compared to the other two components, which are physical and world view-oriented (see: Table 6.74). This seems contrary to the findings of the World Muslims Report (Bell et al., 2012: 43, 50, 53, 54) which shows that the Indonesian community are religious people who have a very high level of involvement in daily religious activities, in terms of praying (77%), daily reading of the holy Qur'an (37%), almsgiving (98%), fasting during Ramadhan (99%), believing in angels (99%), *etc.* Does this imply that having an active religious community does not necessarily directly correlate to a high level of awareness about applying religious values to economic activities? Perhaps the issue here is not just provision of financing; rather, and more importantly, more attention should be given to improvement of customers' behaviour in terms of the implementation of religious values in economic activities. However, it seems that internalisation of values will probably depend on individual's will to improve the quality of their spiritual life. Hence, in this case, it is important to provide long-term and frequent educational processes to the customers and to society in general in the form of training, religious meetings and consultancy services.

(i) Social Impact (relationship with spouse)

The findings show that less than half of the respondents (40%) reported positive effects on relationship with spouse/family members (see: Table 6.29). Unfortunately, this level is far below the findings in Bangladesh by Ahmed (2002: 46) where, on average, more than 90% of the respondents reported better relationships with spouses after financing. This positive effect on family relationship established in this study contradicts the research findings by Nader (2008) and Rahman (1999). However, it might still be assumed that providing financing and social services development to MEs could achieve a positive social impact, although a majority of respondents did not have the same experiences.

In addition, the findings in this study show that 22% of BMT respondents reported a positive social impact, a larger percentage than the BPRS respondents (16.4%) (see: Table 6.75). This may be because BMT provided more social services than BPRS.

However, this seems to contradict the above findings. This raises a question: what other factors might contribute to the improvement of relationships with spouses?

(ii) Religious Impact

The findings in this study show that the percentage of positive religious impact is lower compared to the positive social impact (relationship with spouse), as discussed above. However, more than 20% of the respondents reported a positive religious impact (see: Table 6.30). It is expected that this low percentage of positive religious impact will improve when the same measurement repeated again in the future by other researchers. In comparison, Ahmed (2002: 46) found that the IsMFIs in Bangladesh are more effective in improving the religious impact as almost 100% of the respondents reported an improvement in Islamic knowledge. However, the positive religious impact found in these results is aligned with the findings of Rahman and Ahmad (2010) and Noipom (2013).

In general, it is highly likely that the BMT have been more effective in improving Islamic knowledge and Islamic practice in both the personal and religious life of the respondents. The reason for this may be the close relationship between BMT as a community-based organisation and their customers through religious meetings.

(iii) Other Impacts

This study found a small positive impact on health (see: Table 6.31). This positive result on health supports the findings established by Deloach and Lamanna (2011) and Naipom (2013), while contradicting the findings of Nader (2008).

Moreover, the positive impact on women's decision-making power is the highest impact compared to the other six impact variables (see: Table 6.31). This is probably due to increased ability to use the funds to develop the businesses and contribute to household incomes, thus contributing to women's power and self-confidence in the family decision-making process. It should be noted that the composition of respondents in terms of male and female, who are also mostly the owners of the businesses, is in balance and is not dominated by female respondents. It should be noted that these findings are aligned with those of Nader (2008), Naved (1994), Montgomery *et al.* (1996) and Hashemi (1996), who found that MF has a positive impact on women's empowerment after financing. However, these findings contradict with those of Brett (2006) and Mayoux (2006).

The comparative analysis implies that BPRS respondents report a higher positive impact than BMT respondents (see: Table 6.78), possibly due to their greater ability to manage the funds efficiently. However, the BMT respondents reported a higher impact on family empowerment. Hence, it may be assumed that BMT have been more successful in improving family empowerment, an outcome that may be rooted in the characters of BMT respondents, who are less well off compared to BPRS respondents. Therefore, the financing from BMT is likely to be more beneficial in improving family empowerment.

Lastly, the findings of regression analysis suggest that social services development programmes are the strongest predictors of social, religious and other impact (see: Table 6.81-6.83). These findings support those of Obaidullah (2008a) and Masyita *et al.* (2011: 352), who suggest that provision of spiritual, managerial and technical treatment/training to the clients of IsMFIs in Indonesia, based on experimental study in 2007, positively shapes MEs' behaviour and business performance, and reduces banking risk. Therefore, provision of such services should be improved in terms of frequency and coverage in order to improve social, religious and other impacts.

8.2.6.3. The Role of BMT and BPRS in Economic Development: Interview Findings

The BMT and BPRS' positive role in economic development includes the role they play for their borrowers and their role in local society in general (see: section 7.4.5). First, the positive contribution to borrowers' economic development can be observed directly through the business development, income, savings, assets, improvement of transportation vehicles and the ability to meet production targets. Although BMT and BPRS realise the importance of impact observation, their contribution cannot be observed easily, especially as they have a limited number of staff. It is suggested that a simple questionnaire asking about the business performance before financing be distributed to new borrowers; the same questionnaires could then be distributed again after the borrowers have repaid all the financing. Hence, on the basis of the information gathered from these completed questionnaires, BMT and BPRS could monitor the impact and also seek suggestions for improvement. The distribution and analysis of questionnaires does not require much funding or many staff, and is therefore affordable and manageable.

Second, observing the role played by Islamic microfinance institutions in economic development of local society is a difficult task since it is not as obvious as the borrowers' development. However, positive contributions are noted in the reduction of the influence of moneylenders, helping society to use *zakah* funds, provision of new services (bill payment centres), improvement of awareness of *Shari'ah*-based financing, improvement in trust in the *Shari'ah* micro financing institutions, and transferring funds to *Shari'ah* microfinance institutions. It should also be noted that there are more conventional micro financing institutions than *Shari'ah* ones; thus the impact on society is difficult to observe.

8.2.7. Research Question 7: The Role of BMT and BPRS in Poverty Alleviation

The impact of micro financing on MEs substantially suggests a further impact on poverty alleviation (see: Table 6.84, 6.85). With regard to impact on poverty alleviation, the data analysis shows a reduction in the number of the respondents suffering poverty; however, when measured according to the international poverty line, the percentage of the reduction is lower than that based on the national poverty line. This may be due to the high level of the international poverty line, which is almost double that of the national poverty line. Hence, although micro financing contributes to improving household expenditure, the improvement does not extend above the international poverty line. Overall, BPRS seem to have a better performance in reducing the number of respondents living below the poverty line.

Comparing between BMT and BPRS, the percentage of poverty reduction for BPRS respondents was higher than that for BMT respondents. This may indicate that, in terms of poverty reduction, BPRS has performed more efficiently than BMT.

These findings support those of Shirazi (2012: 20), who noted that only 30% of IsMFI borrowers in Pakistan are poor and that 3% of the poor are able to cross the national poverty line after financing. This also supports the findings of Rahman (2010), who suggests that 2% of the borrowers move above the poverty line after financing.

8.2.8. Research Question 8: Locating the Findings within Financial Inclusion and Financial Deepening Theoretical Framework

In an attempt to measure financial inclusion, Affiliation of Financial Inclusion (AFI) proposes four dimension as financial inclusion indicators, include: access, quality, usage and welfare (AFI, 2010: 4; Ledgerwood, 2013: 115). These indicators are used here to determine whether the findings provide evidences of financial inclusion in Indonesia.

First, access refers to ability to use formal financial services, for example minimal barriers to open an account in terms of 'physical proximity, affordability and eligibility' (AFI, 2010: 4-5). In this case, the findings of this study indicates that top four respondents' motivation to borrow funds from BMT and BPRS are simple procedure (94%), located in various places and easy to reach (93.4%), good services (92.2%) and flexible collateral (90.5%) (see: Table 6.10, section 6.9, section 8.2.4). As community based institution, BMT's and BPRS' offices/branches usually located close to their customers' business, *e.g*. in front of the 'traditional' local market, in the mosque area, in the housing complex residences, *etc*. Thus, this provides an easy access to their customers (see: section 7.4.4). Besides, the financing procedure is quick and easy (see: section 7.4.3.4).

Furthermore, as the empirical findings presented in the earlier chapters suggest, financial problems remain as the main business problems faced by MEs (see: Table 6.7), which is mostly faced by the respondents living in urban areas, clients of BMTs, and employees in government-owned companies (see: Table 6.34 and section 8.2.1.1.a). In addition, 60% of the respondents prefer to deal with families/relatives/friends rather than to contact formal financial sources, as a large majority of respondents did not used other formal financing sources, other than BMT and BPRS (see: Table 6.9). These indicate that financial inclusion remains an important problem in Indonesia, and therefore opportunity spaces should be created to enable 'excluded' individuals to engage with the formal financial institutions. This align with the findings of Mohieldin and Wright (2000) suggesting that, although informal financial sector seems to be more active, however, informal financial sector could not substitute formal sector.

However, as has been elaborated in the interview findings, there are some positive developments, empirical evidence for which can be summarized as follow:

(i) BMT and BPRS are able to reach this low level income society by offering easy financing access with quick and easy procedure (see: section 7.4.3.4. Financing Evaluation and Repayment and Table 7.27);

(ii) BMT and BPRS have maintained close relationship with their clients through direct visiting by Account Officers, conducting regular activities and opening new branches/cash payment offices/outlets to reach customers (see: section 7.4.4 and Table 7.32);

(iii) To support financial services, BMT and BPRS have provided social development programme/services (see: section 7.4.3.6 and Table 7.30);

(iv) The empirical evidence also suggest that BMT and BPRS are confident that they have potential (see: section 7.4.1, Table 7.6) and positive role in developing MEs (see: section 7.4.5. Table 7.33, Table 7.34a, Table 7.34b).

Based on such empirical evidence, hence, it can be concluded that financial inclusion is developing and taking place in Indonesia.

Along with financial inclusion, evidence provided in the earlier chapters indicate that financial deepening has been taking place in Indonesia, as more than 80% of the respondents were categorized as MEs with the productive assets less than IDR50 million (equal to USD5,000) (see: Table 6.6), and almost 75% of the respondents had annual sales less than IDR300 million (equal to USD30,000) (Table 6.18). In addition, the findings show that 40% of the respondents before loan and 30% of the respondents after loan were living under national poverty line of IDR245,035/person/month (see: Table 6.21). This figure will drop when the international poverty line is used, as 85% of the BMT respondents (see: Table 6.84) and around 80% of BPRS respondents (see: Table

6.85) were living under USD2/person/day. The findings also suggest that BMTs and BPRS have been able to help a significant number of respondents to move out from poverty (see: section 6.9 and 8.2.7). Hence, based on the clients and suppliers' perspective, it is highly likely that BMT and BPRS have provided access to their clients and fulfill the first indicator of financial inclusion indicator.

With regards to 'usage', it refers to actual usage of financial services/product, measured based on regularity and frequency (AFI, 2010: 4-5). Based on the empirical findings, 82% of the respondents are repeated borrowers who have been borrowed between 1 to 5 times, while the remaining respondents have borrowed for more than 6 times, and on average the respondents have borrowed for 3.66 times (see: Table 6.13). In addition, on average, the respondents have been the members/clients of BMT/BPRS for 4.12 years (see: Table 6.13a).

As for 'quality', it relates to the suitability of the product with the customers needs and availability of choices (AFI, 2010: 4-5). Although this study does not measure the customer satisfaction, the findings show that BMT and BPRS have concerned to provide products and services that correspond the customers need by developing new product to respond to the local need an environment (see: Table 7.14).

