SUSTAINABLE ISLAMIC MICROFINANCE INSTITUTIONS IN INDONESIA: AN EXPLORATION OF DEMAND & SUPPLY FACTORS AND THE ROLE OF WAQF

MASYITA, DIAN

SUSTAINABLE ISLAMIC MICROFINANCE INSTITUTIONS IN INDONESIA: AN EXPLORATION OF DEMAND & SUPPLY FACTORS AND THE ROLE OF WAQF

Dian Masyita

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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 or any other university or institutions of learning

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ABSTRACT

Sustainable Islamic Microfinance Institutions in Indonesia: An Exploration of Demand & Supply Factors and the Role of *Waqf*

---Dian Masyita---

Whereas Indonesia is the largest Muslim country in the world, the growth of Islamic microfinance institutions (MFIs) has being sluggish and far behind their conventional MFIs. Islamic MFIs are struggling to survive amid the fierce competition in the provision of microfinance services, from both the conventional and Islamic institutions. Meanwhile the high unemployment rate in Indonesia calls for searching for ways in which financing can be provided to the jobless and poor. One way to resolve this is to provide MFIs with low cost funds that can be used to finance viable micro-businesses. The aim of this thesis is to examine the demand and supply side factors related to operations and growth of Islamic MFIs. It also investigates the scope of integrating microfinance and *waqf* to enhance the social mission of providing access financial services and opportunities to the needy and the poor. A survey was conducted to explore the perceptions, understanding and preferences of 581 MFI's borrowers from four MFIs—two Islamic (BMT and BPRS) and two conventional (BRI and BPR) in Indonesia. A total of 18 MFIs' managers and two *waqf* managers/nazirs were interviewed. Secondary data, case-study and a focus group discussion (FGD) were also conducted in order to understand the problems.

The results show that while the majority of MFI's clients indicate preference for Islamic MFIs, in reality their choices of MFI are based on economic/finance (low interest rates and size of loan) and non-economic/non-finance factors (quality of services variables easiness, promptness, nearness, method and loan officers' profile). While the MFIs clients prefer Islamic MFI compared to conventional, in the end, the practical and economic reasons became dominant factors in their choice of MFI. Therefore, the demand for Islamic microfinance can be enhanced if the level of their economic and non-economic factors can be brought to the levels of conventional MFIs. The research reveals that there is still a gap between needs and knowledge of *Sharia'h* financial products and services. When the practice of *murabahah* product is considered, there appears to be no difference in substance between conventional and Islamic MFIs.

In order to understand the operational structure of each type of MFI, their performance was assessed by using the balanced scorecard (BSC) with four perspectives. A balanced non-financial and financial performance is extremely important to create sustainability for microfinance institutions. The relationships between the different components of BSC indicate strong significant correlations between the internal process and customer's perspectives. There are also significant correlation between customer's perspectives and learning-and-growth and slightly significant correlation between learning-and-growth and financial performance. Overall scores of the Balanced Scorecard from the four perspectives for MFIs cemented BRI as the best performer, BPRS in the second place, followed by BPR and BMT in the third and fourth place respectively. The advantage of BRI is partly due to robust government support which makes it difficult for other smaller MFIs to compete. In contrast, BMT showed a weak institutional structure in terms of internal processes, learning-and-growth and customer satisfaction. It seems that BMT is not managed well according to BSC's key performance indicators.

This thesis also proposes to add one more perspective i.e, Social Perspective, for '*The BSC based Islamic MFIs' Model*' to help *waqf* institutions to appraise and choose a MFI in a more balanced and comprehensive way. Social perspective comprises the social mission of Islamic MFIs which can be reflected in providing *qard hassan* and giving more opportunities to the needy, jobless and the poor to start their own micro business. Indicators of the social perspectives can be the amount of funds contributed for *qard hassan*, how many needy clients are being served, and how many months a MFI permits clients to use the *qard hassan* loan. Islamic MFIs such as BPRS and BMT are expected by Muslims to perform more social functions than others. Therefore, one way to implement the social mission is to incorporate *qard hassan* in BPRS and BMT's operations to help the poor and jobless with the low cost loans to start their viable micro-businesses.

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LIST OF ABBREVIATIONS

MSMEs	Micro, Small and Medium-sized Enterprises
IMF	International Monetary Fund
MFIs	Microfinance Institutions
SMEs	Small Medium Enterprises
IWB	Indonesian *Waqf* Board
BRI	Bank Rakyat Indonesia
NGO	Non Goverment Organization
BPR	Bank Perkreditan Rakyat/rural bank
BPRS	Bank Pembiayaan Rakyat Syariah/Islamic rural bank
BMT	*Baitul Maal wa Tamwil*/Islamic Cooperative
BSC	The Balanced Scorecard
GSB	Grameen *Shari'ah* Bank
CGAP	Consultative Group to Assist the Poor
OSS	Operational Self-Sufficiency
ROA	Return On Assets
ROE	Return On Equity
NPO	Non-Profit Organizations
pbuh	peace be upon Him
ICFA	The Internasional Council of Fiqh Academy
MUI	Board of Indonesian Muslim Scholars/ Majelis Ulama Indonesia
ICFA	The International Council of Fiqh Academy
MW	Monetary *Waqf*
IRTI-IDB	Islamic Research Training Institute - Islamic Development Bank
BTPN	Bank Tabungan Perumahan Nasional
HSBC	Hongkong and Shanghai Banking Corporation
BPD	Regional Development Bank
SHGs	Self-Help Groups
CU	Credit Union
KSP	*Koperasi Simpan Pinjam*/ (savings and credit cooperative).
KSM	*Kelompok Swadaya Masyarakat* (self-help group)
PHBK	*Pola Hubungan Bank dan Kelompok swadaya masyarakat/* Bank-Self-Help Groups Linkage
LMFE	Lembaga Manajemen Fakultas Ekonomi/Management Studies Centres
KIK	*Kredit Investasi Kecil*
KMKP	*Kredit Modal Kerja Permanen* (permanent working capital credit)
CAMEL	Capital, Asset, Management, Equity and Liquidity
CSR	Corporate Social Responsibility/
PIRAC	Public Interest Research and Advocacy Center
IDIC	Indonesian Deposit Insurance Corporation
TWI	Tabung Wakaf Indonesia
LKS-PWU	Lembaga Keuangan Syariah - PenerimaWakaf Uang/*Shari'ah* Financial Institution-Cash *Waqf* Receiver
LKC	Lembaga Kesehatan Cuma-Cuma
IDR	Indonesian Rupiah
CEO	Chief Executive Officers

LIST OF ARABIC WORDS

The following has been adapted from the SBP Publication, 'Islamic Banking and Finance: Theory and Practice' by Muhammad Ayub, Sr. J.D. IBD, SBP and Islamic Finance Glossary from Institute of Islamic Banking and Finance

Al Qur'an	Tha sacred (holy) book of Islam. Muslims believe the Qur'an is God's final message to all of mankind.
Ba'i Muajjal	Literally this means a credit sale.Technically, it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the seller earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. The bank has to expressly mention the cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price.
Gharar	This means any element of absolute or excessive uncertainty in any business or a contract about the subject of contract or its price, or mere speculative risk. It has the potential to lead to undue loss to a party and unjustified enrichment of the other, which is prohibited.
Hadist	means custom, habit or way of life. Technically, it refers to the utterances of the Prophet Muhammad other than the Holy Quran. These utterances are known as Hadith, or his personal acts, or sayings of others, tacitly approved by the Prophet.
Hibah	Gift.
Ijarah	means letting on a lease. It refers to the sale of a definite usufruct of any asset in exchange for a definite reward. It refers to a contract of land leased at a fixed rent payable in cash and also to a mode of financing adopted by Islamic banks. It is an arrangement under which the Islamic banks lease equipment, buildings or other facilities to a client, against an agreed rental.
Murabahah	Literally this means a sale on mutually agreed profit. Technically, it is a contract of sale in which the seller declares his cost and the profit. Murabaha has been adopted by Islamic banks as a mode of financing. As a financing technique, it can involve a request by the client to the bank to purchase a certain item for him. The bank does that for a definite profit over the cost which is stipulated in advance
Mudarabah	a form of partnership where one party provides the funds while the other provides expertise and management. The latter is referred to as the Mudarib. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne by the provider(s) of the capital
Musharakah	Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in a joint business. It is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by every partner strictly in proportion to respective capital contributions.

Maqasid al shari'ah	The purpose or ultimate wisdom behind a law or legal ruling. The general objectives of Islamic law, *Shari'ah.*
Sadaqah	Charitable giving or an act of charity
Shari'ah	Often referred to as Islamic law. *Shari'ah* as a legal case did not exist at the time the Qur'an was revealed. Refers to rulings contained in and erived from the Qur'an and the Sunnah.
Sukuk	A financial certificate. Similar characteristics to that of a conventional bond with the key difference being that they are assets backed.
Takaful	Joint guarantee through mutual support and shared responsibility whereby a group of persons agree to jointly guarantee among themselves against a defined loss. Takaful scheme are designed to avoid the elements of conventional insurance (i.e interest and gambling).
Tabarru'	means a donation/gift the purpose of which is not commercial but is done to seek the pleasure of Allah. Any benefit that is given by a person to other without getting anything in exchange is called Tabarru' It is absolutely at the lender's own discretion and without any prior condition or inducement for reward.
Waqf	An endowment of charitable trust in the meaning of holding certain property and preserving it for the confined benefit for a certain charitable objective and prohibiting any use or disposition of it outside that specific objective.
Zakah	An obligatory contribution or tax which is prescribed by Islam on all Muslim persons having wealth above an exemption limit at a rate fixed by the *Shari'ah*.

CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

Expansion of micro, small and medium scale businesses is one of the most effective ways to create jobs and reduce unemployment rates. According to the book with the title “The Role of Local Governments in Promoting Decentralized Economic Governance in Indonesia” (2009), this is particularly true for Indonesia where it is increasingly being recognized that micro, small and medium-sized enterprises (MSMEs) dominate the economy constituting one of its pillars. This sector was able to survive the Asian crisis (Soetrisno, 2002). When many larger companies were in default during the crisis leaving large amounts of bad debt, most Indonesian MSMEs successfully managed their businesses and paid their liabilities. The role of MSMEs, particularly post-Asian crisis, enhanced national economic recovery in Indonesia in terms of boosting economic growth and reducing unemployment rates. According to research done by Bank Indonesia in 2001, it is acknowledged that credit distributed to MSMEs had relatively low risk and compared to large enterprises and MSME’s had sound and better business performance (Bank-Indonesia, 2001).

MSMEs in Indonesia consist of three different groups: micro enterprises, small enterprises and medium enterprises (Ascarya & Sanrego, 2007). Therefore, collaboration among relevant government agencies, banking authorities, and academicians to promote favourable circumstances for MSMEs development efforts is inevitable. Meanwhile, the public sector has experienced budget deficit almost every year since 1997, which implies that the government has found it difficult to cover its routine expenditures. The regular expenditure heads require such a large amount of funds that the government cannot adequately cover these. The items include many that are considered strategic needs such as affordable basic foods, good education facilities, appropriate health services and MSMEs development.

A potential solution to the scarcity of sufficient funds for public needs is to tap into *waqf* (Islamic endowment) fund, which originates from people’s donations. People (*ummah*) donate their money as cash *waqf* to be used in various investment portfolios (i.e Islamic banking, finance, microfinance and property) and the resulting profit can be spent for the abovementioned public needs. While the principal of the *waqf* will be reinvested in variety of moderately profitable but relatively less risky investment opportunities, the profit can also be used for funding poverty eradication programmes.

In the past, *waqf* was effectively used to reduce poverty and enhance welfare by providing funds for education and health development programmes, affordable houses and public facilities development programmes, and so forth. In theory, one way in which *waqf* can used as an instrument of poverty reduction is to employ it to support microfinance development. The microfinance programme should particularly be intended to help poor people establish businesses and enhance their quality of life. Ahmed (2007) introduced a model of *waqf*-based Islamic microfinance institution that can provide finance and facilitate wealth creation for the poor. He suggests *waqf* funds as a means to finance microfinance institution operational activities and using this fund is expected to reduce the financial costs and improve the viability of these institutions.

A *nazir* (a person/an institution who manages *waqf* fund and distributing returns of *waqf* investment) on behalf of w*aqf* institutions may allocate some *waqf* funds to finance micro-businesses on the basis of a profit sharing system. *Nazir* can then allocate all profits and returns gained from the investments to other poverty eradication programs to enhance the quality of poor people's lives, such as free education and health service, cheap basic food, etc. Nevertheless, merely supplying micro entrepreneur especially the new comers with capital is not sufficient, since some of them do not have adequate knowledge and skills to choose and to run a business that is suitable to their condition. Consequently, this programme should provide relevant technical assistance and spiritual input to help the business survive (Masyita, *et al.*, 2011).

The Indonesian *Waqf* Act was passed in 2004 and the government has supported the development of *waqf* aggressively since 2007. An Indonesian *Waqf* Board (*Badan Wakaf Indonesia*) with 22 members was established in July 2007, upon Presidential decree number 75/M/2007. However, it appears that the potential assets of *waqf* have not played any role to contribute to poverty reduction programmes in the country yet. The *waqf* board still faces great constraints in managing the *waqf* assets to increase the effectiveness of poverty reduction programmes. In particular, the *waqf* board as an authorized body must ensure that the *waqf* assets are used optimally and accountably channeled to the poverty alleviation programmes. In particular, the *waqf* based Islamic microfinance institutions model is still merely a concept and there is a need for more research and creativity for its implementation in reality.

1.2 BACKGROUND OF RESEARCH

A group of researchers from research centre of University of Padjadjaran where the researcher is from have been involved with many studies related to micro, small, medium enterprises both at the local and national levels. Based on the long experience of conducting these studies, it was found that the problems and issues facing micro and SMEs are intricate and complex. The problems arise not only from institutions themselves but also from inter-institutional issues. A lack of coordination among institutions at local and national levels combined with conflicts of interest among several players and regulators in the system jeopardize proper implementation. It was not an exaggeration when Thomas Friedman (2000) said after Asian Crisis 1998 that 'Indonesia is a messy state, too big to fail and too messy to work' (Friedman, 2000: A31). The President of the country Bambang Yudhoyono countered these views when he stated that 'Indonesia recently has become a remarkably resilient country after all trials and tribulation until 2004' (Yudhoyono, 2009). He did still admit however, that Indonesia is a misunderstood country.

Microfinance seemed to be an ideal solution to the problem of high unemployment and poverty (Aghion & Morduch, 2005; Ahmed, 2004, 2007b; Armendáriz & Morduch, 2010; Asutay, 2010; Chapra, 2000, 2008; Kahf, 1999; Masyita, 2007a; Masyita, Tasrif, & Telaga, 2005; Morduch, 2005; Obaidullah, 2008b; Robinson, 2001; Wilson, 2007) in Indonesia but to make it happens, much work needs to be done. It should be noted that there are 15.12 million people unemployed[1] in Indonesia according to IMF Report 2011. A number of issues keep arising particularly to bring the poor and needy people to levels of non-poor. The approaches of microfinance as "a poverty lending approach" or "financial system approach" have become relevant (Robinson, 2009). The question arises of what kind of approach should be taken by microfinance institutions (MFIs) in Indonesia or can both be used? Other issues related to Indonesia as a country with the largest Muslim population in the world are the high demand for Islamic financial products and the role of the Islamic voluntary sectors. Islamic financial institutions and instruments such as Islamic banks, Islamic microfinance, Islamic capital market, *sukuk*, *takaful*, and so on and the Islamic voluntary sector have developed rapidly in Indonesia over the last two decades. The demand for these services comes from different social segments ranging from middle class Muslim families that require Islamic-compliant banking and financial instruments to poor households who rely on Islamic microfinance and

[1] Indonesia Unemployment Rate based on the IMF September 2011 report was 6.8%. Sources: www.world-economic-outlook.findthebest.com/d/d/Indonesia/Unemployment-rate Accessed 2nd May, 2012.

the voluntary sector to provide them with important services. Therefore, the Islamic microfinance sector combined with *waqf* as an Islamic voluntary foundation can play an important role in solving the problem of poverty. However, combining profit and nonprofit institutions that incorporate divergent approaches in terms of mission, objective and goals will be a challenging task.

1.2.1 Indonesian Economy

Indonesia is the fourth largest country in the world in terms of population with 237. 5 million people, 88% of them being Muslims making it the largest Muslim population country (based on 2010 Indonesian census). However, Indonesia also has other religions including Protestants, Roman Catholics, Hindus and Buddhists. Recognizing that Indonesia is a country of various ethnic groups, the national motto is "unity in diversity." Even with a wide array of ethnicities, cultures, and landscapes the country has a strong sense of nationality and unity. There are many languages spoken in Indonesia. The official language is *Bahasa* Indonesia, but there are over 700 other languages that millions of people speak. Indonesia is the world's largest archipelago with over seventeen thousand islands. Indonesia's capital city is Jakarta. The area of Indonesia is about 1.910.931 km, the average density is 124 people per km. Unequal distribution of people are a problematic issue with 58% of the population living on Java Island. West Java has the highest density with 18.11% population of the country.

Indonesia has several problems such as economic growth and stability, political instability, poverty and internal violence that it must face. However, the country has developed industries and engages extensively in foreign trade. One of the most important commodities is petroleum, the countries' greatest commodity asset. Agriculture is also important as it employs about 45% of the labour force. Indonesia faced some incidences of political instability since its independence. Judging from previous performance, the Indonesian economy seems to be decoupled from recent world trends. Despite the economic slowdown in the US and Europe in 2010 due to the recent global financial crisis, the Indonesian economy has continued to grow and show resilience. Market participants view Indonesia as a country with great potential.[2] Indonesia's previous economic performance reflects the strength of the two drivers of growth: the population-based economy and the resource-based economy. The population-based economy is closely linked to strong growth in manufacturing, such as automotive and consumer products, property development and construction and many others.

[2] IMF Country Report No. 10/288 'Indonesia: Financial System Stability Assessment', September 2010

Indonesian economy is dominated by micro, small, medium enterprises (MSME’s) with 99% of total business. Micro businesses themselves dominate 98.85% of total business with absorb 90.98% of the total labor force and their contribution to GDP was 57.12% in 2010 (Indonesia Bureau Statistics, 2011). Based on that figure, micro businesses play the strategic role in Indonesia economy. Microbusinesses have proven to absorb more than 90% employment rate. Therefore, microbusinesses need the financial intermediary which suitable with their nature characteristics. Microfinance is a suitable financial instrument to fulfill microbusiness’ need for financial resources.

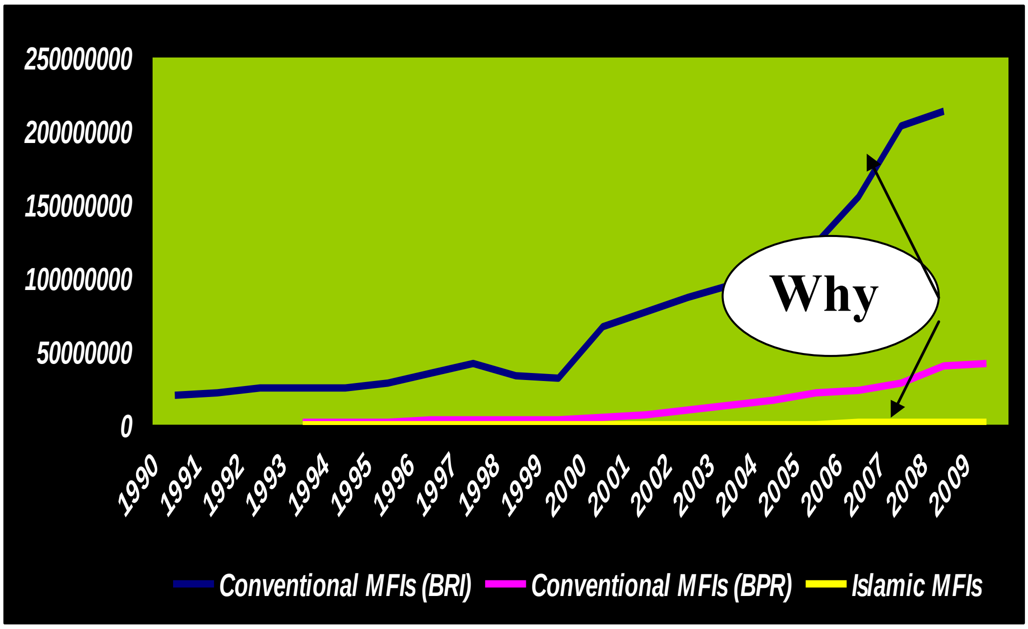
According to Indonesian banking law, the functions of banks in Indonesia are mainly as financial intermediaries, which take deposits from surplus units and channel financing to deficit units. In general, Indonesian banking institutions are categorized into commercial and rural banks. In February 2011, there were 122 commercial banks and 1822 rural banks. Of the rural banks, the number of Islamic rural banks is only 151 with 291 total bank offices. For that reason, micro banking, rural banks, Islamic and conventional, and other forms of microfinancial institutions will become the main theme in this research.

1.3 RESEARCH PROBLEMS

Indonesia has a diversity of both conventional and Islamic microfinance models. Islamic finance commenced in Indonesia, a country with the largest Muslim population, relatively recently since 1990. As figure 1.1 shows, the growth of Islamic MFIs, however, has been sluggish and far behind the conventional MFIs. The Islamic context of this economic system generates the question: *Why has the growth in Islamic MFIs been slower than the conventional MFIs?* A related issue on the supply side is can a potential solution to promote the growth of Islamic MFIs be found by using *waqf* funds? The potency of *waqf* to contribute to the sector is high due to the higher giving rate of Muslims in their community as a religious duty. A combination of *waqf* and Islamic microfinance can be expected to boost the growth of Islamic MFIs in the future.

While microfinance can be an instrument for poverty alleviation (Aghion & Morduch, 2005; Ahmed, 2004, 2007b; Armendáriz & Morduch, 2010; Asutay, 2010; Chapra, 2000, 2008; Kahf, 1999; Masyita, 2007a; Masyita, *et al.*, 2005; Morduch, 2005; Obaidullah, 2008b; Robinson, 2001; Wilson, 2007), in reality it has not been used to its full extent. In a study of lending for SMEs conducted by The World Bank, Ledgerwood (2001) identifies three objectives of a MFI to achieve two long-term goals of microfinance '*outreach* and *sustainability'*. The three objectives are to create employment and income, to increase the productivity and incomes of vulnerable groups (women and the poor) and to reduce rural families' dependence (Ledgerwood, 2001).