Fourthly, as regards to 'welfare concerns' in terms of impact on the customers' business and personal life (AFI, 2010: 4-5). In this regards, the extensive empirical findings presented in section 6.9 and discussion in section 8.2.6. suggest that the financing has been positively contributed to the borrowers welfare in terms of economic, social and religious impact.

With regard to 'gap in financial inclusion on microfinance', it should be noted that findings also is line with those of Mohieldin *et al* (2012: 86-88) in terms of lack of regulation particularly on BMTs before the Government Act No. 1/2003 endorsed in January 2013 that will be effective from 2015 onwards, staffs' knowledge gap and customers' low level of understanding of Islamic financing products. The interview findings reveal that lack of *Shari'ah* knowledge of the staff is one of the obstacles, along with other required skills (see: section 7.4.2.5.5. and Table 7.16b). To overcome this problem, trainings are provided for staffs (see: section 7.4.2.7. and Table 7.18, Table 7.19a and Table 7.19b). Despite the increasing demand for Islamic financing products, however, the findings suggest customers' low level of understanding for the terms used in Islamic financing products (see: Table 6.14 and section 7.2.2, Table 6.38–7.43 and section 8.2.2.1.b) and high preference on personal/internal factor in choosing an IsMFI, such as simple procedure, location and flexible collateral, while *Shari'ah* compliance seems to be less important for the clients in their demand for Islamic financing (see: Table 6.10a, Table 6.10b, Table 6.54 and section 8.2.4).

In addition, the results in this study also support those of Mohieldin *et al.* (2012: 88-99) as for gaps in financial inclusion on SMEs, in particular for MEs transparency in financial reporting and collateral requirements. The interview findings demonstrate that BMTs and BPRS have difficulty in getting access to borrowers' financial flows (see: section 7.4.2.5 and Table 7.15a). Furthermore, collateral seems also to be an issue, as there is a high dependency on collateral, as a large majority of respondents provided assets as collateral higher than the amounts borrowed, although in some cases BMTs and BPRS do not require assets for collateral for very low amount of financing (see: Table 6.16, section 6.7.4, section 6.7.2.2 and section 8.2.2.1.d).

To conclude, as microfinance strategies have shifted to ensure financial inclusion and financial deepening (Ledgerwood, *et al.*, 2013: 1), the findings established in this research show that financial inclusion and financial deepening have been taking place in Indonesia, in particular based on the services offered by BMT and BPRS to lower income strata, even if it is limited. However, this is a gradual process, and with knowledge development and capacity enhancement people's familiarity with financing will increase, which is expected to result in higher financial deepening and inclusion.

8.3. IDENTIFYING THE CONTRIBUTION OF RESEARCH: CONTEXTUALISING WITHIN AND REFLECTING ON THE EXISTING LITERATURE

This research is motivated and inspired mainly by the contrary findings of studies in Bangladesh (Ahmed, 2002) and Indonesia (Seibel, 2005, 2008). While Ahmed's study on Bangladesh shows positive findings and positive prospects for Islamic MFIs, Seibel's study in Indonesia presents conflicting recommendations. This section analyses in further detail why these two studies produced opposite findings.

Bangladesh and Indonesia have certain similarities. For instance, both are developing countries with large populations (having more than 150 million people) mainly dominated by Muslims. They have large numbers of Islamic MFIs serving poor or nearly poor sections of society and micro/small enterprises. They also have similar traditional cultures influenced by Islam, low human development indices, low GDPs, and large numbers of people living in poverty, *etc*. Therefore, it is assumed that Islamic MFIs in both countries will have the same level of achievement and performance.

In particular, there are certain differences between the studies of Ahmed (2002) and Seibel (2005, 2008), as follows:

(i) Scope of research:
   (a) Bangladesh: Covered three IsMFI with data collected from field research in 1999, covering both institutional and customer perspectives;
   (b) Indonesia: Nationwide, based on panel data from 1990 to 2003. Lack of detailed data on the institutional level. It is only from the institutional perspective, and lacks the customer's perspective.

(ii) Problems of IsMFIs :
   (a) Bangladesh: Provision of goods instead of cash in the application of Islamic modes of financing, lack of funds and difficulty in attracting deposits, lack of training for staff;
   (b) Indonesia: Problems of poorly performing BPRS, consisting of governance and management problems, inadequate internal control, lack of popular demand, emphasis on the informal sector and lack of skills in managing complex Islamic banking operations.

(iii) Future prospects of IsMFI:
   (a) Bangladesh: IsMFI has good potential and prospects;
   (b) Indonesia: BMT and BPRS have not performed soundly. BMT has negligible outreach and poor performance.

(iv) Background of establishment:

   (a) Bangladesh: Purely community demand-driven;

   (b) Indonesia: Projects are more political than economic.

(v) Detailed information on institutional level:

   (a) Bangladesh: Provides detailed information for each institution;

   (b) Indonesia: Provides general information.

(vi) Customer perspective included:

   (a) Bangladesh: Included survey of borrowers;

   (b) Indonesia: Did not include information from the borrowers' perspectives.

Regarding the initial establishment of IsMFIs in Indonesia, Seibel (2008: 99) points out that "Islamic microfinance, lacking broad popular demand and Islamic banking expertise, so far has been more a political than an economic project in Indonesia". It might be true that Islamic microfinance still lacks popular demand nationwide, as the share of Islamic banking in general is only around 4%; however, the development of Islamic microfinance, particularly BMT and BPRS included in this research, goes far beyond the political reasons. These institutions were built mainly in response to local community demand for financial access, supported and facilitated by local community leaders who have a concern for their needs. The same applies in Bangladesh, where all the IsMFIs in the research are driven by community demand.

Seibel (2008: 99) further argues that "Only commercial banks appear to be capable of quickly acquiring the art of Islamic banking by training young and dynamic people; but most of the commercial banks lack experience in microfinance as a specialized field". Obviously, the commercial banks, which have been operating for decades, have established resources, systems and infrastructure that enable them to quickly adapt to the unique Islamic banking operations. However, BMT and BPRS, which are younger than the commercial banks providing micro financing, will probably be able to catch up slowly, supported by related institutions that can provide the required training. As institutions focusing on providing microfinance services to micro and small businesses, BMT and BPRS seem to have more capability in the field than the commercial banks, which have previously focused more on medium-sized and large enterprises. It should be noted that the only conventional commercial bank with many years' experience in microfinance and known worldwide as the most successful operator of microfinance programmes is BRI Microbanking Division, which now also runs BRI *Shari'ah*, a strong competitor for BMT and BPRS recently.

Another criticism of IsMFI is that "Islamic, unlike conventional, rural banks, have generally failed to prove themselves as efficient and dynamic providers of microfinance services" (Seibel, 2008: 100). This claim may not be completely true if one considers the BPRS in this research, which seem quite efficient and dynamic in providing microfinance services that have been proved to deliver positive economic and social impacts. In addition, a study by Masyita (2011) shows that BPRS have performed more efficiently than their conventional counterparts (BPR).

As for depositors' risk, Seibel (2008: 100) argues that "Unsupervised Islamic, like conventional, cooperatives are an outright menace to their member-shareholders and depositors who risk losing their money". It is true that cooperatives, particularly Islamic cooperatives (BMT), tend to be neglected and unsupervised. However, the new Act No 1/2013 allows the establishment of a guarantor institution to protect both BMT and their customers in the event of unexpected circumstances.

Further, Seibel (2008: 101) suggests that "Islamic rural banks need to be revamped if they are to play a more than marginal role in Indonesia. This will require an overall development plan for the BPRS sector mutually agreed upon by all stakeholders and a strong banking association to provide a full range of support services to their members. Some of the more successful Islamic rural banks may serve as exposure training sites to future managers. Auditing should be mandatory regardless of size". Indeed, an overall development plan for the BPRS sector is likely to be required in order to improve services and the share of Islamic banking, particularly BPRS. However, is this required only for BPRS? What about their counterpart, the conventional BPR? Do BPR perform much better than BPRS? An Islamic banking association for all Islamic banking, namely ASBISINDO (The Association of Islamic Banking in Indonesia), was established in 1992, the same year in which the first Islamic Bank, Bank Muamalat Indonesia, was established.

ASBISINDO, which provides coordination and communication among its members, aims to achieve unity and cohesion among its members to develop the Islamic banking business and achieve progress (Asbisindo). As a mature organisation of 20 years' standing, this organisation is considered to have conducted many activities to support its members, such as management training. In terms of auditing, it is agreed that this should be conducted by all types of banking, both Islamic and conventional.

With particular regard to regulation and supervision, Seibel (2008: 101) argues that "Islamic cooperatives … need a system of prudential regulation, mandatory auditing, and effective supervision by an appropriate financial authority, which should definitely not be the Ministry of Cooperatives and Small Medium Enterprises. They should be fully financed through equity and savings deposits of members; only healthy and well-supervised cooperatives should be permitted to collect deposits from non-members. They need a strong association and federation to provide a full range of support services to their members". It is agreed that BMT need proper regulation; therefore, the new Act No. 1/2013 on Microfinance Institutions has appointed OJK as a supervisory and regulatory body with the aim of developing more efficient microfinance institutions, both conventional and Islamic, in collaboration with the Ministry of Small Business and Cooperatives and the Ministry of Home Affairs. The OJK will ensure that only feasible MFIs can operate and collect deposits from the public, thus protecting the customers.

Overall, it might be concluded that, compared to the previous research in Bangladesh, the social impact of IsMFIs in Bangladesh is apparently greater and the social services development programmes more successful in achieving the improvement of Islamic knowledge, better relationships between spouses and non-financial benefits. This is probably affected by the role of group financing and the strong role of the group in supporting members, as all of the IsMFIs in the research in Bangladesh apply a group-based financing approach.

8.4. CONCLUSION

Overall, it can be concluded that BMT, BPRS and MEs have a positive future prospects in Indonesia, despite that fact that they face challenges to their operations. The problems of BMT and BPRS include the risk of default and moral hazard mainly due to customers' financial problems, business problems including difficulty in accessing borrowers' cash flows, competition with conventional banks that offer micro financing, lack of capital, particularly in seasonal circumstances, managerial problems due to improper management systems *etc.*

There are also issues related to MEs, such as difficulty in accessing finance, low level of understanding of Islamic financing terms, changes in fund use, collateral requirements, and lack of social services. The micro financing provided by BMT and BPRS mostly relies on the individual financing approach, with *murabahah* as the most popular product. The reasons for choosing BMT and BPRS are mostly based on their simple procedure, location, good service and flexible collateral, while *Shari'ah* is less important than those factors. In addition, in terms of economic and social impact the role of BMT and BPRS is positive, with improvements in sales, business expenditures, net incomes, household expenditures, assets, business activities and employment. Although the social impact is not as strong as the economic impact, there are still significant, positive social, religious and other impacts.

Although the results varied case by case, in general the BPRS respondents were likely to report a stronger impact after financing. Despite the positive results from the above tests, the perception of the impact was dominated by the response of 'no effect', although there were significant numbers of positive impacts reported. The findings also suggest the positive role in poverty alleviation, since BMT and BPRS are able to reduce the number of poor respondents living below the international and national poverty lines. Overall, it should be noted that BPRS gave a better performance in developing MEs compared to BMT, which may indicate that BMT need to improve their services and manage their operations more efficiently.

Chapter 9
CONCLUSION AND RECOMMENDATIONS

9.1. RESEARCH OVERVIEW

The main objective of this study is to explore the potential and role of BMTs and BPRS in developing MEs in East Java, Indonesia. To fulfil the objectives, this research adopted a triangulation as a research method, in which the quantitative and qualitative data analyses were conducted based on the data collected from 348 completed questionnaires and 22 interviews with Directors/Managers of BMTs and BPRS. The findings located within the existing body of knowledge, in particular to evidence the contribution of the study in terms of filling a particular gap in two main research areas: 'financing microfinance 'and 'Islamic microfinance in Indonesia'.

The first three chapters review the body of literature on poverty and poverty alleviation through capacity development provided by MFIs and Islamic MFIs. Considering that poverty remains the most challenging problem in the world, poverty alleviation through the provision of microfinance has been found to be successful. In general, while conventional microfinance has been operating for quite a long time, Islamic microfinance has only begun to appear over the last two decades, concentrated mainly in Bangladesh, Indonesia, Sudan and Pakistan. However, research on the particular area of the role of Islamic MFIs in developing MEs is limited. In Indonesia, the two main players in Islamic microfinance are BMTs and BPRS, each of which has a different nature and regulatory environment.

After extensive empirical analyses and discussion in the previous chapters, the findings of this research suggest that BMTs and BPRS have good potential and play a positive role in developing MEs. As community-based organisations, they continue to maintain close relationships with their customers, a factor missing in larger financial institutions. However, the findings also reveal the challenges faced by BMTs and BPRS in the field, which include tough competition from conventional commercial banks and other institutions that also provide micro financing, and the absence of an appropriate regulatory framework for BMTs, until a new Act no 1/2013 on Microfinance Institution just recently endorsed in January 2013 and will be applied in 2015.

Despite their large numbers, potential and important role in the macro economy, MEs face challenges in gaining access to financing and promoting their products/services. As the findings in this study show, despite being clients of BMTs and BPRS, they have a very low level of understanding of Islamic terms used in the Islamic micro financing products. In some cases, since cash is given instead of goods, the findings show that there are some changes in the actual use of funds due to unforeseen financial difficulties; *e.g.* instead of using the funds as working capital, the customers use them both as working capital and for consumption. As part of the arrangements for approving financing applications, there seems to be a high dependency on collateral, which is likely to be higher than the financing amount, usually in the form of home/land/car/motorcycle certificates and savings. This calls attention to the need to reduce this dependency, such as by establishing a credit guarantees board. The requirement for collateral could be assumed to be a backup in the event of default, as the findings also reveal that almost a quarter of the respondents experienced arrears, mainly due to business failures and distress/urgent consumption needs.

Similarly, the BMTs and BPRS also experienced challenges in terms of risk and moral hazard, difficulty in accessing borrowers' financial flows, lack of capital particularly during seasonal circumstances, managerial problems, lack of infrastructure, lack of personnel, lack of staff skills, lack of vehicles and lack of appropriate legal basis for BMTs. The financing and non-financing services provided by BMTs and BPRS have the same characteristics, such as mainly providing individual financing with *murabahah* as the most common mode of financing, implementation of simple procedures, and quick approval. It should also be noted that all BMTs and BPRS admit to providing social services while more than half of the respondents reported that they had not received any social service development programmes, which might indicate that such programmes should be conducted more often to reach a wider range of communities.

The findings also show that the decisions to choose financing services from BMTs and BPRS are mainly based on the simple procedures offered by these institutions, their strategic locations, good services and flexible collateral; the *Shari'ah*-compliant factor seems to be less important than these technical/practical reasons. To maintain close relationships with the customers, certain regular activities take place: for example, the Accounts Officers of BMTs and BPRS often visit their customers directly, arranging routine and regular religious meetings and organising annual events involving the customers, *etc*.

With particular regard to the socio-economic impact, the empirical findings show significant statistical improvements in annual sales, business expenditures, net income and employment. Although a majority of responses on other variables that were measured based on a qualitative scale, such as assets and economic activities, show 'no effect', some minor positive impacts are still found in the findings, indicating a positive improvement. It should be noted that the empirical evidence, therefore, show that the variables that correlate to the economic impact are assets owned, financing received and duration of relationship with BMT and BPRS, indicating that higher financing and longer relationship with financing provider is likely to improve the economic impact. Similarly, a positive social impact is reported by less than half of the respondents, with fewer respondents reporting religious impact and other impacts. The strong predictor of the social, religious and other impact are social development programme/services, which indicate the importance of improving this services in term of frequency and coverage to improve the impact. Although they present a mixed picture, these findings suggest a reduction in the number of poor respondents after financing.

9.2. REFLECTION OF THEORETICAL FRAMEWORK

The extensive empirical analysis of quantitative and qualitative data are likely to provide evidences that BMTs and BPRS, being community based institutions who could maintain close relationship with their poor customer, have potential and play positive role in enhancing financial inclusion and financial deepening through providing financial access and empowerment to MEs and the poor in Indonesia. As such, these private financial institutions are likely to contribute to finance sector development, particularly in the grass root level serving low income society.

Overall, based on the evidence of comparative analysis on the economic and non-economic conditions before and after financing, the findings of this study supports the premise that opening wider financial access to the poor which will contribute positively to improve financial inclusion, economic development and poverty alleviation (Asutay, 2010; Ledgerwood, *et al.*, 2013; Mohieldin, *et al.*, 2012; Obaidullah, 2008a; Rahman, 2008; Rahman and Ahmad, 2010). A further question whether this economic development may lead to the economic growth will be forwarded for future research.

9.3. RESEARCH IMPLICATION AND PROPOSED RECOMMENDATIONS

The rationale and motivation explained in the introductory chapter resulted in presenting an in-depth analysis of the role of BMTs and BPRS in developing MEs and reducing poverty. Hence, it is expected that this research will contribute to the current academic research in the area of Islamic microfinance by adding information on the current issues, practices and challenges faced by BMTs, BPRS and MEs and the socio-economic impacts on the borrowers. The literature survey process conducted during this research has revealed no previous studies that touch upon these aspects in detail; as far as the researcher has been able to ascertain, no previous studies have investigated large numbers of respondents in both BMTs and BPRS, or provided a comparative analysis of both types of institutions. The previously discussed gap in the literature has provided a better way of looking at BMTs since this study has produced findings that contradict the previous findings in Indonesia. The empirical evidence presented in this research, hence, has implications for customers, particularly MEs, and officials of BMTs and BPRS, the government as regulator, and related organisations.

The implications of the research for BMTs' and BPRS' customers include increasing the possibility of recognising their current characteristics, difficulties and expectations, such as their low level of understanding, and the need for social development programmes, *etc*. It should be noted that such detail comparative analysis of two types of IsMFIs, namely

BMT as cooperative and BPRS as a bank, has contributed to the observed gap in in the literature, as such comparison has not been done previously.

In addition, the findings could be considered valuable for the improvement of BMTs' and BPRS' services through a number of recommendations as follows:

9.3.1. Recommendations for BMT and BPRS

(i) To provide further education and training opportunities to customers and non-customers throughout the year, not just during *Ramadhan*, with the aim of improving their knowledge of Islamic financing products;

(ii) To consider establishing a national deposit and financing guarantee board to reduce the high dependency on collateral, something that is rarely possessed by MEs; this would produce greater access to financing for MEs. This body would also provide a higher level of security level for depositors; hence, in the long run it would increase the funds collected from third parties;

(iii) To consider providing more frequent technological, management, entrepreneurship and bookkeeping training across wider areas to reach more customers in collaboration with other related institutions, for instance, with universities under the community service programmes, BMT and BPRS associations, *etc*, since these services are rarely provided due to limited resources;

(iv) To consider extending their services into social development programmes within the understanding of the developmental needs of their clients as necessitated by the Indonesian political economy context, and also by the rationale through which they were instituted, i.e. not only financial solution but also as a socio-economic proposal; this should not be at the expense of their financial efficiency but in an ingenious manner social and financial optimality should be sought for;

(v) To conduct better promotional activities of their financing products to wider communities;

(vi) To be innovative in their financial product development to meet the particular needs of their clients;

(vii) To reduce high dependency on *murabahah,* when possible, and start to utilise more profit-sharing financing products (*mudharabah, musharakah, etc.*).

9.3.2. Recommendations for Regulator and other Related Organisations

To develop BMT' and BPRS' capacity to serve MEs, the following recommendations for government and other related organisations are developed:

(i) To conduct more routine and regular educational and promotional activities through written and audiovisual media;

(ii) To support and facilitate the establishment of a Deposit and Financing Guarantee Agency for BMT' customers, as the same body has been established for BPRS, to provide a higher level of security for depositors and enable MEs without collateral to have the same access opportunities.

9.4. LIMITATIONS OF THE STUDY

During this research, some limitations and challenges were faced; these affected the outcome of this research, which are as follow:

(i) This research limits its focus to merely two types of Islamic microfinance provider, namely BMTs and BPRS, which are considered the main players in the market, although there are other types of Islamic MFIs serving financing needs of MEs in the market, such as Islamic Pawnshop, Islamic PNM (Permodalan Nasional Madani), *etc*;

(ii) Due to time and cost limitations, this research only focused on 22 BMTs and BPRS in 12 cities/towns in East Java; it was unable to cover all 38 cities/towns;

(iii) The total number of respondents in this research was limited to 348. The analysis and findings would have been more robust had the number of respondents been increased. This, however, could not be possible due to time and cost factors;

(iv) Again, due to resource constraints, this research did not include any control groups - those who do not receive any micro financing either from BMT or BPRS;

(v) This research was conducted on only one occasion; an ideal impact analysis should be conducted through a longitudinal manner, whenever possible.

9.5. SUGGESTIONS FOR FUTURE RESEARCH

Based on the experiences and constraints faced during the research, there are a number of suggestions that might be found useful for enhancing the quality of future research as follows:

(i)_ Future research might consider covering wider samples comparing conventional and Islamic MFIs in order to capture knowledge of their role in reducing poverty through developing microenterprises;

(ii) It may also be useful to cover other types of Islamic MFIs, such as Islamic Pawnshops, Islamic PNM, *etc*.;

(iii) Future research might consider including a control group in order to compare the impacts on recipients and non-recipients;

(iv) It is suggested that repeated measures of the impacts in fieldwork through longitudinal manner should be conducted in at least two different time periods be used to capture more real data and more robust findings;

(v) It is suggested that future research apply more robust statistical analysis tools, such as multiple regression analysis, to produce stronger findings;

(vi) Future research might consider including other aspects of microfinance that have not been covered in this research, such as sustainability and outreach;

(vii) Considering the large amount of work and resources required to produce better research, it is suggested that future researchers conduct their studies in collaboration with other related institutions.

9.6. EPILOGUE

The insightful objective of this research is to support the provision of wider access to financing and social development programmes for MEs by Islamic MFIs, particularly BMT and BPRS, in order to assist them to achieve a higher level of welfare, self-confidence and financial independency. The empirical chapters have presented and provided evidence that MEs have potential and that BMT and BPRS could play an important role in supporting them, an idea generally aligned with related previous studies. Therefore, it is hoped that, at least in some small part, this research will contribute to increasing the recognition of the role and challenges faced by Islamic MFIs and encouraging support from all related stakeholders for the development of MEs and Islamic MFIs in Indonesia.

Considering the research presented in foundational and empirical chapters, it can, hence, be concluded that this research has fulfilled its research aims and objectives set at the beginning of the research.