Figure 1.1 Asset Growth of Conventional MFIs and Islamic MFIs in Indonesia period 1990-2009



One of the goals of the research is to identify the demand and supply side issues related to microfinance and examine the role of *waqf* in supporting sustainable Islamic MFIs. Therefore, how microfinance and *waqf* funds can be applied in the real world is one of the main focuses of this research. On one hand, the research will try to understand why Islamic microfinance moved slowly and sluggishly. On the other hand, while *waqf* regulation has existed since 2004 and Indonesian *Waqf* Board (IWB) was also established in 2007, the problems of implementing *waqf* in Indonesia need to be explored further. Based on theoretical approaches, there are various products and strategies to enhance microfinance and *waqf* institutions. Academicians and practitioners regarding Islamic microfinance and the role of waqf to support this assertion have written numerous papers. The reality however, is still far from these expectations. Thus, one of the goals of this thesis is to explore how these concepts can be implemented. The experience of the Islamic banking sector in terms of its small market share in Indonesia during the last 18 years can clarify the development of Islamic microfinance sector.

This thesis focuses on identifying mechanisms to implement the *waqf* based Islamic microfinance in Indonesia. However, there is no single microfinance model or method that should be promoted. Every microfinance programme needs to be tailored specifically to meet complex local realities prevalent within each country or even different regions within a country; 'The needs of micro entrepreneurs, the complexity and nature of ventures to be financed are also the other reasons (Khan, 2008).

In reality of the development of Islamic microfinance, there appears to be differences in reality and expectations. Seibel and Agung's (2005: VI) study of Islamic MFIs in Indonesia in 2005 concludes that "Islamic, unlike conventional, rural banks have failed to prove themselves as effective and efficient providers of microfinance services; and unsupervised Islamic cooperatives, like their conventional counterparts, are an outright menace to their shareholders and depositors, who risk losing their money". Hence, one of the objectives of this research is to understand the problems facing Islamic MFIs.

1.4 RESEARCH AIM AND OBJECTIVES

The aim of this research is to explore and examine the demand and supply side issues related to operations and growth of Islamic MFIs. It then investigates the scope of integrating microfinance and *waqf* to enhance the social mission of providing access financial services and opportunities to the needy and the poor.

There are nine objectives in this research, which will support the realisation of these aims:

i. To review the literature on microfinance and *waqf*

ii. To identify trends for different types of Islamic MFIs and conventional MFIs.

iii. To examine characteristics of MFI client profiles from different type of MFIs.

iv. To identify the constraints of growth of Islamic MFIs from clients' perspectives.

v. To explore the client's perception and MFI's management perceptions of MFI's products and institutions.

vi. To ascertain the client's preferences and MFI's management perceived towards MFI's clients preferences.

vii. To identify the characteristics of different types of MFIs management styles.

viii. To explore the linkage between Islamic microfinance and *Waqf* institutions

ix. To suggest policies to integrate *Waqf* into Islamic microfinance in Indonesia

1.5 RESEARCH QUESTIONS

As Indonesia has the largest Muslim population in the world, Islamic MFIs and *waqf* can be the alternative financial instruments for Indonesian Muslims in particular. In order to achieve the objectives of research, the following research questions need to be addressed:

Research question for the first objective:
1.1 What are the important factors in managing Islamic MFIs and *waqf* institutions?

Research questions for the second objective:
2.1 What are the facts which show that Islamic MFIs grow slowly in Indonesia compared to conventional MFIs?

Research question for the third objective:
3.1 What are the characteristics of MFIs client profiles compared to other types of MFIs?

Research question for the fourth objective:
4.1 What are the differences in perceptions between conventional and Islamic MFI's clients towards products?
4.2 What are the differences in understanding between conventional and Islamic MFIs clients towards the concept of Islamic microfinance products?
4.3 How do MFI's managers perceptions the lack of these understandings?

Research question for the fifth objective:
5.1 What are MFI's clients' perceptions of their own MFI compared to other MFIs?
5.2 How does MFI management perceive MFI's clients' perceptions?

Research question for the sixth objective:
6.1 What are the preferences and reasons for clients to select a specific MFI?

6.2 What are MFI manager's perceptions of MFI's clients' preferences and reasons for choosing a MFI?

Research question for the seventh objective:

7.1 What are the differences between the management styles of conventional and Islamic MFIs?

7.2 How do Islamic MFIs compete with their conventional counterparts?

7.3 Why do Islamic MFIs grow slowly in Indonesia compared to conventional MFIs?

Research questions for the eighth objective:

8.1 What are the linkages between *waqf* institutions and Islamic microfinance institutions?

8.2 How can *waqf* institutions support the growth of Islamic MFIs?

8.3 What are the constraints inhibiting the integration and collaboration of these institutions?

Research question for the ninth objective:

9.1 How can *waqf* be integrated with Islamic MFI to boost the growth of Islamic MFIs?

1.6 RESEARCH METHODOLOGY

This research uses the triangulation approach (Blaikie, 2000; Bryman, 2008; Bryman & Bell, 2003; Grix, 2004) to investigate the structure of microfinance and *waqf* institutions in Indonesia. Both qualitative and quantitative methods help the researcher to understand the problems and the systems involved. In the conceptual and empirical construction process, this research first examines the demand and supply side issues related to Islamic MFIs and then attempts to develop some policies explaining the integration of Islamic microfinance and *waqf* management in Indonesia. In the associated literature review, this study will also cover microfinance and *waqf* management experiences in different countries and historical periods.

A proper research methodology is an important vehicle to guide this research to realising its aims and objectives. However, it should be borne in mind that microfinance and *waqf* institutions depend on a management team that runs the daily operations and decision-making. Doing empirical and theoretical studies on the voluntary sectors especially *waqf* and Islamic microfinance problems in Indonesia and then using the results of these studies in design some policies are the most important steps to achieve the research objectives.

The subjects of this study are MFIs in Bandung, Indonesia that give small financing to micro and SME entrepreneurs and *waqf* institutions. While field research focused on two main sectors, microfinance and *waqf*, other stakeholders including regulators and academics were also consulted. MFI managers and directors were interviewed about their experiences with the institutions, including gathering their opinions on competitive advantages among other MFI institutions. Informal discussions with MFI staff and loan officers regarding selecting, processing and loan monitoring mechanisms were also conducted to enhance investigations. A discussion 'Islamic microfinance' was also organized where regulators and actors met and discussed the current problems as a form of focus group discussion (FGD). My research methodology included these discussions, reviews of written materials from institutions and other secondary sources, attendance at various related meetings and seminars, and also gathered the MFI borrowers' perspectives about their MFIs and rivals through questionnaires. Case studies of microfinance and *waqf* institutions provide a thorough overview of the structure and operating procedures of these institutions.

1.7 SIGNIFICANCE OF THE STUDY

Most preceding models of Islamic microfinance and *waqf* institutions have not been implemented especially in Indonesia. The majority of these concepts were theoretical and not based on solid empirical data or evidence. Therefore, through this research, I will assiduously search for primary and secondary empirical evidence from MFI institutions, MFI clients and some *waqf* management practices in order to integrate Islamic microfinance and *waqf* fund management. In addition, Islamic microfinance and *waqf* fund management practices in Indonesia are still exploring their best ways. This research, therefore, is considered to be significant in fulfilling the objectives that have been identified. This research is believed to be the first research which tries to investigate the scope of integrating microfinance and *waqf* to enhance the social mission of providing access financial services to the needy and the poor with the exploration of the perceptions, understanding and preferences of MFI's borrowers from four types MFIs, Islamic and conventional, in Indonesia. As a result of in-depth understanding regarding microfinance practices from primary sources, this research also proposes to add one more perspective i.e, Social Perspective, for '*The BSC based Islamic MFIs' Model*' to help *waqf* institutions to appraise and choose a MFI in a more balanced and comprehensive way for an appropriate integration.

1.8 OUTLINE OF THESIS

Following this brief introduction, the dissertation is arranged as follows:

Chapter Two - Microfinance: Conventional and Islamic Perspectives – explains the characteristics, barriers to growth, misleading assumptions, unanticipated consequences, relevant models and mechanisms of microfinance practices. Many aspects of microfinance experiences including Grameen Bank and Bank Rakyat Indonesia (BRI) are discussed. Theory, characteristics, problems, challenges and risk management of Islamic microfinance and the concept, theory, scheme, challenges and nature of risks borne by *waqf*-based Islamic microfinance are also presented in this chapter. At the end of the chapter, the Balanced Scorecard, a tool in evaluating MFI's performance is highlighted to support later research analysis.

Chapter Three - Third Sector and *Waqf:* Concept and Best Practices describes the concept of altruism, which has been extensively discussed amongst scholars and NGO communities alike. The various definitions and dimensions of altruism and trust as social capital are discussed and then best practices of world-class trust and endowment funds are also learned. The concept and classical history of *waqf* are provided and the history of philanthropy foundations and some noted *waqf* institutions in the world are discussed. *Waqf* is subject to *ijtihad* and there is no single ruling in it except it must be benevolent. The static, perpetuity, rigidity and mismanagement of the *waqf* in the past created inefficiencies and ineffectiveness which can be avoided by a good governance system. Transparency and accountability of *waqf* management is a significant aspect of achieving good *Waqf* governance.

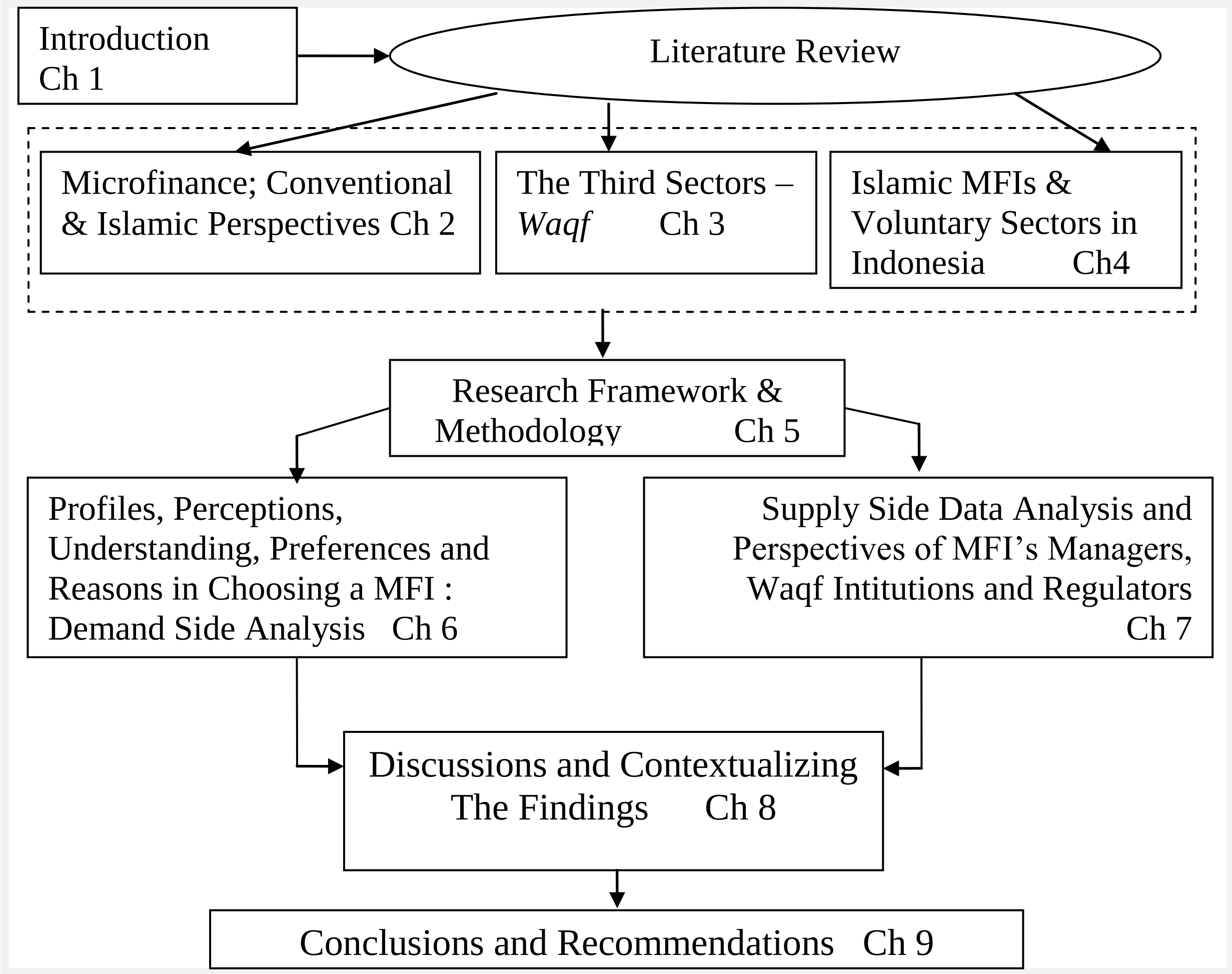
Chapter Four – Islamic Microfinance and Islamic Voluntary Sectors in Indonesia – illustrates the characteristics of existing conventional and Islamic microfinance institutions, Islamic voluntary sectors and other related institutions in Indonesia. The criteria of micro, small and medium enterprises and four types of MFIs; BRI, BPR, BPRS, BMT are described clearly in order to understand the problems and challenges facing their developments. To understand the characteristics and profiles of *waqf* institutions in Indonesia, the discussion adresses the legal and regulatory frameworks for nonprofit organizations, including *waqf* institutions. In light of past studies of philanthropy, this chapter also presents the unique profile of donors and their reasons for giving. The profiles of two *waqf* institutions are presented in the last part of this chapter to give portraits of *waqf* institutions in Indonesia.

Chapter Five - Research Framework and Methodology This chapter comprehensively discusses the research methodology and methods used in this research. Three groups of respondents namely MFI's clients, MFI's managers and *Waqf's* managers (*Nazir*) are facilitated by a series of questions in order to capture their opinions. In-depth semi-structured interviews, distributing questionnaires, secondary data analysis, case study, and a focus group discussion are the chosen methods of data collection. Quantitative and qualitative methods are used in comparative analysis in this research. Various matters related to population, sampling process and the experiences and lessons learned during fieldwork are discussed. Finally, validity and reliability issues also get more attention to complete the research process.

Chapter Six – Profiles, Perceptions, Understanding, Preferences and Reasons of MFI's Clients in Choosing an MFI: Demand Side Data Analysis - this chapter provides characteristic information on profiles, perceptions, understanding, preferences and MFI's clients' rationale in choosing an MFI. The comparative analysis of four types of MFI is presented with the intention of finding the special characteristic of clients in each type of MFI. Some non-economic/financial factors and economy/finance preferred by clients in choosing a desired MFI are presented in this chapter. Clients also rank MFIs based on criteria, which highlight clear differences between the four types of MFIs.

Chapter Seven – Supply Side Data Analysis and Stakeholders' Perspectives–Starting with the profile of MFIs in Bandung, the chapter covers MFI managers' perception of clients' opinions of MFI's services and products. The Balanced Scorecard (BSC) helps to evaluate four types of MFIs and give clear distinctions between them. Causal effects of each perspective of BSC are investigated using statistical correlation. The last part of this chapter presents empirical findings from in-depth interviews with *waqf* managers and regulators on the issue of *waqf* fund integration into Islamic MFIs. This part provides information and analysis of the possibility of collaborative *waqf* institutions and Islamic MFIs which can support Islamic microfinance institutions. Analysis of in-depth interview with Directors of MFI is also presented in this chapter to demonstrate the readiness of MFIs to accept *waqf fund* in their institutions.

Figure 1.2 Outline of Research



Chapter Eight – Discussions and Contextualizing the Findings –This chapter combines the contents of all chapters in this study to contextualize the findings. It provides a comprehensive discussion of the result based on the empirical Chapters Six and Seven. The results of empirical findings with regards to demand and supply of MFIs are presented and analyzed based on theory and past studies from the literature review. This research also proposes '*The BSC based Islamic MFIs' Model*' which has five perspectives. The discussion relates the empirical findings to the opinion of *waqf* institution managers, regulators and Islamic MFI's managers concerning the implementation of *waqf* funds in the form of *qard hassan* into Islamic MFIs. The necessity of *qard hassan* from both the clients' point of view and from that of the MFI's institutions (supply side).

Chapter Nine – Conclusion and Recommendations – Following a brief overview of the chapters of this study, it presents conclusions from demand and supply sides and integration of *waqf* into Islamic microfinance institutions. To this it adds implication of this research and policy recommendations in order to strengthen these issues. It concludes by identifying the limitations of the study and how the research questions can best be answered. Learning from best practices, conducting comparative studies, understanding the facts and reasons why one institution is better than the others, collecting empirical field data, consulting regulators with a view to formulating policies to integrate *waqf* into Islamic MFI mechanisms are the general activities in this research. Regarding the comparative study of Islamic and conventional MFIs, it should be noted that this research has restricted itself from detail exegesis of Islamic tenets in order to focus closely on management and behaviour issues. This is a double-edged sword. The researcher is aware that Islamic microfinance adherence to best practices of conventional MFIs in good governance and corporate social responsibility could offer positive effects. On the other hand, it could also be harmful where concessions are made on the Islamic prohibitions of *riba* and *gharar* in the practice of Islamic MFIs.

CHAPTER 2

MICROFINANCE:

CONVENTIONAL AND ISLAMIC PERSPECTIVES

2.1 MICROFINANCE SECTORS

Microfinance is a phenomenon over the last twenty-five years that needs little introduction. Most MFIs deal in sub-prime markets, which offer services to poor and needy people. The global crisis in 2008, driven by the collapse of major banks in the USA and Europe (Northern Rock), shows “the perception that microfinance operation are somehow riskier than the operation of the more established middle class banking sector has clearly been proved wrong” (Hulme & Arun, 2009 : 15). Microfinance is a popular financial instrument particularly in developing countries whose governments cannot provide some of their citizens with sufficient welfare. In other words, voluntary sectors and microfinance may be viewed as the failures of government rural credit schemes to reach small farmers (Hulme & Mosley, 1996), a failure of the formal banking sectors to fulfill low-income household needs, a government strategy to cut welfare spending and diminishing the role of the state in economic development, basic healthcare, education and welfare (Fernando, 2006). The failure of government to provide subsidised agricultural credit for developing the poor in the past due to higher transaction cost, interest rate restrictions, corrupt practices and high default rates have stimulated the growth of informal financial markets (Arun, 2009).

Microfinance is a financial product which provides financial services such as credit, saving and basic insurance to micro entrepreneurs. It is called “micro” because the poor as micro entrepreneurs can only afford to save, borrow, or buy insurance in small amounts that covers the outstanding balance on a loan owed to the microfinance institution. Microcredit or microfinance is expected to provide the capital for the informal business sector. In reality however, in some places, many researchers found MFI has not make a significant impact to societies as a whole (Hospes & Lont, 2004). The most famous MFI in the world is the Grameen Bank in Bangladesh. It is phenomenal because “its movement has blossomed and captured the public imagination, drawn billions of dollars in financing, reached millions of customers, and garnered a Nobel Peace Prize” (David Roodman & Morduch, June 2009). Hernandi de Soto in his book titled *The Mystery of Capital* (2001) bottom-lines the significance of informal business sector in a developing country's economy. He further reveals that most of the economic crises taking place in developing countries result from the economies' inability to grow capital. Assets in such economies cannot be used as working capital due to the problem of property rights: credit for additional capital requires justification of property right.

Judging from the experiences of microfinance institutions, it seems that the best thing to do is retrace first principles and basic questions upon which microfinance institutions were built. What does the MFI need the fund for? Are the funds to be used for enriching and maximizing the wealth of capital owners? Are the funds to be used for developing micro entrepreneurs to increase their quality of life with appropriate capacity building and sustainable business in particular then combat poverty in general? In developing countries such as Indonesia, Bangladesh, Pakistan and other Islamic countries where most of the microfinance clients are Muslims, there is a need and demand to establish Islamic microfinance institutions, which fulfill Muslim aspirations for *riba*-free microfinance. To fulfill these needs, the development of Islamic MFIs is inevitable. The next question for the MFI is: How can fulfill MFI's shareholders and stakeholders interests be fulfilled while simultaneously providing services to the poor? What are the ultimate goals of both of these parties? Is it possible to accomplish those goals in a win-win situation? What should the structure of MFIs be? What are the differences between conventional MFIs and Islamic MFIs terms of both concept and practice? Nevertheless, Islamic MFI is a part of the field of Islamic finance industry and it must comply with Islamic economics concepts as a whole.

To implement the Islamic MFI concept in a particular environment, the existing reality, system, characteristics and environment surrounding it must first be understood. As Zarka points out "A major objective of Islamic economics is to study the reality to repair it, improve it, or reform it, in order to make it closer to *Shari'ah*. So "how can we reform a reality which we do not understand and we do not know?" (Zarka, 2008: 27). Therefore, a deep understanding of the environment surrounding the system of the particular country is a must for developing an appropriate MFI instrument to be implemented.

This chapter attempts to understand the concept and application of MFIs and answer the above question. However, it does not promise to provide answers and solutions for all MFI's problems. This chapter will explore the factual experiences of several different types of MFI in varying locations and time periods.

2.1.1 Concepts of Microfinance

According to Khan, (2008:6), the characteristic features of microfinance programmes are short term, simply procedures and collateral requirements such as property or collective guarantees from groups. There are some forms of structure of microfinance organizations, cooperative and NGO (Obaidullah & Khan, 2008). Members' own savings are the first main source of funds and donor funds provided by NGOs are the second. Furthermore, modern microfinance has broadened its target from 'the poorest of the poor' to all victims of financial segregation. The phenomenon of financial exclusion has been defined in the literature as 'the inability to access financial services in an appropriate way' (Carbo, Gardner, & Molyneux, 2005).

Christen (1997) defines microfinance as the means of providing a variety of financial services to the poor, based on market-driven and commercial approaches. These services may include savings, insurance, money transfers and credit. However, to generalize a particular approach fit to various circumstances is impossible. In its development, microfinance sector was influenced by two approaches from the 1990s, 'the financial system' and 'the poverty lending' approach (Robinson, 2009: 46). A major debate between these lending approaches remains relevant to recognize the characteristics of MFIs. Robinson's definition provides further clarification of these characteristics (2009: 55):

> 'The financial system approach emphasizes large-scale outreach to the economically active poor. The financial system approach focuses on institutional self sufficiently because, given the scale of the demand for microfinance world-wide, this is the only possible means to meet widespread client demand for convenient, the appropriate financial services. On the other hand, the poverty lending approach concentrates on reducing poverty through credit, often provided together with complementary services such as skill training and teaching of literacy, numeracy, health and family planning. Under this approach, donor, government funded credit is provided to poor borrowers. The goal is to reach the extremely poor with credit to help overcome poverty and gain empowerment.'

In fact, MFIs that used the poverty lending approach were not sustainable because their interest rate was too low to cover the cost of recovery. In contrast, a financial system, which focuses on commercial financial intermediaries, is fully sustainable as savings, commercial debt, and various for-profit investments finance its reasonable cost. Furthermore, Robinson argues that "If the poverty lending approach used the subsidies primarily to fund loan portfolios, the financial system approach used subsidies primarily to disseminate lessons from the best practices" (Robinson, 2009: 58). On the other hand, Counts (2008)[3] believed that the dichotomy between commercial and pro-poor microfinance is a false one. He also endorses a platform, not a product which is more profitable in the long term but still benefits the poor: "The model relies on high volumes, not high margins and it uses private benefit limits, holistic performance standards, and third-party certification to make sure that MFIs meet both of their bottom lines" (Counts, 2008: 48). Creating many divisions of the holding company is the way to run the platform to deliver social services. The consequences of these can be expensive, even when these organizations are profitable. Hence it is not necessarily best to earn the greatest profits in the short term.