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APPENDICES

Appendix 5.1a: |Summary of Normality Test

Q.no	Variable	Kolgomorov	Shapiro-Wilk	Normality
2	Microenterprise as main income	.000	.000	Not normal
3	Other income	.000	.000	Not normal
4	Marital status	.000	.000	Not normal
5	Gender	.000	.000	Not normal
6	Age	.002	.000	Not normal
7	Education	.000	.000	Not normal
8	Religious education	.000	.000	Not normal
9	Religious activity	.000	.000	Not normal
10	Household size (male)	.000	.000	Not normal
11	Household size (female)	.000	.000	Not normal
12	Area of business	.000	.000	Not normal
13	Age of enterprise	.000	.000	Not normal
14	Business field	.000	.000	Not normal
15	Manager/owner	.000	.000	Not normal
16	Place of business location	.000	.000	Not normal
17	Asset : land	.000	.000	Not normal
	Building	.000	.000	Not normal
	Car	.000	.000	Not normal
	Cattle	.000	.000	Not normal
	Productive asset	.000	.000	Not normal
	Electric good	.000	.000	Not normal
	Jewellery	.000	.000	Not normal
	Savings	.000	.000	Not normal
18	Problems. Production	.000	.000	Not normal
	Finance	.000	.000	Not normal
	Bookkeeping	.000	.000	Not normal
	Management	.000	.000	Not normal
	Marketing	.000	.000	Not normal
19	Type of microfinance (BMT/BPRS)	.000	.000	Not normal
21	Keluarga/famili/teman	.000	.000	Not normal
	Rentenir	.000	.000	Not normal
	Arisan	.000	.000	Not normal
	Pegadaian (konvensional)	.000	.000	Not normal
	Pegadaian (syariah)	.000	.000	Not normal
	Koperasi/Simpan Pinjam	.000	.000	Not normal
	Permodalan Nasional Madani	.000	.000	Not normal
	BPR	.000	.000	Not normal
	BRI Unit Desa	.000	.000	Not normal
	Bank Islam	.000	.000	Not normal
	Bank Umum Konvensional	.000	.000	Not normal
22	Are you a member of the group in order to get loan?	.000	.000	Not normal
23	Do you consult other group members on how to use the fund?	.000	.000	Not normal
24	How long have you been member/clients of BMT/BPRS?	.000	.000	Not normal
	How ong have you been borrower of BMT/BPRS?	.000	.000	Not normal

Appendix 5.1b: |Summary of Normality Test

Q.no	Variable	Kolgomorov	Shapiro-Wilk	Normality
25	Level of agreements in the factors in decision making when borrowed from BMT/BPRS: Shariah compliant	.000	.000	Not normal
	The procedure to get fund is not complicated.	.000	.000	Not normal
	Cost related financing product is cheaper	.000	.000	Not normal
	Flexible and easy collateral	.000	.000	Not normal
	Located in various places and easy to reach.	.000	.000	Not normal
	Influence from /follow particular people (Parents, friends, colleagues	.000	.000	Not normal
	Advertisements in printed or electronic media (TV, radio).	.000	.000	Not normal
	Socialization from particular party	.000	.000	Not normal
	Provision of social services (training, consultancy etc)	.000	.000	Not normal
	Good service	.000	.000	Not normal
26	How many times have you borrowed money from Islamic BMT /BPRS?	.000	.000	Not normal
27	Times duration after received the last loan.	.000	.000	Not normal
28	How long is the duration of loan payment?	.000	.000	Not normal
29	What are the types of loan from Islamic Microfinance you use? (choose all appropriate) : musharakah	.000	.000	Not normal
	Mudharabah	.000	.000	Not normal
	Bai' bitsaman ajil	.000	.000	Not normal
	Murabahah	.000	.000	Not normal
	Salam	.000	.000	Not normal
	Qard Hasan	.000	.000	Not normal
30	How is your level of understanding on Terms used in Islamic Finance? Riba	.000	.000	Not normal
	Musharakah	.000	.000	Not normal
	Mudharabah	.000	.000	Not normal
	BBA	.000	.000	Not normal
	Murabahah	.000	.000	Not normal
	Ijarah	.000	.000	Not normal
	Salam	.000	.000	Not normal
	Qard Hasan	.000	.000	Not normal
31	What is the total amount of money you have borrowed (fully paid and outstanding)?	.000	.000	Not normal
	How much fund is your last loan received?	.001	.000	Not normal
32	What was the original intended purpose of the loan? (tick one only)	.000	.000	Not normal

Appendix 5.1c: |Summary of Normality Test

Q.no	Variable	Kolgomorov	Shapiro-Wilk	Normality
34	If you have provided collateral, in your own opinion, has the amount of total collateral you provided for borrowing money been higher than the total amount you borrowed taking into account the number of times borrowing has taken place?	.000	.000	Not normal
35	How often are your installments	.000	.000	Not normal
36	What was/is the actual use of loan?	.000	.000	Not normal
37	Who did make the decision on how to use the fund?	.000	.000	Not normal
38	Have you had any arrears in your instalments?	.000	.000	Not normal
39	If Yes, what are the reasons for the arrears? (you may tick more than one)business failure	.000	.000	Not normal
	consumption requirements	.000	.000	Not normal
	distress/urgent consumption	.000	.000	Not normal
40	If you are a group borrower, what other members did when you had arrears?	.110	.024	Normal
41	Sales (before loan)	.000	.000	Not normal
	Sales (after loan)	.000	.000	Not normal
	Net income (before loan)	.000	.000	Not normal
	Net income (after loan)	.000	.000	Not normal
42	Impact on assets: LAnd/agriculture	.000	.000	Not normal
	Building	.000	.000	Not normal
	Private car/motorcycle	.000	.000	Not normal
	Cattle	.000	.000	Not normal
	Productive assets	.000	.000	Not normal
	Electric goods	.000	.000	Not normal
	Jewellery (gold)	.000	.000	Not normal
	Saving	.000	.000	Not normal
43	Impact on economic activities : Volume of goods/services sold	.000	.000	Not normal
	Quality of your goods/services	.000	.000	Not normal
	Diversification into new goods/services	.000	.000	Not normal
	Production technology	.000	.000	Not normal
	Bookkeeping	.000	.000	Not normal
	Premises	.000	.000	Not normal
44	Business expenditure (before financing)	.000	.000	Not normal
	Business expenditure (after financing)	.000	.000	Not normal
	Household expenditure (before financing)	.000	.000	Not normal
	Household expenditure (after financing)	.000	.000	Not normal

Appendix 5.1d: |Summary of Normality Test

Q.no	Variable	Kolgomorov	Shapiro-Wilk	Normality
45	Impact on business expenditure: Tools/minor equipment	.000	.000	Not normal
	Stocks (eg. shop stock, raw material etc)	.000	.000	Not normal
	Rent (per year)	.000	.000	Not normal
	Utilities	.000	.000	Not normal
	Transport	.000	.000	Not normal
	Wages	.000	.000	Not normal
	Loan repayment	.000	.000	Not normal
46	Impact on household expenditure: Food	.000	.000	Not normal
	Health/medical	.000	.000	Not normal
	Education	.000	.000	Not normal
	Clothing	.000	.000	Not normal
	Transport	.000	.000	Not normal
	Household utensils	.000	.000	Not normal
	Furniture/electronic purchase (per year)	.000	.000	Not normal
47	Male worker (before loan)	.000	.000	Not normal
	Female worker (before loa)	.000	.000	Not normal
	Male worker (after loan)	.000	.000	Not normal
	Female worker (after loan)	.000	.000	Not normal
48	Who does allocate more time in productive activities as a result of the loan? (you may tick more than one)	.000	.000	Not normal
	Spouse	.000	.000	Not normal
	Other household members	.000	.000	Not normal
	Employees (non family members)	.000	.000	Not normal
	Business partner	.000	.000	Not normal
49	In relation to the loan, do you obtained social service from the loan provider? (you may tick more than one). Management trainings (organizational, management and bookkeeping etc)	.000	.000	Not normal
	Technical training	.000	.000	Not normal
	Consultancy services	.000	.000	Not normal
	Religious training related to business ethics	.000	.000	Not normal
	No social services development program	.000	.000	Not normal
	Don’t know/don’t remember	.000	.000	Not normal
50	Impact social, religious and other: Relationship with spouse/family members	.000	.000	Not normal
	Relationship with other group members (if you answer yes to question no 19)	.000	.000	Not normal
	Knowledge of Islam	.000	.000	Not normal
	Islamic practice in personal life	.000	.000	Not normal
	Islamic practice in business life	.000	.000	Not normal
	Children education	.000	.000	Not normal
	Nutrition	.000	.000	Not normal
	Health	.000	.000	Not normal
	Housing stock	.000	.000	Not normal
	Family empowerment	.000	.000	Not normal
	Women decision-making power	.000	.000	Not normal

Appendix 6.1: Spearman Rank Order Correlation: Impact on Asset After Financing

Independent Variables	Impact							
	Land/Agri culture	Building	Private car/motor	Cattle	Productive assets	Electronic	Jewelry	Saving
ME income	-.099	-.030	-.063	.003	-.042	-.085	-.029	.094
Gender	.020	-.025	-.117*	.001	.093	-.055	.107*	-.069
Age	.047	.029	-.108*	.042	-.113*	-.104	-.009	-.081
Educ	-.097	-.040	.047	-.048	.014	.026	-.027	.163**
Relieduc	-.127*	-.195**	-.175**	.066	-.233**	-.160**	-.142**	-.174**
Reliactive	.035	-.040	-.012	-.122	-.044	-.020	.025	.000
Household size	.025	-.084	.076	.014	.004	.076	-.054	-.024
Business area	-.129*	-.144**	-.028	-.215**	-.036	-.112*	-.075	-.008
Business age	.157**	.078	.088	-.078	.003	.101	.005	-.016
Asset land	.292**	.299**	.101	.152**	.298**	.212**	.076	.065
Building	.100	-.009	.024	-.127*	.026	-.007	.053	.052
Private car	.152**	.090	.172**	-.045	.156**	.212**	.166**	.122*
Cattle	.016	.087	.002	.567**	.022	-.008	.037	-.029
Prod asset	.192**	.285**	.280**	.082	.638**	.325**	.183**	.065
Electric	.216**	.239**	.241**	.027	.430**	.324**	.211**	.159**
Jewellery	.078	.125*	.170**	.012	.192**	.121*	.364**	.136*
Saving	.133*	.143**	.160**	.016	.168**	.136*	.154**	.352**
Type of IsMFI	.099	.134*	.210**	.137*	.343**	.177**	.156**	-.053
Member of group	.057	.001	.006	-.100	-.015	-.037	-.014	.000
Membership duration	.244**	.247**	.221**	.074	.112*	.131*	.097	.125*
Borrowing duration	.265**	.264**	.209**	.078	.058	.166**	.122*	.113*
Times borrow	.249**	.215**	.260**	.084	.092	.137*	.159**	.160**
Duration after last loan	.054	.018	-.001	-.032	.006	.008	-.008	.009
Duration loan repayment	.093	.181**	.014	.127*	.095	.074	.005	-.088
Total loan	.354**	.303**	.368**	.081	.209**	.316**	.238**	.201**
Actual use loan	.036	.088	-.008	.107*	-.022	.012	-.073	-.066
Installment	.153**	.161**	.075	.089	.034	.087	.019	-.075
Male worker	.176**	.156**	.212**	.095	.152**	.272**	.100	.170**
Worker female after	.206**	.115*	.003	-.065	.157**	.182**	.141**	-.021
Total worker after	.245**	.214**	.193**	.090	.257**	.355**	.206**	.142**
Social services received (yes/no)	.053	.049	.040	.071	-.064	.019	.063	.201**
Management training	.021	.171**	.017	.130*	.014	.056	.089	.094
Technical	.127*	.089	-.031	-.015	-.060	.080	.143**	.080
Consultancy	.038	-.006	.054	-.023	-.026	.021	.036	.205**
Religious training	.034	-.007	.032	.092	-.033	-.064	-.049	.016

Note: Correlation coefficient are presented

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Appendix 6.2: Spearman Rank Order Correlation: Impact on Productive Activities after Financing

Variable	Impacts					
	Volume	Quality	Diversification	Prod. tech	Bookkeeping	Premises
ME income	-.043	.026	.078	.047	-.011	-.022
Other income	.048	.061	.033	.052	.069	.085
Gender	.063	.041	-.047	-.076	-.177**	-.050
Age	-.081	-.041	-.119*	-.089	-.159**	.001
Educ	.000	.030	.106*	.120*	.117*	.005
Relieduc	-.255**	-.244**	-.241**	-.089	-.194**	-.264**
Reliactive	-.100	-.179**	.010	-.012	.048	-.023
Household size	.007	-.033	.014	-.028	-.062	-.006
Business area	-.060	-.008	-.214**	-.062	-.102	-.215**
Business age	.017	.070	-.044	-.061	-.005	.095
Asset land	.227**	.105	.317**	.067	.056	.216**
Building	.061	.075	-.152**	.014	.037	-.059
Private car	.140**	.128*	.102	.062	.153**	.154**
Cattle	.091	.101	.052	.015	.031	.089
Prod asset	.429**	.436**	.355**	.153**	.140**	.265**
Electric	.316**	.278**	.264**	.118*	.144**	.225**
Jewellery	.200**	.203**	-.030	-.024	.104	.054
SAving	.179**	.116*	.141**	-.027	.065	.076
Total assets	.266**	.232**	.184**	.047	.059	.151**
Type of IsMFI	.145**	.299**	.054	.123*	.036	.209**
Member of group	.029	.010	-.034	-.008	-.022	-.011
Membership duration	.136*	.204**	.114*	.041	.043	.145**
Borrowing duration	.087	.143**	.105	.003	.053	.191**
Times borrow	.157**	.179**	.193**	.058	.124*	.139**
Duration after last loan	-.067	-.052	-.073	-.006	.001	.051
Duration loan repayment	-.019	.020	.140**	.051	-.003	.165**
Total loan	.286**	.279**	.247**	.124*	.199**	.260**
Actual use loan	-.160**	-.213**	-.027	-.087	-.142**	-.019
Installment	.035	.096	.084	.076	.076	.146**
Male workers	.128*	.185**	.217**	.198**	.225**	.184**
Worker female after	.211**	.161**	.067	-.036	-.105	.109*
Total worker after	.279**	.273**	.247**	.162**	.166**	.191**
Social services received (yes/no)	.114*	.152**	.180**	.100	.195**	.090
Management training	.138**	.119*	.128*	.100	.037	.041
Technical	.089	.096	-.039	-.018	-.016	-.028
Consultancy	.085	.147**	.213**	.134*	.182**	.094
Religious training	.030	-.003	-.001	-.017	.148**	.055

Note: Correlation coefficients are presented
**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Appendix 6.3: Spearman Rank Order Correlation: Impact on Business Expenditure after Financing

Independent Variables	Impact						
	Tools/minor equipment	Stocks	Rent /year	Utilities	Transport	Wages	Loan repayment
ME income	.025	-.112*	-.012	.011	.021	-.048	.112*
Gender	-.004	.071	-.107*	-.058	-.082	-.163**	-.037
Age	-.069	-.061	.038	-.067	-.058	-.046	.065
Educ	.037	.093	.079	.088	.010	.076	.005
Relieduc	-.195**	-.230**	-.185**	-.201**	-.245**	-.196**	-.164**
Reliactive	-.004	-.005	.035	.036	-.057	-.094	-.062
Household size	-.045	-.069	-.059	-.003	.091	.071	.038
Business area	-.168**	-.087	-.063	-.227**	-.174**	-.046	-.062
Business age	.035	.050	.095	.037	.026	.078	-.001
Asset land	.240**	.141**	.070	.324**	.217**	.208**	-.141**
Building	-.088	.031	-.053	-.180**	.026	.071	.088
Private car	.101	.223**	-.025	.056	.143**	.168**	-.001
Cattle	.087	.015	.091	.119*	.146**	.073	-.005
Prod asset	.326**	.364**	.005	.352**	.302**	.267**	-.190**
Electric	.229**	.269**	.066	.252**	.204**	.221**	-.060
Jewellery	.038	.175**	.018	.018	.110*	.087	.024
SAving	.056	.031	.070	.108*	.121*	.068	-.011
Total assets	.181**	.235**	.006	.189**	.200**	.198**	-.097
Type of IsMFI	.052	.192**	.005	.143**	.105	.070	-.181**
Member of group	-.100	-.028	.038	-.094	-.004	.068	.081
Membership duration	.076	.094	.143**	.107*	.130*	.129*	.075
Borrowing duration	.073	.073	.149**	.118*	.086	.135*	.041
Times borrow	.189**	.153**	.152**	.206**	.147**	.090	.051
Duration after last loan	-.105	-.012	.030	-.115*	-.146**	-.033	-.093
Duration loan repayment	.021	.085	.018	.111*	-.005	.001	-.115*
Total loan	.221**	.224**	.164**	.272**	.306**	.246**	.013
Actual use loan	.023	-.211**	-.075	.053	-.054	.021	-.143**
Installment	.039	.029	.067	.123*	.087	.119*	-.037
Male workers	.166**	.005	.121*	.263**	.249**	.407**	-.002
Worker female after	.093	.147**	.010	.103	.111*	.175**	-.043
Total worker after	.237**	.108*	.129*	.291**	.293**	.499**	-.012
Social services received (yes/no)	.146**	.033	.113*	.092	.064	.065	.262**
Management training	.145**	.099	.049	.137*	.027	.001	.066
Technical	-.037	-.060	-.013	-.036	.090	.119*	-.029
Consultancy	.104	.115*	.156**	.086	.069	.055	.269**
Religious training	.100	-.059	-.020	.072	.049	.031	.048

Note: Correlation coefficients are presented

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Appendix 6.4: Spearman Rank Order Correlation: Impact on Household Expenditure After Financing

Independent Variables	Impact						
	Food	Health/ medical	Education	Clothing	Transport	Household utensils	Furniture/ electronic
ME income	.046	.052	.113*	.026	.073	-.023	-.034
Gender	-.046	-.045	-.056	-.077	-.096	-.001	.037
Age	.009	.046	-.098	-.110*	-.028	-.060	-.111*
Educ	-.035	-.072	-.009	.002	.088	-.021	.002
Relieduc	-.220**	-.179**	-.224**	-.189**	-.233**	-.231**	-.178**
Reliactive	-.047	-.044	.002	-.005	-.032	.031	.026
Household size	.096	.045	.195**	.061	.118*	.027	.008
Business area	-.117*	-.066	-.168**	-.107*	-.151**	-.182**	-.178**
Business age	.091	.065	.068	-.003	.057	.012	-.002
Asset land	.131*	.117*	.296**	.246**	.217**	.248**	.320**
Building	-.035	-.058	-.097	-.094	-.079	-.059	-.035
Private car	.134*	.072	.067	.108*	.141**	.099	.227**
Cattle	.027	.042	.044	.137*	.098	.022	.056
Prod asset	.204**	.147**	.128*	.243**	.199**	.274**	.339**
Electric	.150**	.028	.070	.079	.133*	.228**	.346**
Jewellery	.127*	.060	-.002	.086	.085	.103	.153**
Saving	.075	.043	-.014	.139**	.083	.176**	.163**
Total assets	.072	.042	.081	.147**	.132*	.182**	.259**
Type of IsMFI	.028	.074	.043	.062	.108*	.074	.136*
Member of group	.028	.067	.030	.113*	.066	-.027	-.051
Membership duration	.181**	.069	.127*	.038	.139**	.058	.039
Borrowing duration	.151**	.045	.083	.019	.127*	.052	.024
Times borrow	.191**	.087	.154**	.143**	.212**	.115*	.070
Duration after last loan	-.003	-.021	.058	-.037	-.092	-.041	-.004
Duration loan repayment	-.039	.034	.075	-.050	-.024	.077	.131*
Total loan	.211**	.097	.189**	.196**	.265**	.179**	.231**
Actual use loan	.057	-.067	.102	.085	.026	.066	.060
Installment	.057	.035	.078	.012	.073	.028	.054
Male workers	.214**	.110*	.140**	.184**	.233**	.155**	.233**
Worker female	.201**	.046	.081	.065	.057	.182**	.183**
Total worker	.315**	.096	.161**	.189**	.201**	.237**	.322**
Social services received (yes/no)	.097	.035	.075	.065	.037	.057	.056
Management training	-.006	.012	-.007	-.045	-.044	-.037	.082
Technical	.078	.118*	.080	.097	.102	.081	.095
Consultancy	.074	.106*	.113*	.120*	.036	.066	.061
Religious training	.065	-.081	-.037	-.001	.062	.037	.010

Note: Correlation coefficients are presented

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Appendix 6.5: Spearman Rank Order Correlation: Other Impact after financing

Independent Variables	Impact					
	Children education	Nutrition	Health	Housing stock	Family empowerment	Women decision making
ME main income	.096	.040	.038	.016	.065	.014
Other income	-.110*	-.095	-.019	-.070	-.036	-.186**
Marital	-.030	.052	.018	-.018	-.028	.064
Gender	-.066	-.010	-.031	.064	-.031	.129*
Age	-.100	-.021	-.053	-.089	-.054	-.027
Education	.028	.005	-.052	-.039	-.055	-.122*
Religious education	-.209**	-.299**	-.242**	-.296**	-.271**	-.248**
Religious activity	.049	-.021	-.020	.013	.145**	.038
Household size	.175**	.085	.065	.022	.036	.089
Business area	-.167**	-.130*	-.094	-.199**	-.148**	-.145**
Business age	.052	.080	.061	.055	.064	-.010
Asset land	.302**	.206**	.132*	.318**	.290**	.255**
Building	-.071	.003	-.041	-.032	-.064	-.165**
Private car	.040	.047	.066	.070	.024	-.048
Cattle	.155**	.133*	.057	.061	.115*	.104
Prod asset	.218**	.279**	.152**	.255**	.127*	.205**
Electronic	.160**	.224**	.091	.264**	.126*	.144**
Jewellery	.079	.109*	.115*	.093	.044	.085
Saving	.027	.087	.046	.177**	.159**	.080
Total assets	.116*	.124*	.029	.170**	.061	.037
Type of IsMFI	.052	.038	-.024	.025	-.148**	.013
Member of group	-.080	-.046	.037	-.097	-.201**	-.114*
Membership duration	.144**	.089	.121*	.070	.039	.149**
Borrowing duration	.118*	.084	.114*	.060	.025	.091
Times borrow	.199**	.178**	.202**	.137*	.158**	.174**
Duration after last loan	-.029	-.071	-.109*	-.077	-.080	-.049
Duration loan repayment	.057	.006	-.021	.023	.004	.031
Total loan	.189**	.187**	.142**	.192**	.127*	.129*
Actual use loan	.093	-.009	-.034	.050	.048	.087
Installment	.036	.050	.011	.073	-.016	-.016
Male workers	.179**	.212**	.203**	.233**	.221**	.055
Female workers	.044	.114*	.055	.184**	.159**	.217**
Total workers	.177**	.256**	.200**	.317**	.283**	.213**
Social services (yes/no)	.233**	.152**	.246**	.192**	.321**	.152**
Management training	.096	.098	.088	.107*	.174**	.063
Technical training	.096	.101	.113*	.106*	.099	.022
Consultancy	.209**	.154**	.279**	.166**	.210**	.138*
Religious training	.067	.005	.044	.060	.205**	.036