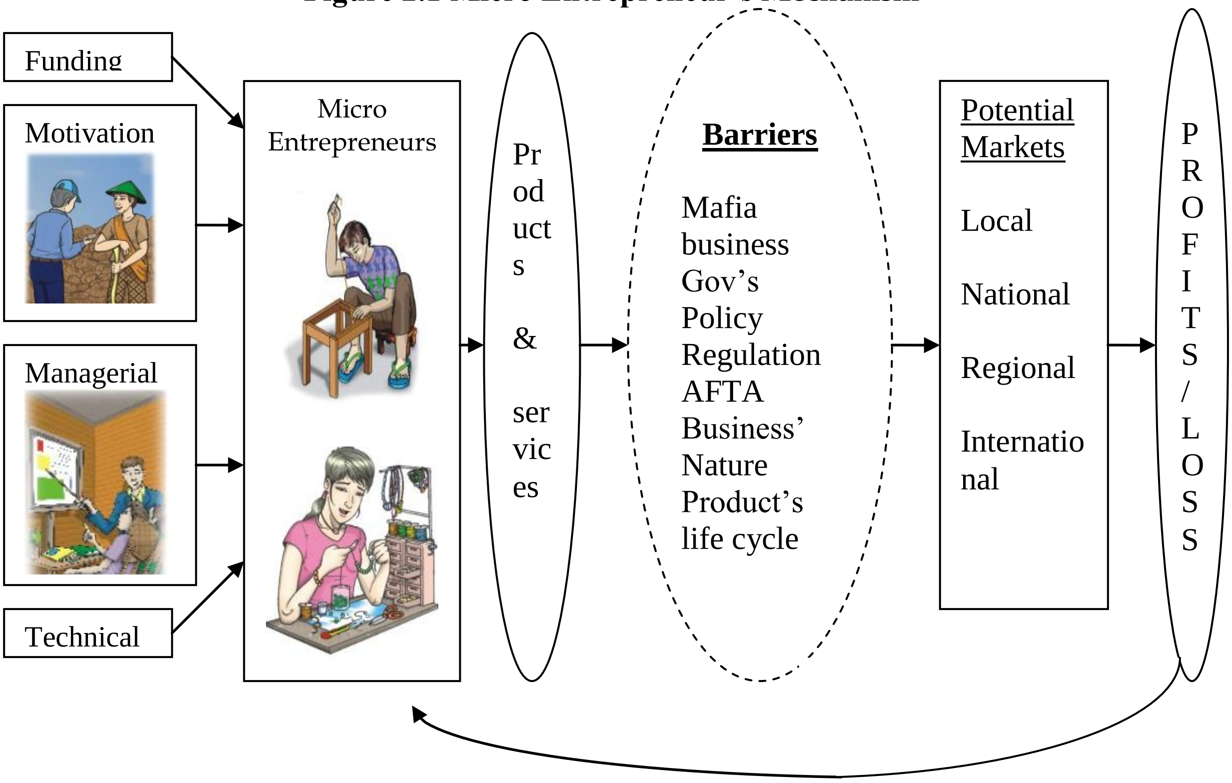
Microfinance studies became increasingly popular after Prof. Muhammad Yunus and Grameen Bank were awarded the Nobel Prize. The Grameen Bank model focused on womens' groups, which normally consist of five members that guarantee each other's loans. Each group has a leader, which has responsibility to motivate and supervise the group. "The key feature of the model is group-based and graduated financing that substitute collateral as a tool to mitigate default and delinquency risk" (Obaidullah & Khan, 2008: 20)

According to Morduch (1999), a good microfinance institution has three attributes. First, it must provide services to the relevant target group. Second, the activities and offered services must also not only be demanded but also have some identifiable positive impact on the lives of customers. Third, a good institution is strong, financially sound and stable. Moreover, Morduch (2005) promotes "smart subsidies" for sustainable microfinance. He argues that smart subsidies can augment social benefits while reducing 'distortions' and 'mis-targeting' (Morduch, 2005). In a more comprehensive study by Fruman and Isern (1996), seven key characteristics of a strong microfinance institution are distinguished. The seven key areas, which are used to provide more insight into the strength of the affiliated institutions, are: vision, financial services and delivery methods, organizational structure and human resources, administration and finance, management information system, institutional viability, outreach and financial sustainability.

[3] Alex Counts is the president and CEO of the Grameen Foundation, a Washington, D.C.–based organization that combines microfinance, technology, and innovation to fight poverty through a network of partnerships in 25 countries.

There are many internal and external factors that act as barriers to micro enterprise development. These include lack of motivation, managerial and technical skills. On the other hand, a market for their products must be available. A market relies heavily on external factors such as government policy, regulation, nature of business and product life cycle. After successfully passing this stage, the micro entrepreneur can count profit and loss of their business.

Figure 2.1 Micro Entrepreneur's Mechanism



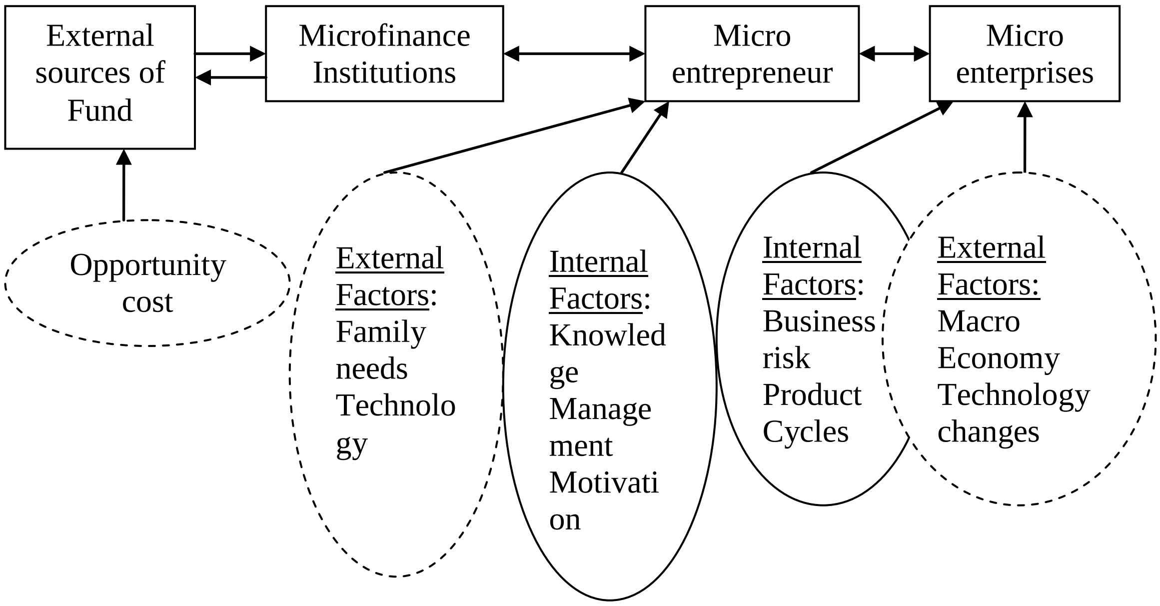
Sources : Author's compilation

Therefore, according to Obaidullah and Khan (2008), a MFI should provide the entrepreneurial poor with a tailored financial service suitable for their needs and conditions. Good microfinance programmes are characterized by "small, usually short-term loans; streamlined, simplified borrower and investment appraisal; quick disbursement of repeat loans after timely repayment; and convenient location and timing of services" (Obaidullah & Khan, 2008: 18).

2.1.2 Barriers to the Growth of Microfinance

Most studies in microfinance are more concerned with the microfinance institutions and micro-entrepreneurs sides in terms of finance matters. On the other hand, many studies of SMEs only focus on micro-entrepreneurs and enterprises. Microfinance and SME studies are conducted separately. However, the success of microfinance institutions relies completely on the capability of micro-entrepreneurs to repay the loan. To be able to repay loans, micro entrepreneurs must make profit from their businesses. The fluctuations of internal and external factors are high and generate high risks for particular businesses. External factors such as macro economic variables and globalization also cause high volatility for micro entrepreneurs. Therefore, amid dynamic environment and unpredictable situations, the micro entrepreneurs must struggle to survive and pay their obligations to microfinance institutions.

Figure 2.2 Internal and External Factors



Sources : Author's compilation from literature

From the reasons mentioned above one of the barriers to the growth of microfinance can be identified as the stagnation of micro enterprises and businesses. In the crisis economy, it is a difficult time for microfinance institutions because the business slow down. The external factors as well as the internal factors are subject to alertness.

In terms of microfinance institutions, high transaction cost is one barrier to the growth of microfinance. A small amount of money per transaction and small volume in terms of scale of business are the causes of high transaction costs. As the size of the loan for micro enterprise is small, the administering cost of a per-unit of loan is high (Ahmed, 2007b: 7; Obaidullah & Khan, 2008: 24). For enterprises, a key driver of success for a microfinance institution is 'the ability to achieve economies of scale through volume, effective management of information flow, and effective action based on that information' (Hirsch, *et al.*, 2005). A microfinance institution is riskier than a traditional financing portfolio. Therefore interest rates on microfinance are pegged relatively higher, since they entail higher administrative charges and monitoring costs.

Obaidullah & Khan (2008: 24) added that “Easy to access, timeliness and flexibility are more important factors for micro entrepreneurs than interest rates”. Ahmed (2007) states that microfinance institutions may find it difficult to attract deposits in the way that commercial banks do. As MFIs grow, the savings of beneficiaries accumulate, which can then be recycled in financing micro enterprises. The time it takes for an MFI to operate its activities based solely on beneficiaries’ savings, however, may be very long. In the absence of deposits (other than savings of beneficiaries), the bulk of the MFIs’ funds are from external sources.

The reluctance of commercial lending institutions to extend their credit to (potential) micro-entrepreneurs is attributed to the high risk and high administrative costs of lending to small firms. However, a lack of understanding, experience and skills of the credit bank’s personnel when apprising feasibility studies, evaluating and monitoring small business loans are more likely to be the real reasons behind such reluctance. The high cost of the raising capital needed to undertake the business venture imposes a heavy debt burden on the entrepreneur (Kayed, 2007: 509). Commercial banks are also hesitant to take risks in financing innovations since “new products lack an account of historical success and the guarantee of future performance and acceptance by the markets remains to be proven” (Kayed, 2007: 508). Even if the potential entrepreneur was able to satisfy the requirements of the lending institution and prove his or her eligibility for the loan, the entrepreneur would then be held accountable to repay the predetermined interest charges in addition to the borrowed principal.

To reduce administrative costs, technology can be used to support MFIs’ transactions such as mobile phones, palm pilots and even laptops (Hulme & Arun, 2009). Hulme and Arun also state that according to Ivantury and Pickens (2006), using mobile phone banking, the cost could be up to one-third cheaper than the lowest price full-service account offered by South Africa’s largest bank.

In the early stage of their life-cycle, SMEs survive with structural difficulties (Tepstra & Olson, 1993), most failures occur in the first two years and 80% of U.S family businesses ended in their second generation (Bianchi, 2002). A lack of understanding regarding the unclear restrictions between the firm and the equity-owning family is the most likely cause of small business failure (Landsberg, 1983). Furthermore, Bianchi (2002) asserts that all family members are involved in the decision-making process regardless of their skills or motivation because the family business is a source of employment and wealth.

2.1.2.1 Finance-related and Operations

There are some finance-related problems for MFIs including asymmetric information, economic viability, low rate of RoI, debt trap, high drop-out rate and non-graduation from poverty (Ahmed, 2002). Furthermore, “What matters to microfinance clients is the access and cost of financial services” (Robinson, 2009: 45). Whatever the type of institution providing the finance, these institutions have to address the fundamental problems related to their operations and sustainability. To ensure income/revenue, these institutions have to mitigate the credit risk by ensuring that micro entrepreneurs repay the principal with returns in the absence of physical collateral and reduce the moral hazard problem. To be viable, the costs of operations have to be kept at a minimum (Ahmed, 2007b).

According to (Akula, 2004: 24), to be financially self-sufficient, MFIs must increase their total loans outstanding which would be impossible if the loans were small. The revenue, which comes from interest, is low on each loan but the cost of delivering funds is high. It makes sense under this situation then that the MFI prefers to deal with the productive clients who are not poor rather than very poor clients who are mostly unskilled and uneducated.

2.1.2.2 Nonfinance-related Factors

There are some non-finance factors, which have a significant impact on developing MFIs such as insufficient supervisory teams, low paid salary for officers, moral hazards, culture and specific behaviours. Sufficient supervisory and monitoring team compared with the number of clients is very important to increase the repayment rate. Wages paid to field level employees can affect their incentive to work and affect recovery rates (Ahmed, 2007b: 7).

Another barrier to developing MFIs is the possibility of irresponsible actors. In places such as Indonesia, households are served by state owned formal financial institutions that provide government and donor financed subsidized credit but “the below market subsidies are often siphoned off by local elites and so may not reach the poor” (Robinson, 2009: 46). On the other hand, a study by J. Kiiru and J. Mburu (2007) revealed that at least 60% of microfinance clients had experienced some form of harassment by fellow group members in an attempt to convince them to repay loans on which they would otherwise have defaulted, given their current financial capability.

2.1.2.3 Misleading Assumptions

There are misleading assumptions in some microfinance models. First, proponents of the model assume that many poor people can become micro-entrepreneurs with the assumptions taking entrepreneurship skills and managerial capability for granted (Kiiru, 2007: 65). To create entrepreneurial skills is not easy, particularly for the micro-entrepreneur who does not have experience of conducting a previous small business. Even, after training with managerial courses, the entrepreneur's skill still takes considerable time to be successfully implemented for specific types of characters. In Indonesia, there are several tribes who have been considerably successful in entrepreneurship: Minangkabau, Bugis and some tribes in Bali. They are tough and have a specific talent for running a business. For these people, the bank approaches them and offers long-term or rollover loans.

Secondly, based on the previous assumption, an MFI is going to "create the market for goods and services for all micro entrepreneurs. In reality, "markets are not available anytime" (Kiiru, 2007: 65). The biggest problem for micro entrepreneurs is the difficulty of finding a market for their products. Low quality products leads to a low price and then low profit, which undermines the overall sustainability of micro-business. Therefore, sustainability of micro-business leads to the sustainability of MFI also.

Thirdly, there is an assumption that "as long as the poor can repay at market rates, or slightly above market rates, it is a good indication that they are doing well financially. It is not totally true" (Kiiru, 2007: 65). The explanation of the third misleading assumption is that borrowers' capability in doing business well is measured by repaying the loan on time and above market rates. For example, "when borrowers seek funds from third party sources so that they can repay on time and thereby become further indebted" (Khan, 2008: 50). In addition, "High repayment rates do not necessarily mean that there is an increase in the borrowers' incomes" (Fernando, 2006: 26). Ahmed (1998) discovers that longer involvement with Grameen Bank reduces household income (Ahmed, 2002). Furthermore, Roodman & Qureshi, (2006) argue that the real genius in microfinance is not because they firmly believe that the poor can pay, but rather it is because they have been able to come up with clever solutions to the problems of building volume, keeping loan repayment rates high, retaining customers, and minimizing scope for fraud, and being able to deliver cost-effective microfinance to thousands and millions of poor clients (Kiiru, 2007: 66).

A fourth misleading assumption is the role of women as potential microfinance clients. Contradictions among researchers have produced ongoing controversy and confusion about this issue. Khandker (1998), however, finds that financing women rarely empowers them. Family empowerment rather than empowerment of women through micro credit, a form of microfinance, represents a significant shift in paradigm (Mannan 1998). Rahman (1999) and (Farooq, 2010) further reports that targeting the women as beneficiaries of credit by MFIs creates tensions within the traditional household and increases frustration and violence in the family. Under the family empowerment microfinance arrangement, the microfinance institutions can also ensure joint liability of wife and husband. This humanizes the family and is clearly linked to social context and culture settings, with implications for Muslim countries in particular and developing countries in general (Masyita, 2007b).

Family business activities significantly influence the economy of a community, particularly in developing countries. Big manufacturing companies indeed dominate the mass production process, both for goods and services, but most enterprises are initiated by family business. In addition, family consumption patterns also affect production and marketing activities, as well as other business activities. Government programmes for family business empowerment has to do with informal sector development efforts, as most family businesses are operated in a non-formal format and business system. Family businesses, which absorb the largest number of employees, are also found mostly in small and medium scale. In most developing economies, these small and medium enterprises (SMEs) have limited access to formal financing practices, as well as to adequate technical assistance from the government.

There are studies that consider the claims of spectacular success by micro-credit institution to be overstated or dubious. For example, according to Morduch (1998), how large is the ultimate impact on poor households? While strong claims are made for the ability of microfinance to reduce poverty, only a handful of studies use sizeable samples and appropriate treatment and control frameworks to answer these questions. In addition, some research demonstrates that research in microfinance does not reveal the institutional process through which the outcomes are achieved and thus remain insulated from criticism of its impact on society and the economy (Fernando, 2006).

The fifth misleading assumption is the concept of credit as a human right. At a micro-credit summit in Washington DC in 1997, a charter was declared stating that ‘credit is more than business and is a human right” but at a second micro-credit summit in New York, 2008 this sentiment was repealed with “Food is a universal need but credit is not. Additionally, not all poor people want or need debt” (Robinson, 2009: 57). Debt mismanagement traps individuals in a vicious circle of debt from which it is very difficult to escape.

In addition, Robinson (2009) asserts that commercial microfinance is not appropriate for the extreme poor. Such people are eligible for government and donor subsidies but after once they become productive, microfinance can reach them. BRI in Indonesia and Bolivia’s Banco Sol are examples of success stories for commercial MFI. “To serve millions of clients on a long-term basis in multiple, competing institutions requires a financial system approach” (Robinson, 2009: 56). Nevertheless, there are positive impacts of microfinance initiatives on socio-economic variables such as children’s schooling, household nutrition status and women’s empowerment (Johnson and Rogaly, 1997 cited in (Arun & Hulme, 2009: 13).

2.1.3 Characteristics of Micro-entrepreneurs

A World Bank study (1978) points out “the advantages of micro enterprises as increasing the aggregate output, enabling the efficient use of capital and labour, initiating indigenous enterprise and management skills, bringing a regional balance, and improving the distribution of income” cited in (Ahmed, 2002: 3). The micro entrepreneur is characterised by a lack of collateral, illiteracy, the small size of the loans, higher administrative cost of loans (assessment, processing and monitoring), which make it impossible for traditional financial institutions to offer credit to micro-enterprises (Ahmed, 2002; Khan, 2008).

However, according to Zarka, “If a person’s poverty can be relieved by providing micro-finance, this becomes a high priority method, because we are helping him or her to do what is mandatory on him, and not be a burden on others”(Zarka, 2007: 2). The reluctance of many commercial financial intermediaries, such as banks, to give relatively small loans to large numbers of the poor is the reason why only few commercial banks become involved in microfinance.

Furthermore, many entrepreneurs are individualistic, they may not like working in groups and also compete with each other by being unwilling to share confidential information with potential competitors (there is also increasing evidence of the negative impacts on individual group members from group lending (Khan, 2008: 28), for example see (Rahman, 2001). A study by Kiiru and Mburu (2007) found that joint responsibility borrowing in Kenya today does not necessarily mean zero collateral loans. Peers no longer agree to guarantee each other's loans based on sociological ties and trust alone; rather they demand a tangible guarantee that the loans shall be repaid. Unlike in Asia where shame, honour and reputation are important incentives for loan repayments by poor clients in the groups, those are of no great importance in Kenya, as it is possible for a client to get a loan and move to another village or city, without being too concerned about such social stigmas.

Mutual trust is very important between the MFIs and micro-entrepreneurs. Trust between micro-financial institutions and micro-enterprises determine the transaction costs. Trust reduces moral hazards, and hence risks of payment default are reduced. When bankers and businessmen share mutual respect and share the same values, less screening is needed of financing applications. Full disclosure of all information relevant to the financing can be done based on mutual trust. In the micro-entrepreneurs side, trust is also created for group peers. In group-based lending, trust among the member of groups is pivotal for continuing future loans, but it is not enough. In reality**,** "trust does not provide systematic solutions, joint liability borrowing groups have invented drastic measures to deal with un-cooperating peers" (Kiiru and Mburu, 2007). In the study by Kiiru and Mburu (2007), they pointed out that the joint liability groups studied had included two preconditions for prospective new members that had to be met before being admitted as members of the group. Formally, a contract must be signed with their prospective peers in order to formally start a group. Every group member must put in particular assets as collateral such as livestock, household furniture and cutlery; capital assets such as sewing machines, and electronic equipment and the suchlike are also accepted as a guarantee for future loans. Later, the prospective member must also provide an acceptable guarantor for their loans. The guarantor's acceptability is based on his or her ability to repay. This person is obliged to sign documents accepting responsibility for defaulted loans by the borrower".

An additional characteristic of the poor micro-entrepreneur is the capacity and willingness to save (Paltteu and Abraham, 1984; Alderman and Paxson 1994; Fafchamps 1995, Matin and Sinha 1998; Dreze *et al.*, 1997) cited in (Arun & Hulme, 2009). The reality is however, "Other than savings, the poor can obtain lump sums through selling assets and through mortgage and pawn" (Arum & Hulme, 2009: 8).

Based on empirical research in several countries, Hulme and Mosley argues that micro-enterprise credit has a more significant impact on the incomes of the non-poor than the poor because the poor have a greater need to divert micro-enterprise loans towards consumption (Arum & Hulme, 2009: 3). Moreover, the household used the money to meet short-term consumption needs not to make long term productive investments (Morduch, 2009: 22). Bank Indonesia Report on *Shari'ah* Linkage Program (2006) found that micro-entrepreneurs cannot separate his business account from his household account on account of pragmatic reasons and size. Therefore, micro-entrepreneurs are mostly confused between their own money and their business capital and leading to complicated financial problems for daily business activities.