Note: Correlation coefficients are presented
**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Appendix 6.6: BMT and BPRS:
Years Of Establishment, Business Age And Number Of Borrowers

Description	Year of establishment	Business age (as at 2011)	Borrowers
BMT MMU, Pasuruan	1997	14	24,193
BMT UGT Sidogiri	2010	1	
BMT Al-Ikhlas, Malang	1996	15	100
BMT SWM, Malang	1996	15	
BMT A Yani, Malang	1999	12	300
BMT ABM, Malang,	2008	3	206
BMT Pahlawan, Tulungagung	1996	15	1,000
BMT Amanah Ummah, Surabaya	2006	5	500
BMT As-Salam, Probolinggo	2010	1	500
BMT Sabilillah, Malang	1999	12	150
BMT Al-Ikhlas, Lumajang	1997	14	
BMT As-Sakinah, Malang	2008	3	
BPRS Al-Hidayah, Pandaan	1999	12	
BPRS Jabal Tsur, Pandaan	2006	5	784
BPRS Ummu/Untung Suropati, Bangil	1993	18	836
BPRS Lantabur, Jombang	2006	5	
BPRS Bhakti Haji Bululawang	1996	15	243
BPRS Bumi Rinjani Junrejo	1993	18	848
BPRS Bumi Rinjani Batu	2001	10	991
BPRS Karya Mugi Sentosa, Surabaya	2007	4	
BPRS Bumi Rinjani Kepanjen	1992	19	2,465
BPRS Amanah Sejahtera, Gresik	1996	15	2,664
Total		Average:10.5	

Appendix 8.1a: Summary of Findings

No	Subject interest	Findings of Quantitative Analysis	Findings of Qualitative Analysis
1	Potential and prospects	----	BMT, BPRS and MEs have good future prospects, although they have some challenges and barriers to deal with.
2	Major issues and problems	MEs' problems mostly related to difficulty to get financial access.	Risk and moral hazard include risk of default, which mostly due to customer financial problems which resulted in repayment delay and misevaluation of financing application, and having customers with bad behaviours.
		Low level of understanding on Islamic terms	Business problems mostly in difficulty to access borrowers cash flow, competition with conventional bank who offer micro financing, lack of capital particularly in seasonal circumstances, managerial problem due to improper management system *etc*.
		The intention of borrowing mostly for working capital, there is a case of changing of the use of fund.	In general, BMT and BPRS experience lack of fund problems, caused by personal ownership, seasonal high fund withdrawal, fund management failure, and high financing demand.
		All institutions require collateral for financing above certain threshold.	
3	The provision of financing services and financing related services	Almost all respondents (97.7%) are under individual financing.	BMT and BPRS apply both individual and group based. BMT apply more group based, while BPRS apply more individual approach.
		Murabahah is the most common contract (40%) among the respondents.	*Murabahah* is the most popular financing product (86.4%) due its simplicity and similarity to conventional financing product.
			BMT and BPRS apply simple procedure and quick approval, focus mostly on character. The repayment rate is above 90%.
			NPF mostly occurs due to businesses failures, and the efforts to reduce NPF are preventing NPF based on improvement of financing evaluation, intensive monitoring and collection, persuasive personal and religious approach, rescheduling, restructuring and writing off.
		More than half of the respondents have not received any social services development programs.	All BMT and BPRS reported to provide social services and the most popular are consultancy services thought Account Officers and religious meetings.

Appendix 8.1b: Summary of Findings

No	Subject interest	Findings of Quantitative Analysis	Findings of Qualitative Analysis
4	The perceptions of MEs towards the financing and non financing services provided by BMT and BPRS	The main reasons of choosing BMT and BPRS are based on the simple procedure, location, good service and flexible collateral, while the *Shari'ah* compliant factor come up as less important than these five factors.	----
5	The maintenance of relationship between BMT/BPRS and MEs	----	To broaden their outreach and attract new customers, BMT and BPRS open new branch(es)/cash payment office(s)/outlet, promote their products and services through personal approach to other institutions, , maintain to get recommendation/references on new customers from existing good customers, and create networking among members.
			To maintain relationship with their current customers, BMT and BPRS visit them actively/directly and maintain friendship/*silaturahim* with their customers, arrange routine religious meetings, distribute gifts to customers, arrange annual events, provide social services to orphans, offer the best services and maintain personal approach through attending customers' invitation on special events.
6	Role of BMT and BPRS in economic development	Economic impact: Positive and significant impact on the improvement of sales, business expenditures, net income, household expenditures, assets, business activities and employment.	BMT and BPRS have positive contribution for economic development for both borrowers and society. The contribution on the borrowers observed directly through the MEs business development, income, savings, assets, improvement of transportation vehicle and the ability to meet the production target.
		Social impact: Although mostly no effect, there are some significant positive impact on social, religious and other impact.	
7	Role in poverty alleviation	BMT and BPRS have contributed to reduce the number of respondents living under poverty line.	---
8	Financial inclusion in Indonesia	Support the evidence of financial inclusion in terms of access, usage, quality and walfare impact	BMT and BPRS support the financial inclusion though providing financial access and welfare impact.

Appendix 8.2. Summary of BMT and BPRS Businesses Problems

No	BMT	%	BPRS	%
1	Lack of capital	58.3%	Difficulty to assess borrowers' financial flow	80%
2	Difficulty to assess borrowers' financial flow	41.7%	Competition	70%
3	Managerial problem	33.4%	Managerial problems	70%
4	Competition	33.4%	Lack of staffs' skills	60%
5	Lack of personnel	33.3%	Lack of infrastructure	40%
6	Inappropriate type of business organization	33.3%	Lack of personnel	40%
7	Lack of infrastructure	33.3%	Lack of capital	30%
8	Lack of staffs' skills	25.0%	Inappropriate type of business organization	30%
9	Other problems		Other problems	
10	Lack of vehicles to reach borrowers	8.3%	Lack of vehicles to reach borrowers	10%

Appendix 8.3: Summary of Findings: Financing and Financing Related Services

Subject interest	Findings of Quantitative Analysis	Findings of Qualitative Analysis
Financing approach	Almost all respondents (97.7%) are under individual financing.	BMT and BPRS apply both individual and group based. BMT apply more group based, while BPRS apply more individual approach.
Financing products	*Murabahah* is the most common contract (40%) among the respondents.	*Murabahah* is the most popular financing product (86.4%) due its simplicity and similarity to conventional financing product.
Ratio of Profit and Loss Sharing	---	Mostly based on individual case basis. BMT and BPRS have different common PLS ratio; 60:40 and 40:60 respectively.
Financing Evaluation and Repayment	---	BMT and BPRS apply simple procedure and quick approval, focus mostly on character. The repayment rate is above 90%.
Strategies to Reduce Non Performing Financing	---	NPF mostly occurs due to businesses failures, and the efforts to reduce NPF are preventing NPF based on improvement of financing evaluation, intensive monitoring and collection, persuasive personal and religious approach, rescheduling, restructuring and writing off.
Social Development Services	More than half of the respondents have not received any social services development programs.	All BMT and BPRS reported to provide social services and the most popular are consultancy services thought Account Officers and religious meetings.

Appendix 8.4. Summary of the Findings: Economic and Social Impacts

Subject interest	Findings of Quantitative Analysis	Findings of Qualitative Analysis
	Economic impact	
Sales	Annual sales improve 50%, in which BMT respondents improve 50% higher than BPRS	---
Business expenditures	Annual business expenditures slightly improve, BPRS respondents have slightly higher improvement.	---
	Majority reported no effect on monthly business expenditures, however, there are small positive effect and the BMT respondents have higher impact than BPRS.	
Net income	Net income of BPRS respondents is three times higher than BMT respondents.	---
Household expenditure	Household expenditures of BPRS respondents improved more than doubled as compare to BMT respondents.	---
Assets	Large majority reported no effect on assets, however, there are small positive impact, in which the BMT' respondents reported higher impact.	---
Economic Activities	The highest impact on economic activities related to good/ services sold, includes improvement of volume, quality and diversification. In general, the BPRS respondents reported higher impact on economic activities.	---
Employment	The total number of workers improved significantly, in which the BPRS respondents reported higher impact on employment.	---
	Social Impact	
Social impact	Less than half of respondents (40%) reported positive effects on relationship with spouse/family members.	---
	Without social service, 25% of total respondents reported positive effect, which is higher than respondents with social service reported only 12% positive effect.	
	Less than a quarter of BMT respondents (22%) reported positive effect, higher than BPRS respondents (16.4%)	
Religious impact	More than 75% reported no religious impact.	---
	The religious impact is higher among the respondents who received social services.	
	The religious impact of BMT respondents is higher than BPRS.	
Other impact	Majority reported no impact, however, there are some positive impact.	---
	The highest no impact is health, while the highest positive impact is women decision making power.	
	BMT and BPRS have positive impact on family empowerment.	
	The greatest impact are among the respondents in urban area.	
	BMT and BPRS perspectives	
Role in economic development	---	BMT and BPRS have positive contribution through improvement of business development, income, savings, assets, transportation tools *etc.*

APPENDIX A

Dear Respondent,

This survey is conducted as part of a PhD research at the Durham Islamic Finance Programme, Durham University, United Kingdom focusing on the area of Islamic Microfinance in Indonesia. The aim of this questionnaire is to find out the Islamic microfinance clients' perception in relation to services provided by Islamic Microfinance Institution and the impact of Islamic Microfinance (BPRS and BMT) in developing microenterprises.

Your participation in this survey is very valuable, so please answer the questions below which should not take much of your time. Please just tick the box(es) which most applicable to you.

The confidentiality of all responses will be protected; as the identity of all respondent will be kept anonymous. If you have any queries, please contact me via email n.i.riwajanti@durham.ac.uk.

I would like to thank you in advance for volunteering to participate. This can provide advantage to the future of Islamic microfinance and the clients (respondents) as well.

Yours sincerely,

Nur Indah Riwajanti

MICROENTERPRISE PROFILE

1. Please state if you have borrowed money from BMT or BPRS for your microenterprise?
   ☐ Yes (continue to Question No. 2) ☐ No (please do not continue)

2. Please state if microenterprise is your main source of income?
   ☐ Yes ☐ No

3. Other than income from microenterprises (being entrepreneur), what is your other job/source of income? (please tick one only)
   ☐ Civil Servant/Government Officials (including Army and Police)
   ☐ Employee in Private company
   ☐ Employee in Government Owned Company
   ☐ Teacher/Lecturer
   ☐ Professional (Accountant, Medical Practitioner, Lawyer etc)
   ☐ Retired
   ☐ Students
   ☐ Housewife
   ☐ None
   ☐ Other……………………………………………

4. Marital status: ☐ Single ☐ Married ☐ Widowed ☐ Divorced/separated

5. Gender : ☐ Male ☐ Female

6. Age :………………….years

7. Your last completed education (please tick one only):
   ☐ Not completed Primary School
   ☐ Primary school
   ☐ Junior High or equivalent
   ☐ Senior High or equivalent
   ☐ Diploma I/II
   ☐ Diploma III
   ☐ Diploma IV/Bachelor (S1)
   ☐ Master
   ☐ PhD/Doctor

8. Religion :
   ☐ Islam
   ☐ Catholic
   ☐ Protestant
   ☐ Hindu
   ☐ Buddhist
   ☐ Confucian
   ☐ Cultist
   ☐ No religion

9. What is your religious education ?
   ☐ Formal
   ☐ Informal
   ☐ None

10. Are you active in personal and social religious activity ? ☐ Yes ☐ No

11. What is your household size (number of your family member under your responsibility, including you)?
    Male :…………..persons
    Female :………..persons

12. The area of your business: ☐ Rural ☐ Urban

13. How old is the enterprise? ……………years + …………months.

14. Please state in which business field you are operating and supported by loan. (please tick one only)
    - ☐ Trade/shops/retail
    - ☐ Manufacturing/craftsman
    - ☐ Services
    - ☐ Transportation
    - ☐ Agriculture services/forestry/stock breeder
    - ☐ Food production (small café, restaurant, catering etc)

15. Who are the main manager and owner the business? (please tick one only)
    - ☐ Self
    - ☐ Spouse
    - ☐ Other family member
    - ☐ Business partner

16. Where do you place business location? (please tick one only)
    - ☐ Fully Mobile
    - ☐ Home
    - ☐ Home shop
    - ☐ Industrial estate
    - ☐ Traditional market
    - ☐ Mall/supermarket
    - ☐ Agricultural land
    - ☐ Other

17. What type of assets (including the estimated value of assets) do you have ?
    - ☐ Land/Agricultural : Rp……………………………………
    - ☐ Building : Rp …………………………………..
    - ☐ Private car/motorcycle : Rp……..
    - ☐ Cattle : Rp…………………………………
    - ☐ Productive assets (machine, car etc) : Rp…………………………………..
    - ☐ Electric goods : Rp…………………………………..
    - ☐ Jewellery (gold) : Rp…………………………………..
    - ☐ Saving : Rp………………………………….

18. How often do you have these following problems in running your business? (please tick one only in every row)

	Never	Rarely	Sometimes	Often	Always
1. Production (eg. difficulty in getting raw material, limited equipment etc)	☐	☐	☐	☐	☐
2. Finance (eg. limited working capital, lack of financial access to get loan etc)	☐	☐	☐	☐	☐
3. Bookkeeping (eg. difficulty in managing financial record etc)	☐	☐	☐	☐	☐
4. Management (eg. difficulty in managing the employees, etc)	☐	☐	☐	☐	☐
5. Marketing (eg. Difficulty in selling the product, finding new market etc)	☐	☐	☐	☐	☐

A. FINANCING

19. What type of Islamic microfinance institution from whom you have borrowed money? (if you borrowed to both type of institutions, please tick one only)
    ☐ BMT ☐ BPRS

20. Please specify name of institution:……………………………………

21. Other than BMT or BPRS, if you have financial problems related to your business, what other institutions have you used ?
    (please tick one only in every row)

Name of Institution	Used	Not used
1. Families/relatives/friends	☐	☐
2. Money lender/landlords (Big Men)	☐	☐
3. ROSCA	☐	☐
4. Pawnshop (conventional)	☐	☐
5. Pawnshop (Islamic)	☐	☐
6. Cooperative/Credit Union	☐	☐
7. Permodalan Nasional Madani	☐	☐
8. Venture Capital	☐	☐
9. Rural Bank (BPR)	☐	☐
10. BRI Microbanking (Indonesian People's Bank)	☐	☐
11. Islamic banks (e.g.BNI Shariah, BCA Shariah etc)	☐	☐
12. Conventional banks (eg. BRI, BNI, BCA etc)	☐	☐

22. Are you a member of the group in order to get loan?
☐ Yes (continue to question 23) ☐ No (continue to question 24)

23. Do you consult other group members on how to use the fund?
☐ Yes ☐ No

24. How long have you been:
a. member/clients of BMT/BPRS? ....years + ……months
b. borrower of BMT/BPRS? ....years + ……months

25. How is your level of agreement in relation to the following factors in decision making when you borrowed money from BMT/BPRS? (please tick one only in every row)

	Strongly disagree	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
1.Shariah compliant (e.g.. prohibition of *riba* (interest), profit and loss sharing system etc)	☐	☐	☐	☐	☐
2. The procedure to get fund is not complicated.	☐	☐	☐	☐	☐
3. Cost related financing product is cheaper.	☐	☐	☐	☐	☐
4. Flexible and easy collateral	☐	☐	☐	☐	☐
5. Located in various places and easy to reach.	☐	☐	☐	☐	☐
6. Influence from /follow particular people (Parents, friends, colleagues)	☐	☐	☐	☐	☐
7. Advertisements in printed or electronic media (TV, radio).	☐	☐	☐	☐	☐
8. Socialization from particular party (ulema, experts in Islamic Economics/Banking, etc)	☐	☐	☐	☐	☐
9. Provision of social services (training, consultancy etc)	☐	☐	☐	☐	☐
10. Good service (staff able to explain banking product clearly and handle complaint quickly).	☐	☐	☐	☐	☐

26. How many times have you borrowed money from Islamic BMT /BPRS? ....times

27. When have you received the last loan from BMT/BPRS?
Month : ……………………..Year:…………….
(Time duration after received the last loan: …………months)

28. How long is the duration of loan payment? ………Years + ……………months

29. What are the types of loan from Islamic Microfinance you use?
(choose all appropriate)
☐ Musharakah
☐ Mudharabah
☐ Bai' bitsaman ajil
☐ Murabahah
☐ Ijarah
☐ Salam
☐ Qard Hasan

30. How good is your level of understanding on terms used in Islamic Finance?
(please tick one only in every row)

Terms	**Poor**	**Fair**	**Good**	**Very Good**	**Excellent**
1. Riba	☐	☐	☐	☐	☐
2. Musharakah	☐	☐	☐	☐	☐
3. Mudharabah	☐	☐	☐	☐	☐
4. Bai' bitsaman ajil	☐	☐	☐	☐	☐
5. Murabahah	☐	☐	☐	☐	☐
6. Ijarah	☐	☐	☐	☐	☐
7. Salam	☐	☐	☐	☐	☐
8. Qard Hasan	☐	☐	☐	☐	☐

31. What is the total amount of money you have borrowed (fully paid and outstanding)?
Rp…………………………

32. What was the original intended purpose of the loan? (tick one only)
☐ Working capital
☐ Fixed capital
☐ Consumption, please specify :……………………………………

33. What collateral have you provided to borrow fund from the BMT/BPRS?
(You may choose more than one if you have borrowed more than once)
☐ Assets (home/building, land) certificate
☐ Car certificate
☐ Motorcycle certificate
☐ Group reference
☐ No collateral
☐ None
☐ Others……………………………….

34. If you have provided collateral, in your own opinion, has the amount of total collateral you provided for borrowing money been higher than the total amount you borrowed taking into account the number of times borrowing has taken place?
☐ Yes ☐ No

35. How often are your instalments (please tick one only):
    - ☐ Daily
    - ☐ Weekly
    - ☐ Quarterly
    - ☐ Monthly
    - ☐ Other

36. What was/is the actual use of loan? (please tick one only)
    - ☐ Working capital only
    - ☐ Fixed capital only
    - ☐ Consumption only
    - ☐ Both fixed and working capital
    - ☐ Consumption and working capital
    - ☐ Consumption and fixed capital

37. Who did make the decision on how to use the fund? (please tick one only)
    - ☐ Self
    - ☐ Spouse
    - ☐ Together (self and spouse)
    - ☐ Other household member
    - ☐ Business Partner

38. Have you had any arrears in your instalments?
    ☐ Yes (continue to question 39) ☐ No (continue to question 40)

39. If Yes, what are the reasons for the arrears? (you may tick more than one)
    - ☐ The business was not successful (business failure)
    - ☐ Natural disaster
    - ☐ Consumption requirements
    - ☐ Distress /urgent consumption

40. If you are a group borrower, what other members did when you had arrears? (Please answer if you stated 'yes' as a member of a group in question 20)
    - ☐ Help pay (with money)
    - ☐ Giving peer and group pressure
    - ☐ Ask spouse/other household members
    - ☐ Do nothing

B. ECONOMIC IMPACTS

41. How much is your average MONTHLY sales and disposable (net) income from your microenterprise in the last three recent months? (please EXCLUDE income from other job)

	Before loan	**After loan**
Sales	Rp	Rp
Net income	Rp	Rp

42. In your perception, what is the impact of the loan to your assets? (please tick one only in every row)

Major Negative Effect	If there is more than 51% decreased after loan.
Minor Negative Effect	If there is a 0% - 50% decreased after loan.
No effect	If there is no effect at all after loan.
Minor Positive Effect	If there is a 0% - 50% increased after loan.
Major Positive Effect	If there is more than 51% increased after loan.

Types of assets	**Major Negative Effect**	**Minor Negative Effect**	**No Effect**	**Minor Positive Effect**	**Major Positive Effect**
1. Land/Agricultural	☐	☐	☐	☐	☐
2. Building	☐	☐	☐	☐	☐
3. Private car/motorcycle	☐	☐	☐	☐	☐
4. Cattle	☐	☐	☐	☐	☐
5. Productive assets	☐	☐	☐	☐	☐
6. Electric goods	☐	☐	☐	☐	☐
7. Jewellery (gold)	☐	☐	☐	☐	☐
8. Saving	☐	☐	☐	☐	☐

43. In your perception, what is the effect of the loan on your economic activities? (please tick one only in every row)

Please use the following information to answer the rest of the question below:

Negative Effect	If there is negative effect after loan.
No effect	If there is no effect at all after loan.
Minor Positive Effect	If there is a 0% - 25% increased after loan.
Moderate Positive Effect	If there is a 26%-50% increased after loan.
Major Positive Effect	If there is more than 51% increased after loan.

Economic Activities	**Negative Effect**	**No Effect**	**Minor Positive Effect**	**Moderate Positive Effect**	**Major Positive Effect**
1. Volume of goods/services sold	☐	☐	☐	☐	☐
2. Quality of your goods/services	☐	☐	☐	☐	☐
3. Diversification into new goods/services	☐	☐	☐	☐	☐
4. Production technology	☐	☐	☐	☐	☐
5. Bookkeeping	☐	☐	☐	☐	☐
6. Premises	☐	☐	☐	☐	☐

44. What is the impact of the loan on your business and household consumptions/ expenditure PER MONTH?

Expenditure	Before loan	After loan
1. Business expenditure	Rp	Rp
2. Household expenditure	Rp	Rp

45. In your perception, what is the impact of loan toward your BUSINESS expenditure PER MONTH (in the last three months)?

Business expenditure	Major Negative Effect	Minor Negative Effect	No Effect	Minor Positive Effect	Major Positive Effect
1. Tools/minor equipment	☐	☐	☐	☐	☐
2. Stocks (eg. shop stock, raw material etc)	☐	☐	☐	☐	☐
3. Rent (per year)	☐	☐	☐	☐	☐
4. Utilities	☐	☐	☐	☐	☐
5. Transport	☐	☐	☐	☐	☐
6. Wages	☐	☐	☐	☐	☐
7. Loan repayment	☐	☐	☐	☐	☐

46. In your perception, what is the impact of loan towards your HOUSEHOLD expenditure PER MONTH (in the last three months) ?