However, from the borrower's point of view, the key elements are "security, convenience, liquidity, confidentiality, access to credit, good service, and returns" (Robinson, 2009: 59). Besides, the phenomenal growth of the sector has brought out the issues of poor management and inadequate corporate governance among MFIs (Lascelles, 2008 cited in (Arum & Hulme, 2009: 8)

2.1.4 Unanticipated consequences of Microfinance practices

Getting trapped in a vicious debt cycle is an unanticipated consequence for microfinance clients. In his research in rural Bangladesh, Hamidul Huq states that unexpected consequences of some MFI programmes drive people even deeper into poverty and insecurity (Hospes & Lont, 2004: 13). This is because they expand more debts to repay microfinance debts in order to get more funds with the hope to offset the debts so far incurred. Furthermore, "loans taken from the bank are often used for purposes other than those for which the loan is sanctioned" (Rahman 1999: 75). In addition to misconducts above after Asian Crisis 1998, Indonesia becomes a messy state, too big to fail and too messy to work (Friedman, 2000). When loans are used for non-productive purposes, the chances of default increase. Buckley reports that in 1993 46 percent of the Malawi Mudzi Fund's (an MFI in Malawi) borrowers were in arrears because they diverted the funds for consumption purposes (Buckley, 1996: 390). “One of the biggest abuses of the micro credit system is using loans to make personal purchase rather than investing in a sustainable project that will allow the borrower to repay their debts and create wealth in the long term” (Lindsay, 2010 : 5). The clients keep borrowing to repay, until the ultimate face to face with excess debt. Excess debt can deplete household capital assets and other basic livelihood assets, thereby leaving the household exposed and vulnerable (Kiiru, 2007). This process of ‘graduation’ is termed by Muhammed Yunus, as the *virtuous* circle of ‘low income, credit, investment, more income, more credit, more investment, and more income’ (see Hulme and Mosley 1996: 108).

Most microfinance institutions operate as a corporation with profit-oriented motives so that it is difficult to reach "win-win" situation with the poor as microfinance clients (Morduch, 1999). Furthermore, a study by Hulme and Mosley (1996) on whether microfinance is appropriate for these poorest of the poor shows that clients below the poverty line were worse off after borrowing than before. Their findings suggest that successful institutions contributing to poverty reduction are particularly effective in improving the status of the middle and upper segments of the poor. By aiming too much at the poorest of the poor (and female), selection bias may take a negative turn.

The profit from MFIs attracts big player banking and financial institutions to become involved such as ICICI, Barclays, ABN-Amro and Citigroup. To manage their liquidity and credit risks, these MFIs also develop asset-backed securitization. There is a cynicism that as “people who had negotiated public grants to establish an MFI and who charged high rates of interest on loans to low-income people (under the banner of poverty reduction) converted the resources generated by grants and high charges into private fortunes” (Hulme & Arun, 2009: 227). Charging the poor with a high interest rate can be deemed ‘business in poverty’. “When the MFIs-NGO became a private sector financial institution, its directors became multi-millionaires overnight. For many observers this was distasteful” (Hulme & Arun, 2009: 227) and also unethical.

2.1.5 Lessons Learned from Grameen Bank and Bank Rakyat Indonesia (BRI)

2.1.5.1 *Grameen Bank*

Grameen Bank in Bangladesh began to provide micro-credit to poor women in 1976. At this time, the way to reduce poverty was to encourage the poor to start their own business. In order to do so, it was necessary to establish financial sectors which provided the poor with small loans or micro credit. Because of large numbers, a huge amount of money was needed to facilitate them. At the beginning there was no bank keen to provide micro credit for the poor and Muhammad Yunus succeeded in changing this situation after struggling for more than two decades.

As we live in a capitalistic era, opportunity cost and time value of money is forefront in all minds. For these reasons micro-credit is difficult to provide cheaply. Altruistic motives, even if they too are natural, are not as powerful: they need to be socially reinforced and nurtured (Mousa, 2007). Nevertheless, the Grameen Bank is not a charity. Its interest rates are commercial, as high as 20 - 30%. It is a business that scrupulously controls costs and aims at profitability while adhering to a social programme whose mandate is to end poverty and hunger (Mousa, 2007).

If we take a look the development of microfinance already mentioned in sub section 2.1.1 about two approaches (financial system and poverty lending) Robinson (2009) says that Grameen Bank started as a poverty lending approach at the beginning and by 2002, it had changed to become much closer to a financial system approach (Hulme, 2009). If using financial system approach, Grameen Bank has the same target as the other financial institutions, which is the maximizing profit. This shifts from a poverty-lending model to that of a financial system have consequences for clients, donors and management.

In order for micro-credit to permanently reduce poverty, it must have a long-run impact. Micro-credit is not a short-run subsidy. Its aim is to lead to a sustainable increase in a household's ability to create wealth. There is some evidence that the effect of micro-credit on poverty is particularly strong for about six years with some leveling off after that point (Chowdhury, *et.al*. 2005). Data analysis suggests that it takes 9-10 years for an average Grameen Bank household to free itself from poverty by borrowing and being a member of Grameen Bank (Khandker, 1996). But many researchers doubt the accuracy of this evidence. Hulme (2000) argued, outside Bangladesh, MFIs have not even scratched the surface of poverty. In addition, income generation is significantly different from reducing poverty (Wright, 1999).

From 2002, Grameen Bank has had a progressively smaller number of clients who are from extremely poor households; most of the clients are productive micro-entrepreneurs. On the other hand, "analysis shows that Grameen Bank is heavily subsidized by donors and the government, thus, with its performance conditional upon grants and subsidized funds, Grameen Bank possibly cannot survive without subsidy" (Khankder, 1996: 65-85). Using the grants and subsidized fund for means other than poverty alleviation is questionable. "To save embarrassment, such MFIs can use token programmes – such as Grameen's Beggars Programme – to show that their heart remains with the poor even when their head (and financial portfolio) has moved to the market"(Hulme & Arun, 2009: 226). "Despite the fact that Grameen bank-type microcredit institutions are highly acclaimed for their success in poverty alleviation, the reality of that success is murky and questionable, because hard data from such institutions is rarely publicly available for independent scrutiny and research" (Farooq, 2010: 15).

There is increasing evidence of microfinance leading to impoverishment, increased domestic conflict or abandonment of women borrowers (Rahman, 2001). In addition, the patriarchal social structure in many countries may limit the extent to which women borrowers can actually benefit from loans (Khan, A,. 2008: 33). However, "the Grameen bank still remains a global icon although there is real confusion about the Bank and Muhammad Yunus's message" (Hulme, 2009: 169).

2.1.5.2 Bank Rakyat Indonesia (BRI)

Aside from Grameen Bank, the other largest MFI is Bank Rakyat Indonesia (BRI) which has about 3.2 million borrowers and 30 million savers in 2004 in its micro-banking division. Grameen bank uses group-based lending, whereas the BRI does not. According to Don Johnston, "The main clients of BRI are petty traders or owners of small enterprises like restaurants and tailor shops, typically making high margins, quick turnaround investments who have capabilities to pay real interest rates approaching 50% per year on 3-4 month loans" (Morduch, 2009: 18).

Bank Rakyat Indonesia (BRI), one of largest and oldest MFI in the world, started in 1895 with the name - the first rural bank – Bank for Civil Servants. With some alterations, the establishment of BRI's unit was a consequence of the Indonesian government's programme for rice farming intensification in 1965. To develop BRI, the government has played crucial role so that the claim that minimizing the government involvement for achieving the successful of microfinance could be proved false in BRI's case (Morduch, 2009). BRI's micro-banking system maintains at least one unit in all sub-districts of the world's fourth largest country (Robinson, 2004: 81). All loans have been financed by savings since 1989, repayment has been consistently high, and the micro-banking system has been profitable every year since 1986, including during the Asian crisis when the country's financial system collapsed (Robinson, 2004: 81).

"BRI's scheme had developed products that have enabled it to work profitably with low-income households and it is more convenient for bank clients" (Arun, Hulme, Matin, & Rutherford, 2009: 11). As a profit making enterprise, BRI's efficiency can be achieved through transfer prices in subsidized programmes. "Transfer prices are the internal prices used by institutions to value capital and determine relative performance at branch levels"(Morduch, 2009: 27). Bank BRI unit savings products are based on principles of trust, security, convenience, liquidity, privacy, linkages with loans and returns (*Microfinance Industry Reports- Indonesia*, 2009: 11). According to Robinson (2009), for sustaining on a long-term basis, a financial approach is required for competing institutions and BRI have showed that it can still reach poor clients.

2.1.6 Risk Management of Microfinance

Dealing with uncertainty is common in social science. Predictions, like weather forecasting, are sometimes close to reality and sometimes very far. An MFI involves a large number of people in its daily activities. People in the chain have their own opinions and it is thus extremely difficult for decision-makers to satisfy them. As a consequence, most MFIs anticipate high risk with the high cost. Most research on risk management in finance, particularly microfinance, is conducted by economists or financiers who rely heavily on statistical methods with limited assumptions and frequently neglect the immeasurable variables to create 'a general theory'. Most of them are difficult to be implemented because of their numerous constraints. However, there is a general theory to solve these problems. Cleaver (2007) provides rationale for this matter, "Most people cannot accept not knowing why things happen and will rush into any causal explanation – from magic to the influence of gods, gurus and aliens – rather than be left with uncertainty"(Cleaver, 2007: 6). However, an urgent decision must always be taken as soon as possible to manage the uncertainty. At least, the most reasonable model for managing risk should be formulated by each MFI developing a tailor-made approach.

Some MFI problems are "high transactions costs per loan when lending at small scales, determining the risk of potential borrowers, monitoring the progress of clients and lack assets to put as collateral"(Morduch, 2009: 20). In regulating the MFIs, "the regulator must understand the dynamics of the system and allow sufficient flexibility with the regards to issues such as documentation and legal procedures" (Arun, 2009: 191). On the other hand, "regulating MFIs must be more conservative in prescribing the financial indicators for risk management such as higher risk weighted capital adequacy ratios ethic reveal the financial strength and the ability of the institutions to absorb losses" (Arun, 2009: 191). For example, CGAP from the World Bank recommends micro-lenders to report as loans with a payment more than ninety days overdue as 'at risk' and Accion requires this after thirty days. Those above are the risk criteria but the Grameen Bank does not publish the figures under these criteria (Chemin, 2002).

2.2 ISLAMIC MICROFINANCE SECTORS

A discussion of the differences between conventional MFI and Islamic MFI reminds us of the polemic between conventional bonds and *sukuk*. Does it deal with form or substance? To borrow McNamara's words (McNamara, March 2010) when he criticized the alteration of *sukuk* by MFI , 'the structure of Islamic MFI that looks like conventional MFI, smells like conventional MFI, and even walks like conventional MFI but does not pay interest'. McNamara then further asserts "Admittedly the profit that it pays looks very much like interest and competes with interest but it is not interest. Or maybe it is, but we will call it a rental return or profit instead" (McNamara, March 2010: 27).

2.2.1 Are Islamic MFI's structures actually *Shari'ah* compliant or not?

Islamic MFI is not solely for profit creation but it should be in line with the *Maqasid al-Shari'ah*. Ensuring that Islamic MFI will only be used for empowering micro-entrepreneurs in the policy process is important. If it is not, then Islamic MFI is not different from conventional MFI. The Islamic world has over 1.2 billion people, stretching from Senegal to the Philippines – comprising six regions: North Africa, Sub-Saharan Africa, the Middle East, Central Asia, South Asia, and Southeast Asia. In Indonesia alone with world's largest Muslim population, over half of the population - about 129 million is poor or vulnerable to poverty with incomes less that US$2 a day. "Bangladesh and Pakistan account for 122 million people each followed by India with approximately 100 million Muslims below poverty line" (Khan, 2008: 25).

Microfinance practice differs from one country to another. There is no one unique microfinance model or method of delivery that should be promoted. Rather, "each microfinance programme needs to be tailored specifically to meet complex local realities prevalent within each country or even different regions within a country" (Khan, 2008: 6). Khan (1997) suggests a variety of activities like *qard-hasan*, financing housing, meeting basic needs, promoting and financing small entrepreneurs. All these aspects, however, can be covered in a comprehensive integrated programme that focuses on micro financing (Khan, 1997).

If Morduch (2005) suggests 'smart subsidies' to underpin sustainable microfinance, Ahmed (2003), Kahf (2004) and Wilson (2007) advocate charitable tools such as *zakah, sadaqat* and *awqaf* to support microfinance institutions and their micro-entrepreneurs. Micro-financing programmes, which use profit-loss sharing, are one of the most important sectors for poverty alleviation. Most funds collected through cash *waqf* certificate issues can be allocated as loans for micro-enterprises. This micro-credit programme should particularly be aimed at helping poor people initiate their business and enhance their quality of life, accordingly. Nevertheless, merely funding them with capital is not sufficient, since most of them do not have sufficient knowledge and skill to choose and to run a business that is suitable for their needs. Consequently, relevant business technical assistance and spiritual treatment is needed to help them survive.

There are three main products, which support the Islamic MFI: micro-credit, micro-saving and micro-insurance. "The Islamic MFIs offer micro-credit using a variety of *Shariah*-nominated mechanisms, such as, *qard al-hassan* (with recovery of actual costs of service), *murabahah* with *bay-bithamanajil, ijarah, bay-salam* etc. Less popular are partnership-based financing based on *mudarabah* and *musharakah"* (Khan, 2008: 25). Regarding micro-saving, poor people prefer easy access, secure, convenient deposit services and however, "poor people in Islamic countries like their counterparts elsewhere, prefer high returns" (Khan, 2008: 26). Micro-insurance is called 'micro-*takaful'* in the Islamic framework. "Credit life insurance, personal accident insurance, savings life insurance and property insurance are the insurance products offered by micro-*takaful* to microfinance clients" (Khan, 2008: 29).

Being poor is hard financially and in some cases, paying insurance may be a serious financial burden. "While there is no question that the poor are highly vulnerable to a wide variety of risks, this vulnerability cannot necessarily be translated into a demand or need for insurance" (Brown, 2009: 171). Additionally, "it may make the very poor worse off by diverting funds from 'protectional' programme" (Akula, 2004: 29)

According to Brown (2009) further, there are some basic questions to ask before launching a micro insurance initiative: Is insurance the most appropriate financial services for protection? And are micro clients willing and able to pay the insurance price (Brown, 2009)? If the answer of the above questions is 'yes', MFIs can be involved more in providing this kind of insurance. Micro-insurance started to be recognized as the growth driver of the microfinance industry as its insurance products are designed for micro borrowers. MFIs can act as the agent, marketing and selling the insurance product to their clients who, as constrained by low incomes, have not had prior access to insurance companies. Few poor households have access to formal insurance against risks such as severe illness, the death of a family breadwinner, or loss of an asset including livestock and housing.

Unsuitable design of programmes for poor households has attracted widespread criticism that most do not match with the demands of the poor. Sometimes, the management or marketing consultant creates many programmes, which claim to satisfy the demands of poor households with micro-insurance in order to get more projects. As the poor are less educated and do not understand the concept of insurance or risk management, consultants thus justify the necessity of financial education programmes as a solution (Ito & Kono, 2010: 75). In fact, in India, the research reveals that (1) low take-up rates, (2) high claim rates and (3) low renewal rates are three characteristics of health micro-insurance problems.

However, in countries such as Indonesia, it is almost impossible for the poor to buy insurance products separately, most of them are protected by insurance embedded in particular products that they have bought. For example, they are protected with death insurance when they buy a bus, train ticket or folk entertainment. Because the cost of insurance is included in the ticket prices, many of them do not realize they are protected. "Through potentially complementary, banking and insurance products can also be mutually destructive. Just as loan losses can erode the reserves required to meet insurance claims, losses in insurance operations can deplete depositor assets and a MFI's loan capital in a single catastrophic event" (Brown, 2009: 171).

Feroz (2007) proposes Grameen *Shari'ah* Bank (GSB) which has a zero tangible collateral scheme, with portfolio approach and is interest-free. Based on the profit-loss system, the bank would initially keep full ownership of financed assets and as the borrower repays the loan, the bank's share would decline. Otherwise the borrower's share would increase until the borrower paid all loans and at the end the assets are owned by the borrowers (Feroz, 2007). Because market value changes overtime, asset value must be re-determined and re-evaluation conducted annually to hinder the unfairness between two parties.

2.2.2 Characteristics of Islamic Microfinance

Debt is a last resort to fulfill an individual's need for either capital or consumption. Giving credit to a productive man is better than giving s*adaqah*/charity. However, a vulnerable structure of debt creates crisis not only for a national economy but also for a household economy at the micro level. Among the most complete studies on the topic, Dhumale and Sapcanin (1999) drafted a technical note in which they tried to analyze how to combine Islamic banking with microfinance. They took into consideration the three main instruments of Islamic finance (*mudaraba, musharaka* and *murabaha*) trying to use them as tools to design a successful microfinance programme. *Musharaka* is rarely implemented. An explanation of these products follows (Sapcanin & Dhumale, 1999):

> **A *mudaraba* model**: the microfinance programme and the micro-enterprise are partners. Of course the model presents a series of difficulties, given most of all by the fact that micro-entrepreneurs usually do not keep accurate accountability, which makes it more difficult to establish the exact share of profit. As stated before, these models are complicated to understand, manage and handle which implies that those who are involved need specific training on the issues. For this reason, and for easier management of the profit sharing scheme, the *mudaraba* model might be more straightforward for businesses with a longer profit cycle.
>
> **A *murabaha* model**: under such contract, the microfinance programme buys goods and resells them to micro-enterprises for the cost of the goods plus a mark-up for administrative costs. The borrower often pays for the goods in equal installments and the microfinance programme owns the goods until the last installment is paid.

Range (2004) underlines how the prohibition of *riba* in Islamic finance does not constitute a barrier to marketing microfinance products; on the contrary, the side effects of an Islamic foundation could probably enhance it. These effects are: the high rate of return (compared to a fixed interest rate), the holistic approach in supporting businesses and productive activities, a more effective mobilization of excess resources and a fairer society (Range, 2004). Though, “it is not surprising that in religious matters people tend to form attitudes that correlate to their religious convictions without possessing the theoretical and/or practical knowledge to justify their attitudes” (Kayed, 2007: 529).

The Islamic approach to poverty alleviation, needless to say, must also be free from *riba*, *gharar*, *jahl* and *darar* (Khan, 2008: 35). Mutual cooperation and solidarity is a norm central to Islamic ethics. The *Surah Al Maida* in the holy *Qu’ran* says: "Assist one another in the doing of good and righteousness. Assist not one another in sin and transgression, but keep your duty to Allah" (5:2).

The following saying (*hadith*) by the Prophet (pbuh) reinforces this principle of cooperation and mutual assistance. The Prophet then said that believers are to other believers like parts of a structure that tighten and reinforce each other. It is also likely that Islamic microfinance programmes build greater levels of trust and understanding between the microfinance provider and the micro-entrepreneur, because they are partners rather than service provider and client (Khan, 2008: 54)

2.2.2.1 Theory of Islamic Microfinance

What are the differences between conventional and Islamic MFI? According to Ahmed (2002), these differences can be seen in table 2.1 below. In principle, the best practice of microfinance can be integrated with the principle of ‘profit-loss sharing’ in the *Shari’ah* which equitably allocates risk and return between investors and entrepreneurs without subjecting micro-entrepreneurs to disproportionate risks (Feroz & Goud, 2008: 3). Therefore, *Shariʼah* scholars in general are of the opinion that *musharaka* is a more ‘Islamic’ form of financing than *murabaha* because it relies upon risks and profit-and-loss sharing. They prefer to give *murabaha* a transitional role in providing *Shariʼah*-based financial services to the poor.

In terms of technicality and practice, the procedure of *murabahah* in Islamic microfinance is similar to conventional microfinance; hence, it is a starting point to socialize more Islamic microfinance products. However, the *murabaha* transaction, which is currently more familiar to clients, can be a bridge to the success of the *musharaka* product in the future. Feroz and Goud (2008) assert that training on basic book keeping for MFI clients is pivotal to enhance their ability to exhibit the financial report regularly, accurate and reliable as a prerequisite for *musharaka* financing. A good combination of trust, managerial and reporting skills is a key success of *musharaka* financing.

Table 2.1 Differences between Conventional and Islamic MFIs

	Conventional MFI	**Islamic MFI**
Liabilities (sources of funds)	External funds, savings of clients	External funds, savings of clients, Islamic Charitable Sources
Assets (Mode of Financing)	Interest-based	Islamic financial instruments
Financing the Poorest	Poorest are left out	Poorest can included byintegrating *zakah* with microfinancing
Funds transfer	Cash given	Good transferred
Deductions at inception of contract	Part of the funds deducted at inception	No deductions at inception
Target group	Women	Family
Objective of targeting Women	Empowerment of women	Ease of availability
Liability of the loan (when given to women)	Recipient	Recipient and spouse
Work incentive of employees	Monetary	Monetary and religious
Dealing with Default	Group/centre pressure and threats	Group/centre/spouse guarantee, and Islamic ethics
Social Development Programme	Secular (or un-Islamic) behavioural, ethical, and social development.	Religious (includes behaviour, ethics, and social)

Sources (Ahmed, 2002: 15)

Instruments for gathering MFI funds may be generally segregated into (1) charity that includes *zakah, sadaqah, awqaf*; gifts that include *hibah* and *tabarru*'; (2) deposits in the form of *wadiah, qard al hassan* and *mudarabah* and (3) equity in the form of classical *musharakah.* For interest-free loans (*qard al hassan*), the principles of Islamic financing can be broadly classified as partnerships (*shirakat*) on the basis of profit sharing or output sharing and exchange contracts (*mu'awadat*) (Ahmed, 2002: 10).

While *sadaqah, hibah* and *tabarru*' have parallels in conventional microfinance, such as, donations or contributions, *zakah* and *awqaf* have a special place in the Islamic system and are governed by elaborate Islamic jurisprudence rules. Deposits in the form of *wadiah, qard al hassan* and *mudarabah* have their parallel in savings, current and time deposits respectively and are a regular source of funds for Islamic microfinance institutions, especially those in South-East Asia. Other Islamic finance instruments such as price deferred sale (*bay'-mu'ajjal),* sharing in agricultural production (*muzara'ah)* and leasing (*ijarah and ijarah wa iqtina)* can be implemented for Islamic MFIs (Ahmed, 2002).

2.2.2.2 Problems of Islamic Microfinance

Islamic microfinance institutions, recently, have displayed wide variations in the products, instruments and operational mechanisms. Despite the fact that in terms of reach, penetration and financial competence, Islamic microfinance institutions still lag far behind their conventional counterparts. Akin to conventional MFIs, Islamic MFIs are also faced with numerous problems such as assymmetric information, moral hazards, loan misuse, irresponsible users of loans, a lack of skilled and quality micro-entrepreneur products (Ahmed, 2002).

This is in addition to high administration costs which translate to higher costs for borrowers. Obaidullah (2008b) also said that how can micro-entrepreneurs develop their business if they are always trapped in vicious debt with high interest rates? Fixed interest rates and the dynamic fluctuating nature of business are mismatched which is unfair for start-up micro-entrepreneurs. Therefore, there may be an urgent need for rich endowments to be established solely for the purpose of financially supporting microfinance institutions.

Islamic MFIs management should keep their alertness concerning fulfilling *Shari'ah* complaint requirements in their financial products and mechanisms. However, "*Shari'ah* compliance is indeed the differentiating factor between a conventional and Islamic microfinance institution. Islamic microfinance institutions must not only conform to *Shari'ah* in all their products, processes and activities, but they should also be perceived to be so by their clientele" (Obaidullah and Khan, 2008:31).