Household expenditure	Major Negative Effect	Minor Negative Effect	No Effect	Minor Positive Effect	Major Positive Effect
1. Food	☐	☐	☐	☐	☐
2. Health/medical	☐	☐	☐	☐	☐
3. Education	☐	☐	☐	☐	☐
4. Clothing	☐	☐	☐	☐	☐
5. Transport	☐	☐	☐	☐	☐
6. Household utensils	☐	☐	☐	☐	☐
7. Furniture/electronic purchase (per year)	☐	☐	☐	☐	☐

47. How many people are working in your business (paid and unpaid including your family members and yourself)?
Before loan: Male :………………persons
Female :…………….persons
After loan: Male :………………persons
Female :…………….persons

48. Who does allocate more time in productive activities as a result of the loan? (you may tick more than one)

- ☐ Self
- ☐ Spouse
- ☐ Other household members
- ☐ Employees (non family members)
- ☐ Business partner

C. SOCIAL IMPACTS

49. In relation to the loan, do you obtained social service from the loan provider? (you may tick more than one)

- ☐ Management trainings (organisational, management and bookkeeping etc)
- ☐ Technical training
- ☐ Consultancy services
- ☐ Religious training related to business ethics
- ☐ No social services development program
- ☐ Don't know/don't remember

50. What has been the social, religious and other impact of loan on your life after? (please tick one only in every row)

	Negative Effect	**No Effect**	**Minor Effect**	**Moderate Effect**	**Major Effect**
A. Social impacts					
1. Relationship with spouse/family members	☐	☐	☐	☐	☐
2. Relationship with other group members (if you answer yes to question no. 22)	☐	☐	☐	☐	☐
B. Religious impacts					
1. Knowledge of Islam	☐	☐	☐	☐	☐
2. Islamic practice in personal life	☐	☐	☐	☐	☐
3. Islamic practice in business life	☐	☐	☐	☐	☐
C. Other impacts					
1. Children education	☐	☐	☐	☐	☐
2. Nutrition	☐	☐	☐	☐	☐
3. Health					
4. Housing stock	☐	☐	☐	☐	☐
5. Family empowerment	☐	☐	☐	☐	☐
6.Women decision-making power	☐	☐	☐	☐	☐

Thank you very much for your participation

APPENDIX B

Dear Respondents,

This survey is conducted as part of a PhD research at the Durham Islamic Finance Programme, Durham University, United Kingdom focusing on the area of Islamic Microfinance (particularly BPRS and BMT) in Indonesia. The aim of this interview is to find out: what and how financing services provided by the institution for microenterprises, the role of Islamic microfinance institution in microenterprises development, and the problems face by the institution. The respondents of this interview are officials of BMT and BPRS in East Java.

Your participation in this interview is very valuable, so please answer all the questions below which should not take much of your time.

The confidentiality of all responses will be protected; as the identity of respondents will be kept anonymous. If you have any queries, please contact me via email n.i.riwajanti@durham.ac.uk.

I would like to thank you in advance for volunteering to participate. This can provide advantage to the future of Islamic microfinance and the clients as well.

Yours Sincerely,

Nur Indah Riwajanti

A. Organisation

1. Name of institutions : …………………………………………………………
   Address :…………………………………………………………..
   …………………………………………………………
2. When and where this institution was founded?...
   ………………………………………………………………………………..
3. Who were the initiators or members of the board management?
   ....
   ………………………………………………………………………………..
4. What is the legal type of this organisation?
   ☐ Cooperative
   ☐ Bank
   ☐ Others, please specify :…………………………………

5. Objectives:
   a. What was the original objective? ……………………………………………
      …………………………………………………………………………….
      ……………………………………………………………………………
      ……………………………………………………………………………
   b. Have this original objectives been revised? ☐ Yes ☐ No
   c. If yes, what is/are the new objective/s?
      ……………………………………………………………………………..
      …………………………………………………………………………….
      …………………………………………………………………………….
6. What association do you joint with ? ……………………………………………..
7. How many branches do you have?...
8. Please provide management/organisation structure and job description.

A. Financing Products and services

9. In your opinion, do clients understand terms used in Islamic banking products?
   ☐ Yes ☐ No
   Comments : …..……………………………………………………………
   ……………………………………………………………………………………..
10. Financing approach:
    a. What type of Financing approach have you applied ?
       ☐ Group ☐ Individual ☐ Others, please specify:…………………..
    b. Why do you choose that approach?..
       ……………………………………………………………………………..
       ……………………………………………………………………………..
       ……………………………………………………………………………...

11. Financing product:
    a. Please rank the popularity of the following mode of financing product in your insitutions (1 is the most popular, 5 is less popular) :
       _____Musharakah
       _____Mudharabah
       _____Bai'bitsaman ajil
       _____Murabahah
       _____Ijarah
       _____Salam
       _____Qard Hasan
    b. In your opinion, why is it the most popular mode?
       ………………………………………………………………………………………
       ………………………………………………………………………………………
       ………………………………………………………………………………………
    c. For PLS based, how much the share profit ratio with the clients (bank : clients) ?
       ☐ 40: 50 ☐ 50 : 50 ☐ 60 : 40 ☐ Others :………………….
    d. How long the duration of the loan (in months)?
       Maximum :………………months
       Minimum : ……………....months
       Average :………………months

12. Loan evaluation
    a. How do you evaluate client before distributing loan to them?
       ………………………………………………………………………………………
       ………………………………………………………………………………
    b. What are your criteria to give loan?
       ☐ Assets owned (collateral)
       ☐ Annual revenue
       ☐ Number of labour
       ☐ Credit limit
       ☐ Others:……………………………………………………………………..
    c. Do you know the purposes of loan application? ☐ Yes ☐ No
    d. How long is the time required to evaluate the credit request, from application until the clients get the fund (in working days)?
       ☐ 1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ more than 6 days

13. Collection of repayment
    a. How often do you collect the payment from clients?
       ☐ Everyday
       ☐ Every week
       ☐ Every two weeks
       ☐ Every months
       ☐ Others:…………………………

b. How much the collection/repayment rate in the last 5 years (in percentage)?

2011	2010	2009	2008	2007
…………..%	…………..%	…………..%	…………..%	…………..%

(Note : Repayment rates measure the amount of payments received with respect to the amount due (Ledgerwood, 2000: 206)])

c. What are your strategies to improve collection rate?
……………………………………………………………………………………..
…………………………………………………………………………………….

14. Collateral
   a. Do you required collateral from the clients? ☐ Yes ☐ No
   b. If yes, what collateral do you require?
      ☐ Assets (home/building, land) certificate
      ☐ Car certificate
      ☐ Motorcycle certificate
      ☐ Group reference/pressure
      ☐ Others:………………………………………………………………………...

15. Risk
   a. What risks have you deal with?
      …………………………………………………………………………………….

   b. What types of moral hazard problems have you deal with?
      …………………………………………………………………………………….
      …………………………………………………………………………………….
16. Have you considered to develop more authentic products to respond to the local need and environment? …………………………………………………………………….. ………………………………………………………………………………………… ……………………………………………………………………………………...
17. Please provide the following data of loan outreach:
   a. Number of currently active borrowers :
      - Male……………………persons
      - Female……………………persons
      - Total ……………………..person
   b. Total balance of outstanding loans : Rp……………………….
   c. Real annual average growth rate of loans outstanding during the past three years (in real terms)
      1…………..%, 2…………%, 3……………%
   d. Loan size
      - Minimum : Rp……………………………….
      - Maximum : Rp……………………………….
      - Average : Rp……………………………….
   e. Average outstanding loan size : Rp…………………….
   f. Annual mark up rate (murabahah) :……….%

g. Value of loans per staff member (per credit officer) : Rp………………….
h. Number of loans per staff member (per credit officer)……………….persons

B. The clients (outreach)

18. How do you broaden the outreach?...
....
……………………………………………………………………………..
19. How do you maintain relationship with clients?
……………………………………………………………………………….
20. Please provide the following data on clients and staffs:

Clients/members (in persons)	Male :	Female :
Borrowers	Male :	Female :
Total target clients	Male :	Female :
Staffs	Male :	Female :
Branches	Urban :	Rural :

C. Non-financial aspect

21. How often do you face the following problems :

Problems	Never	Rarely	Sometimes	Often	Always
1. Lack of capital	☐	☐	☐	☐	☐
2. Managerial problems	☐	☐	☐	☐	☐
3.Lack of infrastructure	☐	☐	☐	☐	☐
4. Inappropriate type of business organisation	☐	☐	☐	☐	☐
5. Difficulties in allocating the fund					
6. Competition with other microfinance institutions					
6.. Lack of personnel	☐	☐	☐	☐	☐
7. Physical barriers	☐	☐	☐	☐	☐
8. Difficult to assess borrowers' financial flow	☐	☐	☐	☐	☐
9. Lack of vehicles to reach borrowers					
10. Others:…………………………..					

22. Would you consider that your organisation in particular and the microfinance institutions in general have experienced lack of funds?
……………………………………………………………………………………….
……………………………………………………………………………………….
23. Trainings for staffs
    a. Have you provide trainings for officials in order to keep them updated with their knowledge and skills? ☐ Yes ☐ No
    b. What trainings have you delivered?
    ………………………………………………………………………………..
    ……………………………………………………………………………….

c. How often do you provide trainings for your staffs?
………………………………………………………………………………….
………………………………………………………………………………….
………………………………………………………………………………….

24. What is/are your development planning?
☐ Capital increase
☐ Increase sustainability
☐ Market expansion (outreach)
☐ Skill improvement
☐ Others…………………………………………………………………………

25. Impact on economic development
a. Have you in general observed any change in individual life after the borrower completed the process with you? ☐ Yes ☐ No
Comments:……………………………………………………………………….
…………………………………………………………………………………..
…………………………………………………………………………………..
b. Do you observe any development in the society due to the positive activities of Islamic Microfinance Institutions? ☐ Yes ☐ No
Comments:………………………………………………………………………
…………………………………………………………………………………..
…………………………………………………………………………………..

26. What type of enterprise and social development services do you provide to customers (borrowers/microenterprises)?
(you may choose more than one option)
☐ Management trainings (organisational management and bookkeeping etc)
☐ Technical training (production process, etc)
☐ Marketing
☐ Consultancy services
☐ Religious training related to business ethics
☐ No social services development program
☐ Others:…………………………………………………………………………….

27. In your opinion, what will be the future prospect of Islamic microfinance and microenterprises in your area?
……………………………………………………………………………………..
…………………………………………………………………………………….
…………………………………………………………………………………….

Thank you very much for your participation.

APPENDIX C

Durham University

School of Government
and International Affairs

Shaped by the past, creating the future

29th June 2011

Dear Nur Indah Riwajanti,

Please accept this letter as formal ethical approval for your project **'Exploring the Potential of Indonesian Islamic Microfinance in Developing Microenterprises'** You should print it out and keep it for your records.

Please note that approval relates only to the project proposal submitted. If you wish to change the project, for example to widen the scope of enquiry, then you must reapply to the Ethics Committee for further approval.

If you have any questions relating to your approval, please contact Dr. Lorraine Holmes lorraine.holmes@durham.ac.uk.

We wish you well with your research.

Yours sincerely,

Lorraine Holmes

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Research Administrator

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الْحَمْدُ لِلَّهِ

All praise belongs to ALLAH