The questions in sub chapter 2.2.1 are some of the problems faced by Islamic MFIs. In practice, *Bay' mu'ajjal* is hard and is costly to implement (Ahmed, 2002). *Mudarabah* as the ideal concept is very rarely implemented in the Islamic MFIs because of the moral hazard problem in the underreporting of profit. Although, *mudarabah* as it is perceived to be more Islamic in spirit, most borrowers perceive that under the profit-sharing mechanism is more expensive for them than other alternatives within Islamic banking. Moreover, some borrowers do not like the profit-sharing of *mudarabah* because they do not want to reveal their profits to Islamic MFI's officers. This is a classic problem of the greediness and inconsistency of economic man. Furthermore, Obaidullah and Khan (2008: 33) said that “Agency problems with Profit-Loss-Sharing (PLS) in mainstream Islamic finance have already been highlighted as a matter of grave concern that pushes Islamic FIs to opt for debt-based products”. The problem becomes acute if PLS-based modes as compared to sale and lease based modes. Therefore, giving technical, managerial assistances and spiritual approach especially the honesty in disclosed the profit & loss for borrowers is very important but also raises the implementation costs (Masyita, *et.al*: 2011). These costs, hopefully, can be funded by Islamic voluntary fund such as *zakah*, *infaq* and *shadaqah*.

Murabahah as the second best concept is still dominates Islamic MFIs but in reality, it is just a form without much substance. Islamic MFI’s borrowers initially express doubts about the aptness of the “buy-resell” mechanism (*murabahah*) because it appears too similar to the forbidden practice of fixed interest rates/*riba* (Obaidullah : 2008). However, in case of Islamic debt financing too, the negative effects of financial risk arising out of use of fixed rate financing (*murabahah*) are limited as compared to interest-based debt. This is because the former does not allow for compounding of the debt in case of possible default (Obaidullah and Khan, 2008: 12). Nevertheless, it needs the further explanation and education to the borrowers and local religious leaders to be accepted. They perceived *murabahah* product is easier to be administered and monitored.

2.2.3 Risk Management of Islamic Microfinance

In Islamic teachings, the importance of risk in businesses is clearly acknowledged. Risk cannot be sold in any manner. The study of finance in Islam is built on the foundation that risk must be shared between parties in any endeavour (as opposed to being all assumed by one party). Accoding to Askari, Iqbal, & Mirakhor (2009: 49), compared to conventional economics, there are at least two important differences to risks from Islamic perspectives. Firstly, Islam prohibits the notion of a ‘*risk-free, interest-bearing debt*’. Secondly, instruments that partition risk contrary to Islamic teaching cannot be allowed. Therefore, the central goal is ‘*better risk sharing’* (Askari, Iqbal, & Mirakhor, 2009: 50).

According to Obaidullah (2008: 47) “The Islamic MFIs must bear a certain amount of risk associated with ownership, risk of destruction of asset and other risks of default and delinquency in order to legitimize its returns. However, such risk exposure is not enough to legitimize gain". He also reminds that in term of the risk of destruction, the subject of sale must exist in the ownership, physical or constructive possession of the seller at the time of sale. Instruments as tools to manage of the risk of default and delinquency in risk management and insurance in Islamic microfinance are based on "the concept of guarantee (*kafalah*) and collateral (*daman*). For protection against unforeseen risks by borrowers/members, microinsurance would take the form of micro-*takaful* based on mutual guarantee"(Obaidullah and Khan (2008).

Risk is an uncertainty. Profits is an uncertainty, fluctuate overtime, and a big issue of the PLS's models. Fluctuating profits make it extremely difficult for either MFIs or microentrepreneurs to predict their cash flows. In addition, some micro-entrepreneurs hardly keep their bookkeeping in accurate accounts. However, the PLS model is difficult to understand for loan officers and borrowers as well. "Even in the hypothetical situation that profits were known, the borrower has to repay a different amount each period (and the loan officer has to collect a different amount each period). This lack of simplicity—relative to equal repayment installments—is a source of confusion for borrowers and loan officers" (Obaidullah and Khan, 2008 : 33).

Furthermore, there is a need to develop systemic-level mechanisms to perform collective monitoring of economic agents to reduce monitoring costs for financial intermediaries and institutions to support risk-sharing, partnership-based and equity-style financing and investment also (Askari, *et al*., 2009: 54). On the contrary, depositors and other stakeholders of Islamic bonds have placed a special "trust" in the management of these financial institutions, assuming that they are facilitating a *sacred obligation*, and any damage to this trust can lead to a breach of confidence (Askari, *et al.*, 2009: 57). An Islamic bank's reluctance towards risk-sharing instruments such as *musharakah* (equity partnership) and *mudarabah* (principal-agent partnership) is problematic for achieving the true potential and promise of the system (Askari, *et al*., 2009: 59).

Economy of scale and a lack of variety or products matter when creating organizational efficiency both in activity and cost. Due to their small size and lack of diversification, "Islamic banks are unable to reap these benefits especially compared to foreign conventional banks that are better equipped to meet these challenges" (Askari, *et al.*, 2009: 60-61).

2.2.4 Islamic Microfinance in Practice

According to Obaidullah (2008), cases of successful Islamic microfinance experiments in Muslim societies are small in number. Further, these institutions are not integrated into the formal financial systems, with the notable exception of Indonesia. "The majority of microfinance institutions in the MENA and South Asia are set up as NGOs (Societies, Trusts, Foundations and Associations etc.). Generally, NGOs are allowed to *make* profits but not to *take* profits" (Obaidullah & Khan, 2008: 30).

It is important to emphasize that successful implementation of microfinance, even the most clear and well-designed microfinance policies and programmes, ultimately depend upon staff that understand and accept these policies. Therefore, the success or failure of the microfinance programme is dependent in large part upon the capacity of the staff. While this is true of all microfinance programmes, it is particularly pertinent in the case of Islamic initiatives since they generally involve more complex procedures and frequently requires a greater input and understanding of loan-financed activities. It is necessary to ensure, therefore, that not only should staff receive adequate training but also that this process is ongoing. It is important that funds are allocated also for institutional capacity building and strengthening and not just for on-lending (Khan, 2008: 22).

The growth of Islamic microfinance institutions as "Financial exclusion is aggravated by failure on the part of conventional microfinance programs to give due importance to the religious sensitivities of Muslims" (Obaidullah (2008:1). But the current practice from Islamic MFIs which can be a solution for helping the poor is still far from their expectation. The poor who hardly produced the collateral are very difficult to get financing from Islamic MFIs. Microcredit only for someone who can produce collaterals which are it a house, land, jewelry, factory, raw material, semi finished products, etc.

2.2.4.1 Challenges for Islamic Microfinance

Many challenges have been facing by Islamic MFI management teams to expand the market and volume. One of them is that there is always a danger that borrowers will see loans as something that they do not need to be repaid, especially if the same organization is also implementing other projects that involved donations. Successfully combining a microfinance programme with other essentially humanitarian work within the same country programme is a difficult task and something that perhaps should not always be attempted (Khan, 2008: 24).

To fulfill the Muslims expectation, Islamic MFIs should enlarge the proportion of the poor entrepreneurs as their clients. The surpluses in earnings generated by the poor microenterprises tend not to be reinvested for expansion and tend to be applied to household expenditure. Therefore, they face a continuous need for external financing (Obaidullah, 2008). Divergence of views among *Shari'ah* scholars on many issues particularly on Islamic microfinance products is the other challenge. "The local nature of the practices in microfinance allows for many variations from the standardized set of contracts discussed in *fiqh* literature and can open up rooms for debate "(Obaidullah & Khan, 208 : 31). Furthermore, many Islamic microfinance providers realized that most micro borrowers who are uneducated and poor are not comfortable with techniques like *murabahah* and *ijarah* (lease-purchase and financial lease variety) and view them as interest-based loan-substitutes. "At times, such perceptions are rooted in the ignorance of the clients about *fiqhi* rules governing the various *riba*-free mechanisms. It is pertinent to note a few survey findings on attitude of Muslim borrowers towards alternative modes of financing" (Obaidullah & Khan, 2008: 32).

2.3 THE BALANCED SCORECARD

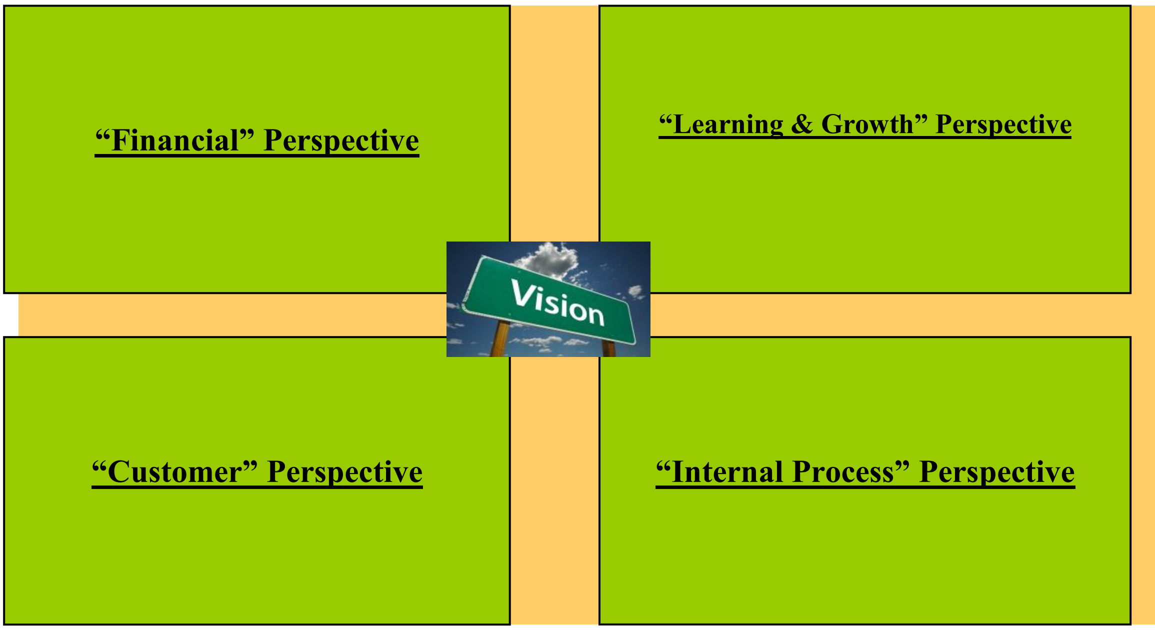
Microfinance is a profit institution and undoubtedly deals with daily management issues. The measurement of performance is important for both stakeholders and stockholders. There are several ways or tools to measure the institution/firm's performance one of which is the Balanced Scorecard (BSC). The specific characteristics of the Balanced Scorecard (BSC) include a mixture of non-financial and financial measures (see Figure 2.3). Financial perspectives measure whether a firm/organization's strategy, implementation and execution are contributing to firm's improvement (Kaplan & Norton, 1996b). Customer, internal business process and learning-and-growth as non-financial categories combined with financial performance categories are the balanced perspectives to analyze a firm/corporation or profit organization. These categories are also relevant to profit and non-profit organization. Customer perspectives measure customer satisfaction, customer retention, market competition in targeted segments. Internal-business-process perspectives identify the critical internal processes in which the firm/organization must excel such as innovation and operation process

(Kaplan & Norton, 1996b). Learning and growth perspectives identify the infrastructure that the organization must build to create long term growth and improvement.

The BSC is a part of corporate strategy, which was initially proposed in the late 1980s and early 1990s and then developed to be modern performance management tools not only for corporations but also more flexible for organizations. Not many researchers have measured MFI's performance with comprehensive and holistic approaches. Tapanya (2004) is an exception and maintains that with a holistic view, BSC measures both inside and outside the institutions or operational level and then allows each group of the institution to see how their activities contribute to attainment of the institution's overall mission (Tapanya, 2004).

In this study, the way Kaplan and Norton (1992), promoters of the Balanced Scorecard in the early 1990s, measure a firm's performance is highly relevant to microfinance institutions. Along with BSC, four factors of CGAP's technical tools (Rosenberg, 2009) for appraisal for MFI also complement BSC. A balanced non-financial and financial performance is extremely important to create a sustainability of microfinance institutions. Therefore, this research adopts four perspectives of the Balanced Scorecard and CGAP to measure and compare the performance of Islamic and Conventional MFIs.

Figure 2.3 Balanced Scorecard Perspectives



Sources : Kaplan & Norton, 1996b

In general, different types of performances can be measured using different tools of performance measurement. Figure 2.4 below shows how different tools can be applied to certain types of performance to get the appropriate measurement. According to Vanelli (2002) Managerial Accounting and “Output-Fortified” Accounting Systems are most frequently used for measuring financial performance institution. On the contrary, financial accounting and Herzlinger’s Four by Four reports are rarely used for measuring the same performance. Cost benefit analysis and Social RoI measurement tend to measure the performance with more balance than the first two tools. On top of them, Balanced Scorecard is more popular to measure the balance and comprehensive perspectives of an institution. Chai (2009 : 18) further stated that

> “In the 1980s and 1990s, a plethora of measurement frameworks were designed to help organizations implement a balanced set of measures (Kennerley & Neely, 2002). Fitzgerald, Johnston, Brignall, Silvestro, and Voss (1991) group the multidimension performance in service industries under two heads: the results and the determinants of the results. Atkinson and McCrindell (1997) distinguish between primary objectives, which are externally oriented and concerned with measurable deliverables, and internally oriented secondary objectives concerned with how services will be delivered. In the area of strategically oriented performance measurement, Kaplan and Norton’s Balanced Scorecard (BSC) has been one of the most debated suggestions for developing a framework for performance measurement and management (Bukh & Malmi, 2005). The BSC (Kaplan & Norton, 1992, 1996) argues for performance measurement over four dimensions of performance: financial, customer, internal business processes, learning and growth.”

The BSC, in general, seeks responses to four kinds of basic questions (Kaplan & Norton, 1992): (1) How do customers see us, (2) What must we excel at? (3) Can we continue to improve and create value and (4) How do we look to shareholders?

Figure 2.4 Locating Selected Performance Measurement Tools (Vinelli, 2002: 64)

		Financial			**Mission-Related**
Frequency of Measurement	**High**	Managerial Accounting	“Output-Fortified” Accounting Systems		
			Balanced Scorecard		Outcome Measurement
			Social Return on Investment		
	Low	Financial Accounting	Herzlinger’s Four by Four Report	Cost Benefit Analysis	Most types of Program Evaluation

The answer for the first question deals with customer/clients' perspectives. Internal business processes are something that the institution/company must excel at. Innovation derived from learning-and-growth allows the organization to continue to improve and create value as ultimately financial aspects are important issues for shareholders. Based on two decades of experience, organizations have adapted the BSC and both commercial and non-profit organizations have successfully used this framework.

2.3.1 Measurement of Performance Using The Balanced Scorecard

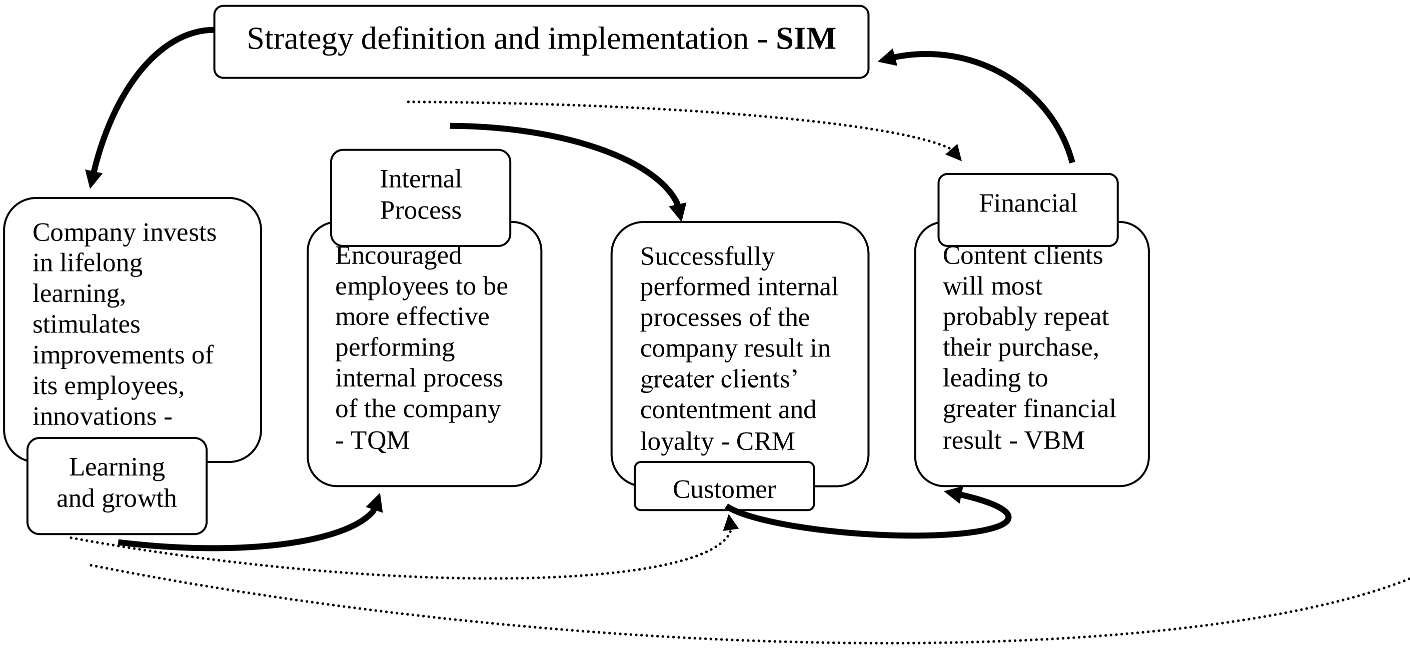
Numerous options of the Balanced Scorecard are suitable for measuring the performance of an institution. However, it must also be noted that there is no one accurate tool to measure it. There are those who believe that financial performance is everything and is the only way to measure an organization/institution performance. They often ask the following questions: how can one trust non-financial reports of an institution with regards to customers, internal processes and development efforts? Are such reports subjected to be quantified and then audited? Many studies have been done and conclude that non-financial elements can be quantified as well as financial element using scoring methods.

The globalization and the dynamics of business were changing rapidly whereas customer knowledge and the rise of intangible assets determine the way business was conducted. Reliance on financial measures of performance such as Activity - Based Costing (ABC) and Economic Value Added (EVA) are not sufficient to anticipate future financial performance. Niven (2008) criticized abundant use of financial measurement. He mentioned that it is not consistent with today's business realities, driving by rear view mirror, reinforcing functional silos, sacrificing long - term thinking and not relevant to many levels of the organization.

2.3.2 Relationships Among Perspectives

Generally, there is a causal-effect chain that leads from the capability of internal business processes through learning and growth to customer perspectives, which affect the final financial performance. This structure is consistent with the Balanced Scorecard concept developed by (Kaplan & Norton, 1996a, 1996b, 2001) who emphasize the importance of maintaining the balance between financial and non-financial elements in the business entity.

Figure 2.5 Cause-Effect Interactions between Perspectives/variables of the BSC model (Kaplan & Norton, 2001)



An integration of financial and non-financial strategies measures variables in a cause-and-effect relationship, which incorporates the following basic assumptions: measures of internal business processes, organizational learning and growth, customer and financial perspectives. The assumption that there is a cause-and-effect relationship between four perspectives is essential because the measurements in non-financial areas make the performance measurement system a feed-forward control, solving the problem of the historical nature of accounting data (Kaplan & Norton, 1996b).

However, there are extensive criticisms of the BSC. Norreklit (2003) argues that the BSC's four pillars do not comprise stakeholders' interests, competitor actions, unexpected event and development of technology. These lackings make it static rather than dynamic (Nørreklit, 2003). Even though the BSC assumes a "cause-effect" relationship between the measures of learning-and-growth which drive the internal business process and then in turn drives customer perspectives leading to the financial indicators (Kaplan & Norton, 1996a), this cause-effect relationship is not given and is subject to empirical findings (Nørreklit, 2000).

The balanced scorecard contains outcome measures and the performance drivers of outcomes, linked together in cause-and-effect relationships (Kaplan & Norton, 1996a, 1996b). Furthermore Janes and Sasser (1990) state that it is not generic that a ''high level of satisfaction will lead to greatly increased customer loyalty and that increased customer loyalty is the single most important driver of long term financial performance.'' (Nørreklit, 2003: 616). In a study of hundred companies, Reichheld and Sasser (1990) found the tendency that a causal relationship exists between customer loyalty and profitability which finally claimed that loyal customers are the most profitable (Nørreklit, 2003: 616).

2.4 MICROFINANCE INSTITUTIONS PERFORMANCE

The social and financial performance of an MFI depends on internal (structure of institutions) and external (macroeconomic) factors. Various factors can influence performance such as lending methodology (Aghion & Morduch, 2005), governance mechanism, geographical zone, networking, form of ownership and legal status of MFIs. Research conducted by Hubert cited in (Tchakoute-Tchuiqoua, 2010) shows that the performance of private corporations is better than that of NGOs only when portfolio quality is used as an indicator for measuring performance and profit: MFIs are more socially efficient than not-for-profit MFIs. The key focal sustainability indicator is operational self-sufficiency (OSS) ratio (Ahlin, Lin, & Maio, 2011). Mersland and Strøm (2009) examined the relationship between firm performance and corporate governance in MFIs and studied the effects of board and CEO characteristics, firm ownership type, customer-firm relationship, competition and regulation on an MFI's financial performance and outreach to poor clients (Mersland & Strøm, 2009: 662). They found that financial performance improves with local rather than international directors, an internal board auditor and a female CEO. They also found that outreach is lower for lending to individuals instead of groups and that bank regulation has no effect on performance. Therefore, it has been widely recognized that customer satisfaction may be the most influential factor in the selection of a MFI. Therefore, it becomes apparent that more attention must be given to customer service and satisfaction amid the fierce competition of MFIs.

There are many ways to measure performance of microfinance institutions. The performance indicators are not only useful for managing internal MFI; accountability, learning and decision-making process, but also useful for external parties such as investors and donors in considering their portfolio investments. In general, there are six groups of performance indicators: (1) portfolio quality; (2) productivity and efficiency; (3) financial viability: profitability, leverage and capital adequacy, (4) scale, (5) outreach and (6) growth (Vinelli, 2002: 67). Most of the indicators above can be found when evaluating a microfinance institution.

According to CGAP, there are five core indicators when measuring MFI performance:

> "Breadth of outreach (how many clients are being served?), depth of outreach (how poor are the clients?), Loan repayment /portfolio quality (how well is the lender collecting its loans?), Financial sustainability/profitability (Is the MFI profitable enough to maintain and expand its services without continued injections of subsidies?) and efficiency (how well does the MFI control its operating costs?)" (Rosenberg, 2009: 1).

These are the core indicators recommended in *Good Practice Guidelines for Funders of Microfinance* (CGAP 2006). Other indicators of outreach from Schreiner (2002) include social benefits of microfinance for poor clients – in terms of six aspects: worth to clients, cost to clients, depth, breath, length, and scope was proposed by Schreiner. First, the worth of outreach to clients is defined as microfinance clients 'willingness to pay'. The costs to clients involve all of the costs, the price and transaction costs, charged to microfinance clients. The depth of outreach, according to Schreiner, is the net added value of an active microfinance client to society as a whole: "in welfare theory, depth is the weight of a client in the social-welfare function with this weight depending on the preferences of the society" (Schreiner, 2002: 7). Recently, authors of microfinance research used 'average loan size' as a proxy for depth of outreach: a smaller average loan size is linked to ability of a MFI to reach out to poorer microfinance clients, implying a greater depth of outreach (Engels, 2010: 34). Schreiner (2002:8) argued,

> "Along each dimension of size, smaller amounts or shorter times usually mean greater depth because as clients are poorer, they are less able to signal their risk to the lenders, and so they get smaller loans to reduce the exposure of the lender to losses from default and must repay in more frequent installments to allow the lender to monitor them"

Nonetheless, not all experts agree and continue to question this fundamental assumption. Hatch & Frederick and Dunford (2002) found that loan size is ineffective in attracting and selecting poor individuals, since large size loans are often unavailable or unattractive (higher interest rates and guarantee requirements) to non-poor individuals (Dunford, 2002; Hatch & Frederick, 1998). The number of microfinance clients reached measures breadth of outreach. The extent of outreach refers to the future time frame of the supply of microfinance. Lastly, the scope of outreach is determined by the number of microfinance products provided to microfinance clients (Schreiner, 1999: 2).

An MFI history matrix combines the institution's *age* and a measure for the institution *size*, measured by the institution's total assets. Their key financial performance indicator is the *FSS* ratio. The *OSS* (o*perational self-sufficiency), ROA (return on assets) and* ROE (*return on equity*) ratios are also used as financial performance indicators. The OSS ratio, measures how well the MFI is able to cover its total costs of operating. Morgan Stanley (2007) and Fitch (2008) implicitly included the OSS ratio in their rating methodologies to assess the financial sustainability of MFIs (Engels, 2010: 54). The return on assets (ROA) ratio indicates how well an MFI uses its total assets to generate returns. The return of equity (ROE) ratio indicates the returns produced for the owners and are also part of the financial sustainability indicators for MFIs.

2.5 CONCLUSIONS

This chapter presented the practices and theory of microfinance, Islamic microfinance and MFI evaluation measurement tools. Microfinance remains an issue of global importance, particularly for developing countries with high levels of poverty. The debate over the differences between 'the financial system' and 'the poverty lending' approach is still an issue for microfinance development. However, to generalize a particular approach to fit to various circumstances is impossible. The different characteristics of microfinance institutions both conventional and Islamic and micro-entrepreneurs were also presented in this chapter. In the journey of microfinance practices, there were many misleading assumptions and barriers that hinder the growth of microfinance on account of both finance and non finance-related factors. These factors inevitably created unanticipated consequences in the field.

Regarding Islamic microfinance institutions, understanding the unique characteristics, risk management and problems of Islamic MFIs is a specific challenge itself for policy and decision-makers in this field. The structure and performance of each type of microfinance institution needs to be identified. The measurement of performance is very important for both stakeholders and stockholders. Therefore, a specific approach, which applies a combination of non-financial and financial measures, the Balanced Scorecard, was chosen to explore and evaluate MFIs in this chapter.

CHAPTER 3

THE THIRD SECTOR AND *WAQF*: CONCEPTS AND BEST PRACTICES

3.1 INTRODUCTION

The third sector is known by various names including 'nonprofit', 'voluntary', 'civil society' or the 'independent' sector (M.Salamon & K.Anheier, 1999). ‘Philanthropy’, ‘charity’, ‘giving’ and non-profit organizations are also other names for the third sector. Donating money, services (time and/or effort), and goods to the beneficiary without material rewards for the donor are considered to be philanthropic activities. Non-profit organizations (NPOs) in common law countries generally take three organizational formats: associations, trusts and charitable or nonprofit corporation/companies. In civil law countries there are two organizational formats of NPOs, associations and foundations, though in some countries the form of limited liability companies exists (Ahmed, 2007a).

Philanthropists’ aim is to improve a human’s quality of life. Everybody, including those who are not wealthy, can be a philanthropist, although most philanthropists are often rich. The potential of philanthropy is great as suggested by Pozuelo-Monfort (2007). He then predicted that if the 500 wealthiest individuals devote 10% of their wealth to the philanthropy fund, total annual profits of the investment strategies would yield $20 billion per annum (Pozuelo-Monfort, 2007). Monfort further explains that “the good sides of globalization which is an economic system where everybody is interconnected, are not only about destroying trade barriers to sell internationally but also redistribution from the rich to the poor globally” (Pozuelo-Monfort, 2007). However, the phenomenon of philanthropic activities is dynamic and complex.

In the section 3.2, the concept and practice of conventional altruism, philanthropy and NPO are explored. From section 3.3 to section 3.7 Islamic third sectors such as *waqf* in terms of the legal, historical, contemporary, governance and the critiques are reviewed. At the end of this chapter, the concept of *waqf*-based Islamic MFIs are also introduced.

3.2 ALTRUISM, PHILANTHROPY AND NPOs

From the perspective of capitalism, man is selfish and rational. Maximizing profit or utility for his/her welfare is the ultimate goal. "Focusing on material pleasure as life's major driving force, Adam Smith argued that the pursuit of private interest, and not altruism, by the economic man in the market, secured a harmonious system within which social interest as maximized" (Nomani & Rahnema, 1994: 29). However, all great economists such as Adam Smith, Mill, Walras, Pareto and Bentham have considered altruism, although under different names but still in the same spirit, in their books. Pareto thought that "people are altruistic and care positively for the welfare of others" (Kolm, 2000: 16). Adam Smith wrote in his book, "The Theory of Moral Sentiment" about the propensity towards benevolence or altruism. But, followers of capitalism only refer to Adam Smith's other book, *The Wealth of Nations*. As a consequence, "Neo-classical economics does not question the motive or ethics of a desire or a need as long as it is backed by the ability to pay" (Nomani & Rahnema, 1994: 86).

Altruism can be seen from different perspectives, various types and causes. Some literatures present "conspicuous giving or return giving motivated by a desire for recognition, fame, a reputation for generosity, or other's approval rather than through altruism, gratitude or sense of fairness (Kolm, 2000: 15)." This study focuses specifically on sincere giving motivated by non-purely selfish reasons, despite the fact that that "mixed altruism motives" are inevitably in the real world. Poverty is a complex and universal problem. Altruistic actions such as charity, giving or bestowing trust funds are important ways to alleviate poverty. Altruistic motives, even if they too are natural, are not as powerful: they need to be socially reinforced and nurtured (Mousa, 2007).

Altruism is a fact of life. Not only donating money, but also sharing non-material goods such as effort, time, ideas and knowledge is part of human life. Batson *et.al*. (2002) furthermore argued that "Altruism refers to a specific form of motivation for one organism, usually human, benefiting another" (Batson, *et al.,* 2002: 485). Altruism is a willingness to do things which bring benefits to other people. "If one's ultimate goal in benefiting another is to increase the other's welfare, then the motivation is altruistic. If the ultimate goal is to increase one's own welfare, then the motivation is egoistic" (Batson, *et al.,* 2002: 485). However self-benefit is an unintended consequence of reaching the ultimate goal of reducing the other's need (Batson, *et al.,* 2002: 489).

Philanthropy's action is easy to get the sympathy from the public, but public opinion can vary and fluctuate, ephemeral and more often motivated by emotion than reason. Philanthropy includes altruistic activities intended to improve the quality of human life. Broadly speaking, philanthropy is the act of giving money, thinking, ideas, services, goods, time and/or effort to support the poor, community, society or be socially beneficial in general without financial or material reward for the actor.

Philanthropy has a long history in British society (Smith, 1995). The roots of voluntary action in Britain can be traced back at least as far as the sixteenth century, and possibly much earlier. Each year around 12,000 new charities are added to the Charity Register and around 10,000 are removed. At the moment there are close to 200,000 charities in the UK although about 30,000 of these are subsidiaries or branches of others (Brown, 2005). Registered Charities in the United Kingdom are considered a Trusts or Charitable Trusts. A charity should be run by a clearly identifiable body of people (which may be a governing committee that takes responsibility and is accountable, for controlling the charity so that it is run effectively and economically. Based on *Guidelines for Best Practice; The Association of Guernsey Charities* (2006), a charity which works effectively for its beneficiaries takes steps to discover and understand their changing needs, and directs its charitable activity towards meeting those needs. An organization can only be a charity if it works in the public interest and not just to further the interests of certain individuals (Brown, 2005). However, there is no consensus or agreement on the ideal way of governing nonprofit organizations. (Bradshaw, *et al.*, 1998).

3.2.1 The Characteristics of the Non-Profit Organizations

A voluntary body is an organization that uses volunteers for some of its activities that are non profitable. NPOs are organizations which are producers of social outputs such as public and social value to "downstream clients" who are clearly defined and identified (Ahmed, 2007a). There are various names for NPOs such as foundations in the USA, charity organizations in the UK, voluntary associations in the Germany and Nordic countries, grassroots groups and other different names from different countries. In the USA, NPOs are normally formed by corporations and individual. There are five core criteria that should be satisfied by an organization before being labeled as "voluntary". These criteria are formal, self-governing, independent of government, not profit-distributing (and primarily non-business) and voluntary (Kendall & Knapp, 1995).

The managerial aspect is very important to mobilize funds which can fluctuate from time to time. Capacity building is the classical problem faced by most NPOs, which need sufficient funds and full commitment to operate. In some countries, the government supports the development of NPOs through tax exemptions easily but in others this is highly restricted.

Donor or founders are the "upstream clients" who are the sources of funds or input for NPOs presented as lump-sums of moveable or immoveable assets, the services or income generated from NPOs' assets and continuous periodic donations (Ahmed, 2007a). These funds are governed either by an individual or by a group of individuals (board of directors/trustees) (Ahmed, 2007a). The trustee runs the NPO as a corporation/firm and generates profit. In the UK, many NPOs are driven by either volunteer, paid staff or a combination of both. Students, senior citizens, local communities are often NPO volunteers.

A charity organization must do one of the following activities; relieve property, disability/distress, advance education, advance religion and other charitable things that benefit the community. Voluntary organizations need to use skills such as administration, finance, marketing, fundraising, publicity, research, information technology and specialist skills such as medical, technical and scientific (Brown, 2005). 'Funding-led' and 'needs-led' are two kinds of phrases in the voluntary sector. Funding-led means that decisions on policy and work areas are taken on the basis of what the money can be raised for. In contrast needs-led means that priorities are decided according to the needs of clients, whether or not they are easy to raise money for (Brown, 2005).

Furthermore, Brown (2005) states that fundraising does two jobs for the voluntary sector, it raises money and also raises awareness. There are lots of different ways for an organization to raise money. Firstly, it applies for grants from local, national or international government bodies. Secondly, it applies for grants from trusts (trusts are charities that give money to specific causes). Thirdly, it encourages donations from individuals through street collections, mail shots, television appeals and so on. Fourthly, it receives donations from support groups that might, for example, organize jumble sales or sponsored walks. Additionally, it accumulates income from membership fees, in return for which members get regular updates about the organization's work. Furthermore, it sells products (through catalogues and shops) or services (such as consultancy work). Effective fundraising is a highly skilled job. Therefore, as a third sector, *waqf* fund management, should also learn from the best practices of Western charity organizations in order to contribute more to society.

More recently, improper charity activity received negative attention from the public. This is often on account of a lack of transparency with regards to management as well as in decision-making. Interest-led collusion with large companies created a bad image for charity activities following the Tsunami in South Asia and earthquake in Pakistan. Another example is the Gates Foundation:

> There is no ethical assessment of the financial investments which yield the profits meant to finance the charitable actions of the Foundation. One can very well imagine that this Foundation endangers people because of the pollution generated by the companies in which it owns shares, and on the other hand, that it acts against the environmental consequences of these programs, this time through the Foundation thanks to the surplus generated by the shares. Under these circumstances the Foundation gives with one hand what it takes with the other, and in some cases gives less than what it takes (Guérin, Roesch, & Servet, 2009: 25).

However, philanthropic or charitable activities need to maintain public trust. Charity has many forms, both short-term and long-term (perpetuity). From the Islamic perspective short-term charitable initiatives are *zakah* (compulsory), *infaq* and *sadaqah*.

3.3 ISLAMIC CONCEPT OF ALTRUISM AND PHILANTHROPY

An economy is a dynamic complex system. Dynamic interaction of various factors builds the system and the degree of organizations within the system changes overtime. Nomani and Rahnema (1994) propose a design of dynamic modern Islamic society based on compassion, social justice, freedom, democracy and equality. This design requires "the formulation of certain fundamental theoretical axes which would combine the articles of the faith with contemporary socio-political and economic concepts of vital concern" (Nomani & Rahnema, 1994: 31).

Historically, during the golden age, the period between the Prophet's establishment of an Islamic community in Medina and the death of Ali, was the ideal Islamic era in which "Islam permeated every aspect of human behaviour and interaction" (Nomani & Rahnema, 1994: 31). They, further state:

> In this period, the Islamic man's private religious practices constituted a well integrated part of a homogeneous Islamic system, characterized by its own particular

> social, political and economics practices. Islam shaped and coordinated every aspect of his life, private and public; material and spiritual, political, economy and cultural. The ideal Islamic life fused each aspect of life with another in an inseparable whole. The fragmentation and bifurcation of Islamic Man, through the disintegration of Islam's holistic system, did not later than the death of the Fourth Rightly Guided Caliph. The phenomenon of confining religion to the private domain of personal laws and separating it from socio-political, economic and cultural activities of the community, thus 'subverting' the ideal Islamic society of the Golden Age of Islam, began in earnest in 661 (Nomani & Rahnema, 1994: 32).

A well-integrated Islamic system creates the ideal framework of life. Based on this ideal Islamic society, the concepts of social justice, equality and altruism are combined in a holistic system. Muslim societies have a long history of *waqf* institutions devoted to philanthropic outcomes. God asks Muslims to be altruistic and help one another financially[4]. Islam has recognized the integrative nature of the secular and the spiritual. Not only in Muslim societies, but also in non-Muslim societies philanthropy is a fact of life. However, altruism is a universal concept, if not the nature of human life.

The Islamic view-point is quite different from the capitalism viewpoint regarding "man is selfish and rational". Khan (1987) argues that, it is totally wrong to say that man is selfish by nature. As a matter of fact, there are numerous evidences in all civilized societies that people have been motivated by altruistic motives. Islam persuades people to make sacrifices for others. *Zakah, infaq, sadaqah* and *waqf* are forms of Islamic philanthropy. Caring for others is "a paramount value of Islamic society" (Khan, 1987: 18). Furthermore, "God repeatedly invites Muslims to be altruistic and charitable and promises great material recompense to those who part with their wealth in the cause of God" (Nomani & Rahnema, 1994: 26). Based on this there is always more room in society to engage in altruism.

The ultimate goal for altruistic Muslims is the "Islamic divine incentive mechanism" (Nomani & Rahnema, 1994: 78). Muslims believe that they can obtain worldly material rewards as well as salvation in the hereafter by doing altruistic acts. Muslims also believe that God will recompense their donation to the poor and needy people on one condition, that their donation was devoted with all their heart and soul (*ikhlas*) only to God's acquiescent (*ridho*). They then said that "The absence of immediate personal material rewards distinguishes the divine Islamic incentive system from other incentive mechanisms" (Nomani & Rahnema, 1994: 78).

[4]See *Qur'an* (2:177, 2:195, 16:90)

Even though Islam has concepts for voluntary sectors, *zakat, infaq, sadaqah* and *waqf*, Western countries apply and manage their voluntary sectors more efficiently than Muslim countries. *Waqf* is a long lasting form of charity, distinguished by perpetuity but in reality, the poorest areas of the world are in Muslim countries or those countries with Muslim majority populations such as Afghanistan, Bangladesh, Indonesia, Ethiopia and Sudan. Ironically, the richest countries in this world are also Muslim countries such as Kuwait, UEA, Qatar, Saudi Arabia, Brunei Darussalam, etc. Therefore, there are numerous things that the Muslim countries can learn from the best practices of NPOs in Western countries.

3.4 WAQF

Philanthropic foundations are known in the Islamic world as *waqf* (plural=awqaf) or *habs*. Cajee and Barzinji ask "What triggers the potential of the Muslim *ummah* to give and revive itself in the art of giving and can be planted for rebuilding the institution of *waqf?" (Cajee & Barzinji, 2008: 26).* This question emerged in the 1st World Congress of Muslim Philanthropists in Istanbul, Turkey in 2008. Although this question was not answered in detail during the conference, it remains highly relevant for this study. Unfortunately, the congress report did not provide more information about the factors that trigger the willingness to give and rebuild the *Waqf* institution.

The role of voluntary organizations such as *waqf* is essential and there are varying levels of *waqf* in practice. Briefly, the *Waqf* was either a family or charitable endowment of property created by a waqif/donor for use by designated beneficiaries and administered by *mutawalli*/*nazir*/trustees who in turn were under the supervision of a local judge. The hazards resulting from untrustworthiness influence the structure of *waqf* institution.

3.4.1 Definition of *Waqf*

The *waqf* originated from the Hadiths (3:895) when Umar bin Al Khattab was recommended by the Prophet Muhammad (pbuh) to bequeath his land as an endowment and then give its fruits as charity. Since then, the *waqf* has grown monumentally and common in the Islamic world. A *waqf* is a charitable endowment, a gift of land or property made by a Muslim, intended for religious, educational, or charitable use. The word *waqf* comes from an Arabic root meaning "to prevent or restrain." It signifies confinement or detention.

Waqf means hold, confinement or prohibition. *Waqf* means forbidding movement, transport or exchange of something (Raissouni, 2001:13). *Waqf*, a form of "*sadaqah jariyah*" (continuous charity), is created by giving away an asset that produces benefits/revenues for a targeted objective on a permanent basis. A *waqf*, known in English also as an 'Islamic trust' or a 'pious foundation', is "an unincorporated trust established under Islamic law by a living man or woman for the provision of a designated social service in perpetuity" (Kuran, 2001: 842). *Waqf* may be defined as "holding a *Maal* (an asset) and preventing its consumption for the purpose of repeatedly extracting its usufruct for the benefit of an objective representing righteousness and/or philanthropy" (Kahf, 1998: 4). The definition of *waqf* by Ibn Qudama: *Waqf* means bequeathing the property and dedicating the fruit (Raissouni, 2001: 14).

An important feature of *waqf* it is that is must be designated to the idea of *birr* (doing charity out of goodness). "The reason *waqf* is considered an expression of piety is that it is governed by a law considered sacred, not that its activities are inherently religious or that its benefits must be confined to Muslims**"** (Kuran, 2001: 842)**.** *Waqf* may be dedicated to poverty alleviation programmes; socio-economic relief to the needy, the poor, health, education, environmental, scientific, and other beneficiaries. Many scholars view the ownership of *waqf* asset/property "as if it were owned by God." (Ahmed, 2007). Originally the *waqf* assets had to be immoveable (Kuran, 2001: 842). Recent fatwa issued by the Internasional Council of Fiqh Academy (ICFA) clearly state that "using cash (movable assets) as the subject matter in *waqf* is permissible" as long as it keeps the principal intact and makes benefits from it".[5]

The *Waqif or* founder donates their money as *waqf* funds to beneficiaries or *mauquf'alaih* (a person who is entitled to get benefit from *waqf* fund) through *Nazir/Mutawalli/*Trustee (a person/an institution that is in charge for managing *waqf* fund and distributing returns of *waqf* investment). The *waqif/*founder determines the objectives of distributing of the *waqf* assets profits/fruits, services or revenues (Ahmed, 2007; Masyita & Febrian, 2004). Only return/profits/gains of the invested *waqf* fund will be delivered to *mauquf'alaih.* The principles are continuously invested in potential investment opportunities. As the *waqf* fund investment manager, *Nazir* on behalf of the *Waqf* institution may allocate some *waqf* funds to finance SME businesses on the basis of the profit sharing system. *Waqif* can enforce certain qualifications of *Nazir* on his/her *waqf*.

[5] See Resolution no 140 (15/6) issued by the International Council of Fiqh Academy

3.4.2 The Role of *Waqf* in the Economy

Historically *waqf* have played a significant role in the world for both Muslims and non-Muslims. While under the *waqf* juriprudence, a *waqif* must be a Muslim (except for the *Hanafi*'s school of jurisprudence), there was no legal barrier for non-Muslims to be the beneficiaries. As a result, soup kitchens, hospitals, shelters, and other social welfare institutions served people of all religions, and non-Muslims commonly served on their staffs (Stillman, 1975: 112-13 in Kuran 2001:852). As an example, when a Jewish man in the 1640s travelled from Egypt to Istanbul, he and his companions spent most nights at a *waqf*-endowed inn which opened to travellers of every faith (Lewis 1956:97-106 cited in Kuran, 2001). Another example is a situation in the Ottoman period written by Yediyildiz (1990: 5) as follows:

> Thanks to the prodigious development of the *waqf* institution, a person could be born in a house belonging to a *waqf*, sleep in a cradle of that *waqf* and fill up on its food, receive instruction through *waqf*-owned books, become a teacher in a *waqf* school, draw a *waqf*-financed salary, and, at his death, be placed in a *waqf*-provided coffin for burial in a *waqf* cemetery. In short, it was possible to meet all one's needs through goods and services immobilized as *waqf* .

The above clearly explains how *waqf* was embedded in a Muslim society. Furthermore, in the *Venture of Islam*, Marshall Hodgson (1974:124) observes that the *waqf* system eventually became the primary "vehicle for financing Islam as a society."

In the last decade, Islamic Relief UK, a non-governmental organization, started its *Waqf* Future Fund programme in 2001[6] with sub-programme as follows: water and sanitation *waqf*, orphan *waqf*, education *waqf*, urban *waqf*, healthcare *waqf*, income generation *waqf*, emergency relief *waqf* and general *waqf*. A further example of a charitable *waqf* donation was given by Yusuf Islam, a popular singer also known as Cat Stevens, established the *Waqf* Al-Birr Educational Trust, a registered UK Charity, in 1992 which aimed specifically to provide *da'wah* as well as educational research and development.

Currently, the World Congress of Muslim Philanthropists is held annually in Istanbul, Turkey in 2008; Abu Dhabi, UAE in 2009 and Doha, Qatar in 2010, Dubai, UAE in 2011 and Kuala Lumpur, Malaysia in 2012. The aim of these meetings in to create a forum where Muslim philanthropists from various backgrounds can work together, interact and subsequently

[6] see www.islamic-relief.com/uk/*waqf*/questions_*waqf*.htm Accessed March 28th 2010

become leaders of the international community of humanitarians driven by Islamic intrinsic values (1st World Congress of Muslim Philanthropist, 2008).

3.4.3 Cash *Waqf* and Cash *Waqf C*ertificate Framework

Besides the mosques, tomb, school, other properties are well known as form of *waqf* assets, nowadays there is one of potential solutions to the necessity of sufficient fund for public needs namely *waqf* fund from people's donation. According to Cizakca, definition of cash *waqf* is the following:

> The gifted capital of the *waqf* was transferred to borrowers who after a certain period, usually a year, returned to the *waqf* the principal plus a certain "extra" amount, which then spent for all sorts of pious and social purposes (Cizakca, June 2004: 2).

Structure of cash *waqf* is built by Ottoman jurists based on three philosophies: "the approval of movable assets as the basis of a *waqf*, acceptance of cash as a moveable assets and, therefore approval of cash endowments." (Cizakca, June 2004: 3). Although *waqf* assets are mostly immovable, "in some places, this requirement was eventually relaxed to legitimize what came to be known as a cash *waqf*" (Kuran, 2001: 842). In particular, Cizacka says that the cash *waqf* was "a Trust Fund established with money to support services to mankind in the name of Allah" (Cizakca, June 2004: 2).

The gathered fund is invested in various investment portfolios and the profit spent for the specified public necessities. The gained profit will also be used for funding poverty alleviation programs, while the principal of funds will be reinvested in various highly profitable investment opportunities. Only gains of the invested *waqf* fund will be delivered to *Mauquf'alaih.*

Nowadays, cash *waqf* has become increasingly popular, particularly because of its flexibility, which allows distribution of the *waqf*'s potential benefit to the poor in any location. Cash *waqf* has two forms, the first is used for free lending to beneficiaries (*qard al hassan*) and the second is invested with its net return assigned to *waqf* beneficiaries (Ahmed, 2007b: 4).

The implementation of cash *waqf* began in the Ottoman era. The Bursa Court registered many cases of the establishment of cash *waqf* since 1676. In addition, Cizakca describes the practice of cash *waqf* as follows:

> Providing business capital to the entrepreneurs (borrowers), they might have also enhanced entrepreneurship and generated capital distributing and capital accumulating institutions. Although the Bursa Ottoman court case did not support it, but the evidence from the Venetian archives informs that the Bosnian cash *waqf* provided entrepreneurial credit to merchant in trade between Bosnia and Venice (Pedani, Fabris, 1994) cited from (Cizakca, June 2004: 18)

Providing the entrepreneurs capital to run their business through cash *waqf* is not a new practice. Despite the malpractice and mismanagement inevitable in the eighteenth century, there were still the benefits of cash *waqf* instruments. In general, the principal funds are continuously invested in potential investment opportunities. In its role as *waqf* fund investment manager, the *Mutawalli*/*Nazir* on behalf of *Waqf* institution may allocate some *waqf* funds to financial portfolio and finance SMEs' businesses on the basis of the profit-loss sharing system. The larger the investment returns, the more funds that can be allocated to poverty alleviation programmes.

3.4.4 The Classical Islamic Jurisprudence of Cash *Waqf*

Cash *waqf* was firstly introduced in Ottoman era, which followed the general guidelines of the Hanafi's school of jurisprudence for operating their business and social life. Previously, *waqf* from buildings and land were the most popular forms of *waqf* assets because of their perpetuity. Although the concept of perpetuity is a *sine qua non* condition, Hanafi scholars recognize three exceptions (Cizakca, June 2004: 2):

> First the endowment of movable assets belonging to an endowed real estate, such as oxen or sheep of a farm, was permitted. Second, if there was a pertinent *hadith*, and third, if the endowment of the moveable assets was the customary practice, *ta'amul*, in a particular region.

Nowadays, cash *waqf* has become increasingly well known, particularly because of its flexibility, which allows distribution of the *waqf*'s potential benefit to the poor anywhere. While the cash *waqf* dates back to as early as the turn of first century of *Hijrah*, most established *awqaf* are real-estate based (Ahmed, 2007). The ICFA issued a Resolution no. 140 (15/6), 2004 concerned with 'endowing cash as *waqf*'. This resolution clearly defined that "using cash as the subject matter in *waqf* including for *qard hassan* is permissible on the condition that the *waqf*-related objective of the *Sharia'h* of keeping the principal intact and making the benefits arising from the *waqf* is found.

In Indonesia, there was a Fatwa from the Board of Indonesian Muslim Scholars/ Majelis Ulama Indonesia (MUI) on Cash *Waqf*. They responded to the necessity of cash *waqf* certificate programme in Indonesia by issuing the following *fatwa* (dated on 11 May 2002):

> (1) Cash Waqaf (*Waqf al-Nuqud*) is *waqf* donated by individuals, groups of individuals, or legal entities, in cash, (2) Cash *waqf* includes securities, (3) Money donated as *waqf* is not forbidden (*jawaz*), (4) Cash *waqf* can only be distributed and allocated for anything not against *shariah* (Islamic law), (5) The existence of *waqf* funds should be conserved. *Waqf* funds cannot be transferred to anyone.

Regarding the irrevocable issues of cash *waqf* in particular and *waqf* in general, the jurists of the Hanafi school state that "a *waqf* was an irrevocable act based upon the hadith pertaining to Omer's endowment" (Cizakca, June 2004: 3).

In the Islamic socio-economic framework, *Cash-Waq*f is a source of social fund that can accumulate and redistribute money. There are any differences between the management of Western foundations, charities or donation funds such as Ford, British Trust, Rockefeller, Carnegie and the management of *Cash-Waqf*. *Cash-Waqf* has a principle of perpetuity that makes it different from a western endowment or charitable funds. The perpetuity principle means that the principal of *Waqf* should be preserved and the benefits of *Waqf* portfolios should be available for religious, philanthropic and righteous purposes.

Perpetuity in *Waqf* provides capital accumulation in the third sector that builds necessary infrastructure for providing social services on a non-for-profit basis. Hence, perpetuity in *Waqf* accounts for the accumulation of assets in the non-profit sector which is a first and necessary step for the growth of this sector in contrast with the profit-motivated sector and the government sector that is built on authority and law enforcement (Kahf, 1999).

The *Waqif* is the person who donates money as *waqf* by purchasing a cash *waqf* certificate. The certificate can be bought in the name of a family member, even if he/she is already dead, from the legal institutions which launch the cash *waqf* certificate. The *Waqif* expects the returns of the managed fund to be assigned for certain purposes, e.g. public facility development, rehabilitation of the poor, etc (Masyita, *et al.*, 2005). *Nazir* invests the collected funds in various investment portfolios. *Nazir* may (1) invest the funds in *shari'ah* (non interest) banking products in both domestic and overseas banks, (2) finance selected businesses, (3) establish new prospective businesses, or (4) finance small and medium scale enterprises (SMEs) (Masyita & Febrian, 2004).

According to Mannan (1998) cited from Masyita *et al*., (2005), the objectives of cash *waqf* certificates are to collect social savings through cash *waqf* certificates (cash *waqf* certification can be done in the name of other beloved family members to strengthen family integration among rich families), transform collected social savings to social capital, as well as to help develop the social capital market. This would encourage rich communities' awareness as to their responsibility for social development in their environment and stimulate integration between social security and social welfare. In addition to the afore-mentioned objectives of cash *waqf* practice, profit of the managed *waqf* fund can be allocated for rehabilitating poor families, enhancing education and cultural development, and providing health, social, or religious services. The reasons behind a waqif purchasing a Cash *Waqf* Certificate are for one's own welfare (in this life and life after death), family's welfare (in this life and life after death) and social welfare and social investment (Masyita & Febrian, 2004).

As the appointed nazir, the fund manager may carry out the following to sustain investment return of cash *waqf* fund: (1) Invest cash *waqf* funds in various domestic or global S*hari'ah* portfolios with good prospects. (2) Invest cash *waqf* funds in real sectors or businesses whose sources, processes, and outputs are in line with *Shari'ah*. Funds can be invested in existing businesses or in a newly initiated one. *Nazir* may establish new businesses that provide public services, such as convenience stores, hypermarkets, basic food stores, universities, hospitals, etc. This generates more job opportunities and appropriately satisfies some people's basic needs by allocating collected funds as a profit sharing-based loan to selected small businesses. Technical and managerial assistance are required to accompany this investment. If this investment runs well, the *nazir* will not only generate returns, but also help accelerate poor people's economic development.

The *Nazir* should also pay attention to the following issues:

a. **Transparency**. The *Nazir* has to manage cash *waqf* fund transparently and regularly make financial and performance reports, which are accessible by waqif.

b. **Productivity**. The *Nazir* has to be able to manage the fund productively, so that disadvantaged people can benefit from the cash *waqf* fund on a continuous basis.

c. **Trustable.** The integrity of a *nazir* is crucial. It must avoid any business opportunity and process that can lead to moral hazards. All proposed business activities should be assessed in terms of Islamic law.

The more the *waqf* investment return, the more *mawquf 'alaih* benefits from *waqf* funds. According to *fiqh*, *nazir*, as the *waqf* fund manager, is obliged to handle the fund productively. Furthermore, Manshur bin Yunus al-Bahuty cited from Lahsasna (2010) states in *Syarh Muntaha al-Adaab* (p. 504-505) that the *nazir* is responsible for maintaining, expanding, and developing *waqf* assets so that they provide income in the form of investment returns, rent fee, agricultural products, etc. Cash *waqf* can be an instrument for business such as cash *waqf* in micro financing, debt financing and equity financing (Lahsasna, 2010).

With different frameworks, cash *waqf*s were a source of capital into the economy of Bursa, a city in Turkey in the 18th century. In fact, "around 10 out of 12 persons approximately borrowed from a single *waqf*. About 10% of the total population of Bursa resorted the cash *waqf* of the city as a source of credit" (Cizakca, June 2004: 14). Cizakca also proposed the idea of establishing the biggest cash *waqf* in Saudi Arabia (Cizakca, 2002: 284-285). If every pilgrim donated to the cash *waqf* box in front of the mosque every time they pray, there would be enormous amounts of collected money ready to be managed and distributed to the *Mauquf'alaih/*beneficiaries by *mutawalli/nazir*. This pilgrim *waqf* fund, then, can be used to reduce the unemployment rate and be distributed to poverty alleviation programmes in Muslim countries. However, the flexibility of cash *waqf* has created some innovative instruments. 'The issuance of *sukuk*' (Pirasteh and Abdolmaleki, 2007: 7) such as *Sukuk Al-Intifaa*' (Ahmed, 2004: 128), *sukuk* for 'the construction of Zam Zam Towers in Makkah' (Iqbal and Khan, 2004: 63), *takaful* operators based on *waqf* (Khan: 2003, taken from Ahmed, 2004: 130), *qard hassan* bank (Ahmed, 2004: 130), a *waqf*-based Islamic MFI (Ahmed, 2007: 10) are innovative instruments of cash *waqf*.

3.5 JURISPRUDENCE/LEGAL ISSUES OF WAQF

One of the major impediments for the growth of the *awqaf* sector according to Ahmed (2007) is that there is discriminatory legal treatment of these institutions compared to other nonprofits. To establish and run independently NPOs like trusts, foundations and nonprofit corporations is relatively easy from a legal perspective but to establish *waqf* institutions is more restricted based on *waqf* laws (Ahmed, 2007). However, there are special roles and limitations imposed by law for NPOs as the consequences of given tax exemptions such as NPOs must be audited by public accountant and relevant authorities. Therefore, many NPOs find the corporate organizational format more attractive because of the separate legal entity and limited liability features (Ahmed, 2007). Furthermore Makdisi argues that "anyone who familiarizes himself with the legal opinions of medieval jurist consults regarding matters of *waqf* will soon become aware of the fact that the term of a *waqf* instrument were sacrosanct and were to be followed when known" (Makdisi, 1981: 35).

3.5.1 Classical

In the terminology of Islamic jurisprudence, a *Waqf* entails the 'detention of the corpus from the ownership of any person and the gift of its income or usufruct to charitable purpose (Cattan, 1995 cited in (Marwah & Bolz, 2009: 811). Al-Shàfi'ì was certainly correct in his assertion if we look at some of the unique characteristics and the scope of the Islamic *waqf*. One of the major points in this regard is the principle of perpetuity. Perpetuity in *waqf* means that once a property is dedicated as a *waqf*, it remains so until the Day of Judgment – it is immutable (this is perhaps why many Muslim jurists argue that a *waqf* property is owned by God, the Almighty). Therefore, "the motivation of the *waqif* for establishing a *waqf* deeds was "*qurba*" (Makdisi, 1981: 39)**.**

Despite still debatable among the jurists or school of thought, the Al Hanafi's school allows non-Muslims to be a *waqif* and "declare a *waqf* provided that such *waqf* is for purposes that are deemed acceptable under Shari'ah law" (Marwah & Bolz, 2009: 812). If the trustee legally owns a trust asset and manages them freely as long as is appropriate, the *mutawalli* does not own a *waqf* but only administers the *waqf* assets in line with the wishes of the *waqif*. In most Islamic schools of thought with the exception of the Hanafi School, a *mutawalli* must be a Muslim (Marwah & Bolz, 2009: 813).

In the classical fiqh of *waqf*, only the Maliki school group jurists accept the temporality of *waqf* or revoke the *waqf*. The Malikis assert that even if a *waqif* decreed his/her *waqf* for a mosque as temporal, the *waqf* is still considered perpetual (Kahf, 1999: 3). Kahf says that *waqf* of usufruct is known only in the Maliki School. The use of a parking lot given as *waqf* for two hours for the *Eid* prayers twice a year is an example of a usufruct *waqf*. Fiqh and Waqf law does also not regulate property rights, patents, as well as financial rights and then it is necessary to be ruled under contemporary *fiqh* of *Waqf*.

3.5.2 Contemporary

Waqf law is almost uniformly perceived by Muslims even from different countries of different social, economic and political circumstances (Schoenblum, 1999: 1192). However, another source of information is "the collection of legal opinions regarding matters of *waqf*, in the fatwa-works" (Makdisi, 1981: 37). A *fatwa* issued by the International Council of Fiqh Academy (IOFA) on "Investing In *Waqf*, Its Yield and Its Income (2004)[7] pertains to 'investing *waqf* properties' and endowing 'cash as *waqf*' issues.

Zarqa says that everything about *Waqf* is subject to *Ijtihad* and there is no single ruling in it except it must be benevolent (Kahf, 1999: 3). *Waqf* for charitable purposes is called '*waqf khairi*' and the *waqf* for reserving income of its asset for family is known as '*waqf ahli*' (Marwah & Bolz, 2009). Religious, philanthropic and family *waqf* are categorized by Monzer Kahf in order to distinguish the beneficiaries of *waqf* (Kahf, 2003). Supporting religious needs and poor societies fulfils religious and philanthropic *waqf* objectives respectively. Family *waqf* or posterity, only a surplus of *waqf* assets, is dedicated to the *waqif'*s family and descendants who are poor and needy in order to improve the welfare of future generations.

There are two types of *waqf*, perpetual and temporal (Kahf, 1999: 2). Not all *waqf* assets are perpetual by nature except land. Perpetuity requires three conditions: (1) The property made w*aqf* must be suitable for perpetuity either by its nature, legal status or accounting treatment. (2) It needs an explicit or implicit expression of the will of the *Waqf* founder. (3) The objective of *waqf* must be perpetual. The perpetuity of the endowment is the *sine qua non* condition for any *waqf* (Cizakca, June 2004). Concept of perpetuity in w*aqf* over time can create capital accumulation to build infrastructures and social services for community. Furthermore, Kuran argues that perpetuity is not a necessity and in some cases it is not suitable with the mission of a *waqf*. "Although the matter was controversial, in practice it could be temporary, for example, to assist the victims of a particular flood" (Kuran, 2001: 864).

[7] Resolution no 140(15/6) issued by the International Council of Fiqh Academy, which is an offshoot of the OIC, organized its 15th session in Masqat, Oman, 6-11 March 2004.

Kahf also states that there is little attention given to the importance of temporality in *waqf*. Hence, temporality in *waqf* should be developed as well as perpetuity because of the nature of certain *waqf* assets. When questioned on how to measure the durability of *waqf* assets, Ibn Arafa – a Maliki, defines perpetuity of *waqf* in term of "as long as the property lasts" (Kahf, 1999: 4; Marwah & Bolz, 2009). The *waqf* assets must be met with certain conditions such as a clear intention, clear subject and object so "they are not subject to inheritance but are simply a gift" (Marwah & Bolz, 2009: 814).

Struggling with the issues of temporality, public and private, the effectiveness of *Waqf* is still a controversial topic to discuss in practice. Policy makers when designing a particular waqf policy should take corrupt practices resulting from the mismanagement of *waqf* assets into account. In some countries such as the USA, family trust (private) and temporal *waqf* are very common in practice. Strong third sectors can be created by protecting *waqf* assets from both the profit-motivated behaviour of individuals and the authority-dominated actions of the government (Kahf, 1999: 8). The government is often assumed to be a bad manager for *waqf*, "*waqf* management should be run by local people who relate to the beneficiaries" (Kahf, 1999: 10). Nevertheless, *waqf* is a unique institution compared to "corporations, NPO and judiciary entities which if *waqf* under NPOs can be liquidated, sold and disposed" by the proper authority of the management (Kahf, 1999: 12).

3.6 GOVERNANCE AND OPERATIONAL ISSUES

3.6.1 Trust as Social Capital and Transparency

Since Islam carries the notion of being an alternative system, essential part of this alternative system is the ethical and moral nature of social economy conducted within the Islamic paradigm. This goes beyond the current practice of Islamic finance, which has failed to work within such a paradigm. However, *waqf* being an essential; positive measure of Islamic moral economy can be configured to base on trust as a social capital to further the welfare of the society. The expansion of trust as a social capital between individuals and *waqf* institutions implies that the effectiveness and efficiency of *waqf* will increase but also *waqf* activity will increase in the society as fund will be directed to *waqf* to fulfill their expected activities in overcoming the welfare problems in the contemporary society.

The contemporary economy mainly has two major issues: welfare and development needs in the Muslim society; however the mistrust which marks the market economy and the behavioural norms of individuals. The first problem can be alleviated by the regeneration of *waqf* system in the Muslim world in the case where the states have failed. This role historically played well by *waqf*, which they could repeat again. However, trust in the Muslim societies and communities are terribly low; as individuals do not trust each other nor do they trust the institutions and the state.

Trust is an important aspect of the voluntary sectors. Trust for some people is a luxury, yet it is a key to sucessfully achieving the ultimate goal of the voluntary sectors. Trust is dynamic by nature. As Henk Akkermans finds, when the modeler map trust in a stocks-and-flows format, it makes sense that trust is an accumulation that slowly grows over time. Interestingly, in the initial stages of a relationship, trust is easier depleted than grown (Akkermans, 2008).

Higher levels of trust lead to lower costs. Trust is an important indicator of customer satisfaction with Islamic financial institutions, *waqf* institutions in particular. Understanding the dynamics of trust in Islamic finance such as *waqf* and Islamic microfinance is pivotal to determining the managerial actions that lead to adequate *waqf* institutional performance. Creating a framework for understanding the dynamics of trust in an institution and how these influence policy scheme is therefore essential.

Trust as social capital creates efficient, effective work and saves considerable sums of money. If people can trust the other party, there is no need to waste energy and time thinking negatively, no need for extensive contracts, no need for lots of guarantees, making administrative work simple. Transparency and accountability are prerequisites to the success of trust/endowment fund management.

> This lack of transparency may also have attributed to the attitude that direct donations are better than a donation to an institution; for example, in Turkey, nearly 87% of donations are direct donations. This by passes philanthropic organizations, and thereby excludes aid to the neighbourhood in which the donor resides. This model of giving stagnates capacity building (Awad & Carkoglu, 2008: 19).

Effective collaboration between parties involves a great deal of openness and transparency. Transparency improves trust. The Annual Report is a tool to provide transparent information not only to the trustees, members, donors, beneficiaries, but also the wider public who want to know what benefits they bring to the community.

The real root cause of lack of trust is a lack of transparency. If people do not trust the other party, people will not share their information openly with them. Therefore, the greater the trust among parties, the higher their openness towards each other can be and the greater the focus on getting the work done. Therefore, from a system dynamics perspective, trust and transparency are causally linked into a reinforcing cycle, which may operate as either a virtuous or a vicious cycle, depending on what direction things are moving.

If a non-profit organization, charity, *waqf*, trust fund or endowment fund does not transparent dealing with the sources and uses of fund, the donors will not really trust them. Consequently, it is difficult to donate money to those institutions. Building mutual trust and openness takes time. Henk Akkermans says that trust "comes by foot but leaves on horseback." There is another asymmetry to take into account in the development of trust over time, namely differences between the process of building trust versus destroying it or creating distrust (Dasgupta, 1988; Lewicki & Bunker, 1996; Burt & Knez, 1996). Empirical and theoretical analyses of trust are consistent in pointing out that while building trust is a gradual process, it can be destroyed very quickly by single events or inconsistencies on the trustee's behaviour.

The inferior performance gives both sides all the more reason to distrust each other and then leads to even less openness, even more inferior performance and, obviously, less trust even further. Akkermans then states that reversing a vicious cycle into a virtuous one is always very difficult in business settings and especially so when such "soft" and cultural issues such as trust are involved. It can however, be done.

In third sector management of trust/charity/endowment/*waqf* fund, openness when sharing information between trustee and donor or *nazir/mutawalli* and *waqif*/founder is crucial for flexibility. Openness, or transparency, requires high trust levels among parties. Trust and transparency form a reinforcing loop, with either good or bad non profit organization performance as the link between them. Through joint hard work, through jointly mapping out how things work between parties, and through an increased understanding of the other side, which, over time, leads to more trust. A long relationship between parties is important for building trustworthiness. Each party has passed some kind of trust barrier. Mistakes at the start will have consequences for the relationship later on. This also makes clear why people that work well together manage to do so for considerable amounts of time. In the voluntary sector context, once donors bequeath to a charity organization, they do not give their money to other organizations. The credibility of a non-profit organization is an important consideration for donors as it is not easily accumulated. Credibility is built by two aspect expertise and trustworthiness (Hovland, Janis, & Kelley, 1953).

3.6.2 Managing Risk

There is a close connection between trust and risk. If there is no risk, there is no need to trust. According to Johnson-George and Swap (1982: 130) cited in (Mayer, Davis, & Schoorman, 1995) "willingness to take risks may be one of the few characteristics common to all trust situations”. Hence, trust can be seen as a mental mechanism that helps reduce complexity and uncertainty in order to foster the development or the maintenance of relationships even under risky conditions (Luhmann, 1988). Indeed, the absence of risk implies confidence, i.e. certainty in positive outcomes. On the other hand, risk, implying unpredictable future events, requires trust to overcome uncertainty and enable constructive interpersonal relations. In terms of non-profit organization, the ability to manage risk becomes the pivotal matter under consideration by donors. The more professional the investment manager when managing the risk of endowment fund portfolios, the more benefits that can be garnered for achieving the goals of organization.

From July to December 2008, the value of U.S. schools' endowments dropped an average of 24.1 percent, according to a report released by the Common Fund Institute, a nonprofit group that polled 629 educational endowments on their results (Herbts-Bayliss, March 5, 2009). Columbia University lost 16.1 percent of its endowment fund, Harvard and Yale also suffered heavy losses of more than 30 per cent. As a result, Harvard is freezing salaries, offering early retirement, reassessing construction projects and considering selling off art collections. "These are the worst-ever half year results that educational endowments have seen," Common Fund Executive Director John Griswold said in an interview. "Even the most diversified endowments suffered serious declines." Last year bets on U.S. equities dealt endowments the biggest blow. "It was the stock market," Griswold said, noting that the Standard & Poor's 500 index lost about 38 percent in 2008 (Herbts-Bayliss, 2009). Larger schools were able to navigate the market slightly better, the report said, noting that schools with endowments of $1 billion or more lost 21.7 percent. The news above clearly explains that part of the endowment funds were invested to financial instrument portfolios. Investment managers of those endowment funds must take full responsibility for their actions to the donors. The cases demonstrate the huge impact of mismanagement in trust/endowment fund which resulted in a reduced amount of funds. Risk management is crucial for such a non-profit organization.

3.7 CRITIQUES OF THE *WAQF* CONCEPT

Despite being a unique institution of Islamic civilization, with the decline of the Muslim world, the *waqf* as an institution and its role in the society declined. This is very much related to the decline and disappearance of the income sources of the *awqaf* system as well. As the new nation states in the Muslim world, mostly appropriated the portfolio of the *awqaf* system are in Turkey and Egypt. The new legal systems in the new Muslim nation states also created legal hindrances with the development and sustenance of the *waqf* system. Kuran (2001:866) argued that "the net effect of all these sources of conservatism was to make *waqfs* favor ritual continuity over substantive effectivenes which creates the consequent economic losses". Locating *awqaf* as a historical or sacred institution eventhough there are no particular rule regulated it in *Al-Qur'an* will hamper the development of *waqf* and adhering to form rather than substance.

Furthermore, there are many other critiques of the *waqf* concept in general and cash *waqf* in particular. Some scholars say that *waqf* fails to meet the founder's ultimate goals and the structure and law of *waqf* create inefficiencies and ineffectiveness (Kuran, 2001; Schoenblum, 1999). There have been examples of instrumental foundations of *waqf* for personal interest such as to extend social recognition, wooing selected constituencies for political agenda, spreading an ideology, controlling public opinion, sheltering wealth from confiscation and other pecuniary motives such as asset laundering (Kuran, 2001; Makdisi, 1981) and avoiding inheritance rules (Cizakca, 2000; Schoenblum, 1999).

In light of the above criticisms, this sub chapter addresses two major issues; firstly perpetuity and irrevocable issues and secondly, moral hazard issues.

3.7.1 Perpetuity and Irrevocable Issues

The perpetuity debates began in the 15th century when *waqf* became popular for dealing with the complex issues of vested interests. Kuran (2001: 843) argued that the static perpetuity and rigidity of the *waqf* system proved "unsuitable for the relatively dynamic economy of the industrial age". Kuran argues further that a *waqf* becomes stagnant, dysfunctional and inefficient if "the founder can not alter his goals, the designated mission was irrevocable, and the *waqf*'s objectives specified have to be pursued exactly" (Goldstone, June 2003; Kuran, 2001: 862-864). As a response, Asad Zaman (2008) argues "In fact, there is substantial dynamism and flexibility in Islamic law, and creative adaptations to changing situations can be documented in different areas…. Rather, it is clear that Islamic society as a whole became ossified and did not adapt to changing situations in many different dimensions" (Zaman, 2008: 71). He also asserted that the increasingly dysfunctional properties of the *awqaf* were an effect of the general decline of Muslims rather than a cause: "A central operational principle of *waqf* law is that a *waqf* for a limited period of time is invalid". Schoenblum (1999: 1192) added "The consequences of this mandatory rule in favour of perpetuities were catastrophic from an economic standpoint".

Schoenblum further compared the concept of trust to *waqf* as follows:

> Whereas the trust has proven remarkable flexible, resilient, efficient and responsive to changing conditions affecting intergenerational management of family wealth, the *waqf* extremely remained a static institution, rigid, inefficient, inability to adapt to modern condition, and populist concerns about alternative political power centers (Schoenblum, 1999: 1226)

To respond to these critiques and find a solution to these matters, the International Council of Fiqh Academy (ICFA)[8] firmly asserted that it is 'compulsory' to ensure the 'perpetuity' of the *waqf* and its benefits in developing *waqf* assets in a *Shari'ah*-compliant manner. Furthermore, the ICFA states as follows:

> …..The conditions given by the creator of an endowment with regard to the investment of the *waqf* is binding and does not nullify the requirement of *waqf*. It is also binding, even if he stipulates that the full investment returns are to be spent on specific areas. In this particular case, the investment returns cannot be used to enhance the principal amount, which is the *waqf* itself; If the creator of a family *waqf* did not stipulate any restrictions and did not stipulate that the *waqf* should be invested, then it is impermissible to invest part of the yield, except if such investments are approved by the beneficiaries. However, if it concerns a charitable *waqf*, it is permissible to invest part of it for a prevailing *maslahah* (public interest), subject to stipulated rules.

The *fatwa* above ensures the flexibility of *waqf* (including cash *waqf*) as long as the founder stipulates it so that the *waqf* deed might not be burdened with rigidity. The avoidance of static perpetuity has been discussed by the Kahf (2007) who proposes the activation of temporary *waqf*.

[8] Resolution no. 140 (15/6), 2004

3.7.2 Moral Hazards

The understanding of donations as devotions to God is the fundamental difference between Islamic and secular concept of charity. Furthermore, Muslims believe that "God never fails to reward the giver, the desire to be close to God and perform good works are some of the motives of *waqif*"(Makdisi, 1981: 39). Although Islam as a way of life provides complete guidelines for good ethics in honesty, moral value, high commitment, integrity and other good things, in practice without a good governance system, which interprets Islam's moral value, moral hazard can still occur. This can cause considerable damage to *waqf* assets.

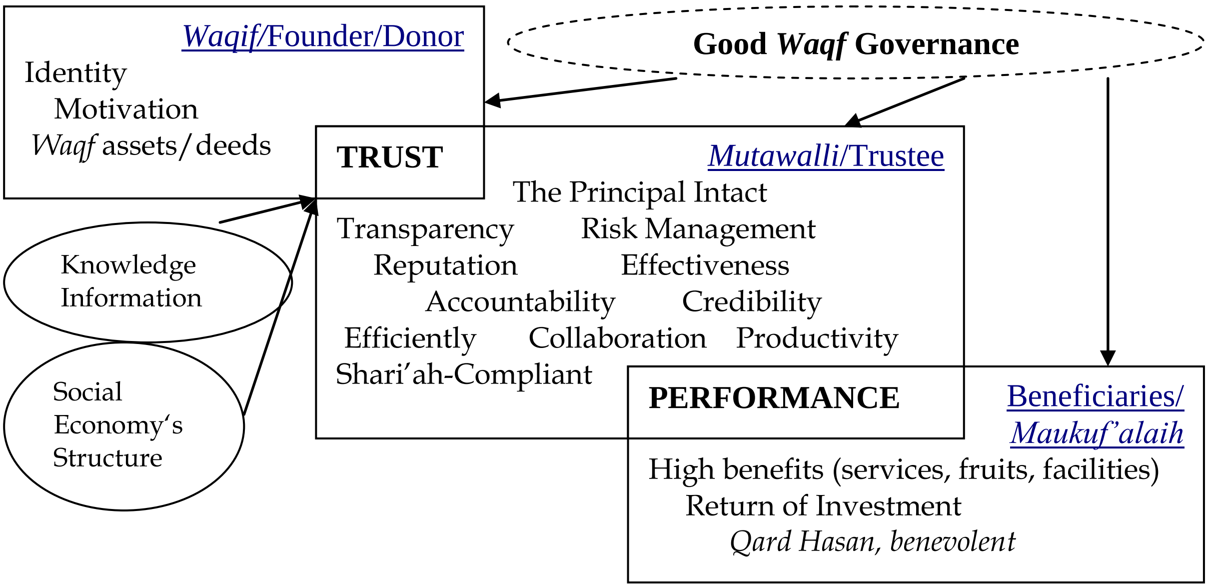
In terms of *waqf* management, the lack of published information regarding the investment/financial performance of the *waqf* periodically emerges as an issue of good governance practices for *waqf* management. Good governance in *waqf* is crucial in order to reduce moral hazards either on the part of the founder or trustee/*mutawalli* as well as the government. Historically, on the founder's side, there have been some bad practices in the past including selfish motives, arrogance, corruption, willingness to be famous, prestige, excessive gratitude and misappropriations (Makdisi, 1981). Some facts from the *mutawalli*/ trustee side, in many cases, generated unsacred circumstances *waqf* such as "an abuse of privilege power toward *waqf* assets done by incumbent officers in many places and times" (Makdisi, 1981). Kuran states that the value of *waqf* can be diminished especially after the founder's death if "*mutawalli* and the appointed employees will be tempted to embezzle" (Kuran, 2001: 868). Cizakca asserts too that the trustee lent cash *waqf* at a higher rate to the sarrafs and bankers, in the eighteenth century (Cizakca, 2004: 12). An additional *waqf* management issue which generates principal-agent problems was "there was no guarantee that these two agents-*mutawalli* and judge-will share the same interpretation of the founder's stipulations" (Kuran, 2001: 866). Besides the founder and *mutawalli*, the role of government in the past worsened the value of *waqf* assets (Ozbek 2000; Ener 2000 cited from (Kahf, 1999; Kuran, 2001).

Moral hazard problems can be reduced through **'good *waqf* governance'** applied to all *waqf* institutions. This can be achieved through a clearly defined relationship between the *waqif*, *mutawalli*, *waqf* board and *maukuf'alaih* which provides the structure of *waqf* through which the objectives of the *waqf* are set, and the mechanism of accomplishing those objectives, monitoring performance, assuring compliance with Islamic *Shari'ah* rules and principles are determined. Nevertheless, as the ICFA resolution says, "*Waqf* management ought to be subjected to good governance practices, through *Shari'ah* Advisory Councils, good management, financial reporting and auditing".

The management of *waqf* institutions also creates dilemmas and has a marked effect on society because of the large amount of money required to centralize and thus mobilize a *waqf* fund. However, based on past experiences, the evidence shows that the centralization of *waqf* institutions can create inefficiency and destruction of *waqf* assets (Cizakca, 2000).

Mobilizing a large fund is only possible through the centralization of the *waqf* institution by government, which can prove to be an ineffective manager of third sector activities. The ability of small *waqf* institutions to gather *waqf* funds is quite small and even if there are a lot of *waqf* institutions established, it is still difficult to match the scale of the economy. In addition, many *waqf* institutions have their own objectives and beneficiaries' portfolio spread in several areas, which can weaken the ability to mobilize a huge fund. However, the scale of economy is important in order to reduce costs, remain competitive and ultimately have a significant impact on society.

Figure 3.1 *Waqf* Governance Model



3.7.3 Social Welfare and *Waqf*

While it is true that historically *waqf* played an important role it mitigating the social failure of the economy and the state in providing for the needs of the poor people. It may still be true that *waqf* institutions can be developed through a dynamic understanding to response to poverty issues. However, the nature and magnitude of the poverty related issues in modern times cannot be compared to the historical reality. Therefore, one has to be realistic on the potential role of the *waqf* institutions in alleviating poverty; as at the end of the day *waqf* sources is very much depended on the 'mercy' of the rich, the degree of which in various times does not provide stability in dealing with poverty issues in a dynamic manner. Taking into account such a critical analysis will help in recognising the potential role of *waqf* in modern times in responding to the developmentalist issues.

3.8 WAQF-BASED ISLAMIC MICROFINANCE

The combination between *waqf* and finance institutions particularly in Islamic microfinance has been suggested by various Islamic scholars (Ahmed, 2003, 2007b; Cizakca, 2004, June 2004; El-Gari, 2004; Kahf, 2004). Ahmed (2003) and Kahf (2004) propose establishing a microfinance institution based on Muslim philanthropy such *zakah*, *awqaf*, and *sadaqah*. Wilson (2007) also suggests that non-banking institutions conduct microfinancing by using the *wakalah* model through the collection of *zakah* and *waqf* funds. Cizakca (2004) suggests a model in which the concept of cash *waqf* can be used in contemporary times to serve social objectives. One use of cash *waqf* would be to provide microfinance to the poor. Similarly, Elgari (2004) suggests establishing a nonprofit financial intermediary, a *qard hassan* bank that gives interest free loan (*qard hassan*) to finance consumer lending for the poor. Bank capital would come from monetary (cash) *waqf* donated by wealthy Muslims. Furthermore, Ahmed (2007) describes the prospects of a *waqf*-based poverty-focused microfinance institution. Zarka (2007) proposes a Monetary *Waqf* (MW) as interest-free loans for funding microfinance. He further suggests that "MW must have two tiers of philanthropic guarantors: Guarantors of liquidity and Guarantors of losses" (Zarka, 2007: 2).

3.8.1 Theory of *Waqf*-Based Islamic Microfinance

The MFIs' desire to "achieve financial self-sufficiency is a slippery slope to a movement away from the very poor" (Akula, 2004: 24) because it drives MFIs towards commercial activity. Despite this however, their overall social mission is to graduate the extreme poor to moderately poor status by financing their small business. Therefore, an MFI needs external funds to provide zero interest to the extreme poor. Since a lack of funds has been a major constraint to the growth of Islamic MFIs, a *waqf*-based Islamic MFI would be an external source of fund instead of funds from government agencies and NGOs which impose certain terms and conditions (Ahmed, 2007b).

The Islamic microfinance schemes are derived by two principles (Linari-Pierron & Flatter, 2009) as follows: (i) Based on the Muslim philanthropy such as *Zakat* (compulsory) or almsgiving through *Shadaqah*; (ii) through two redistribution vehicles channeled, either voluntary loans – *qard hassan* or endowment fund – *Waqf*. The instruments above are the main distinguishing features of Islamic MFIs compared with conventional MFIs. In the table 3.1, Ahmed (2007) proposes a balance sheet for a *waqf*-based Islamic MFI.

Table 3.1 Balance Sheet of *Waqf*-based Islamic MFIs

Asset	Liability
Cash (C) Asset (A) - Low-risk assets (F) - Microfinancing (M) Loans-*Qard* (Q) Investments (I) (*murabahah, ijarah, salam, istisna, mudarabah, musharakah*)	Saving Deposits (D) *Qard hasan* deposits (Q) *Waqf* Certificates (S) *Takaful* reserves (T) Profit Equalizing Reserves (P) Reserve/Economic Capital (V) Capital-Waqf (W)

Sources: (Ahmed, 2007b: 10)

3.8.2 Scheme of *Waqf*-Based Islamic Microfinance

In general, there is no specific scheme of *waqf*-based Islamic MFIs, as they are not yet implemented in the real world. The success of the scheme itself depends on the unique characteristics of the place, culture and socio-economy in which it is based. However, building the structure of *waqf*-based Islamic MFIs can be addressed through Islamic philanthropy oriented towards poverty reduction. Zarka proposes the 'monetary *waqf*' concept as follows:

> Financing is one form of help that many would love to do, but for two hurdles: cost of administering and collecting the funds, and the risk of loss (default by recipients for any reason). The proposed Monetary *Waqf* employs "philanthropic resources" to over-come these two hurdles, thus facilitating for many people of average means to participate in helping the poor through micro-finance. Monetary *Waqf* assures lenders to the *waqf* of instant liquidity for their withdrawals, and insulates them from any risk of default. Give the *waqf* for the productive poor and needy and *zakah* for unproductive poor such as the sick and very old (Zarka, 2007: 4).

A Monetary *Waqf* that leverages as far as possible its three "philanthropic resources", namely: *waqf* donations, the moral sentiments of Guarantors of Liquidity and the share of *garimeen* (those burdened with debt) in *zakah* provided by Guarantors of losses. It employs all three to eliminate the transaction costs to lenders for the *waqf*, thus increasing the flow of funds of micro-finance (Zarka, 2007: 6). Note that in many cases, a beneficiary who becomes unable to pay back the micro-finance he had received also becomes *ghaarim* (one burdened with debt) according to the *zakah* rules in the Holy *Qu'ran* (9:60). He thus becomes a legitimate recipient of *zakah* to pay back what he owes the w*aqf*. Hence, Guarantors of Losses can pay the sums they pledge from their *zakah*. "Thus we see strong complimentarity between *zakah*, which must be given as one-way- transfer to the poor and cannot be advanced to them as a loan, and Monetary Waqf which is designed to provide charitable finance" (Zarka, 2007).

Ahmed (2012) suggests cash *waqf* can be used in *waqf*-MFI in three different ways[9]:

1. Corpus of *waqf* invested in income generating assets and returns used for social purposes.
2. Corpus of *waqf* given for financing as interest-free loans (*qard hassan*).
3. Corpus of *waqf* can be used as capital to create MFIs.

Most funds collected through cash *waqf* certificate issues will be allocated as loans for micro-enterprises. This microfinance programme should particularly be aimed at helping poor people initiate their business and enhance their quality of life, accordingly. At the same time *zakah* funds will protect them from the poverty trap. Nevertheless, merely supplying them with capital is not sufficient, as the majority do not have adequate skills to choose and run a business that is suitable to their condition. Consequently, relevant business technical assistance and spiritual treatment are needed to help them survive.

3.8.3 Challenges faced by *Waqf*-based Islamic Microfinance

A *waqf*-based Islamic MFI is a new scheme, still struggling to be implemented in Islamic MFIs. The *waqf* concept, combined with Islamic MFIs, needs to be well recognized by society. More *Cash Waqf* needs to be introduced as well as the Islamic MFI concept. In some countries, especially in developing countries, good governance is still a sizeable obstacle and the credibility of *waqf* and Islamic MF institutions is pivotal. Building mutual trust between

[9] Presented at Distance Learning (DL) Lecture with title "*Integrating Waqf in Islamic Finance*",16th May, 2012. This online lecture was organized by IRTI-IDB.

parties is important to sustain MFIs. On the other hand, as the matter of fact, recently trust as social capital is a luxury thing in modern society.

3.8.4 *Qard Hasan* as Interest/Mark-up/Cost plus *Murabahah*-Free Loans

In the previous section, *qard hassan* was frequently mentioned without further definition. *Qard al hasanah* is an interest-free loan with different names in Muslim countries: *Alqardhul hasan* in Malaysia, *Qarz-e-hasna* in Pakistan, *Qard-e-hasana* in Bangladesh and *Al-qird al-hassan* in Jordan (Vaziri, 2006). A *Qard Hassan* loan can be granted as if a favour from God without any expectations (Linari-Pierron & Flatter, 2009). As such *Qard hasan* is often called a voluntary loan. In this thesis, the term *qard hasan* was chosen, as it is frequently used in literature and is a benevolent loan for the poor. These people can be helped by lending them money until they can afford to repay back without any charge to burden them.

Because of the interest-free loan, the needy borrower is only obliged to repay back the loan principal to the lender. The reward for the lender is not material but comes from the knowledge of God's favour. In practice, *qard hassan* can be used by needy students, carpenters, street-traders and novice entrepreneurs who are not qualified to get loans from financial institutions. Linari-Pierron & Flatter (2009) said that

> "the efficient association of *Qard Hasan* and *Waqf* are the main differentiators of the Islamic microfinance scheme compared with the conventional counterparts in so far as Qard Hasan and Waqf really address the financing need of the poorest of the poor, category usually excessively penalized (either through the usurious interest rate or the collective pledge) in the conventional microfinance solutions". (Linari-Pierron & Flatter, 2009: 4)

3.8.5 Risk Management Issues of *Waqf*-Based Islamic Microfinance

A *waqf*-based MFI faces certain unique operational and risk management issues (Ahmed, 2007b). In table 2, the balance sheet shows only investment (*I*) yields returns, on the other hand *qard-hasan* (*Q*) does not produce return and covers actual costs only. Deposits, being *mudarabah* contracts share the risk on investments, and *waqf* that the corpus of the endowment (*W*) must be kept intact, can be the sources of investments. *Waqf* should be invested to safe low-risk instruments. The nature of *waqf* requires using appropriate risk management techniques to protect the endowment from decay (Ahmed, 2007b).

The sale-based or partnership mode of financing is difficult to implement in Islamic MFIs on account of the small-scale nature of Islamic MFIs operations. It is too costly (in terms of man-hours) and at times impossible to buy the goods/assets that beneficiaries want (Ahmed, 2002). This problem can be solved through the use of profit-sharing modes of financing. Sharing modes of financing also has it own problems - the moral hazard. Ahmed (2002) identifies the risk of *waqf*-based Islamic MFIs such as depositors-withdrawal risks and risk-return of *waqf* endowment.

Social collateral of groups, weekly repayments, using *murabahah*/*bai-muajjal* or *ijarah* (leasing) can reduce low payment rates and moral hazard problems (Ahmed, 2007b). The opportunity to divert funds for non-productive use can be reduced by using asset-based financing. As philanthropy is the nature of *waqf*, it will significantly reduce the financial costs and improve financial viability of the institution.

3.9 CONCLUSIONS

To encourage Muslims to donate their money, it is better to recognize the factors that drive them to donations. Identity and motivations are the primary reasons behind why people give altruistically. Altruism is a natural part of human life and Islam persuades people to make sacrifices for others through philanthropic practices: *Zakah, infaq, sadaqah* and *waqf*. Muslims are motivated to be altruistic by the Islamic divine incentive mechanism even in the era of capitalism. Trust, which can be derived from various contexts, is easier depleting than to be grown. Therefore, transparency, reputation, accountability, credibility, good collaboration, productivity, risk management and *Shari'ah*-compliant are the key issues for sustainable *waqf* management. If a non-profit organization, charity, *waqf*, trust fund or endowment fund does not act transparently when dealing with the sources and uses of funds, the donors will not trust them. This is particiaulary important when dealing in issues of risk, which benefit from positive expectations or optimistic beliefs about the trustee.

Waqf is subject to *Ijtihad* which rules that it must be benevolent. The static perpetuity, rigidity and historical mismanagement of *waqf* created inefficiencies and ineffectiveness that can be avoided by good governance. However, the perpetuity of *waqf* is compulsory and its benefits in developing *waqf* assets should be Shari'ah-compliant. This can be ensured through a transparent relationship between *waqif, mutawalli, waqf* board and *maukuf'alai*h, which accomplish *waqf* objectives, monitors performance, and assures compliance with Islamic *Shari'ah* rules and principles.

The last section of this chapter presented a combination between *waqf* and Islamic microfinance to discuss the how this concept can fit into current practice of Islamic MFIs. Combining Islamic voluntary sectors (non-profit oriented) and microfinance (profit oriented) is not an easy task. Therefore, it has explored an appropriate scheme of *waqf* fund management, which fit with the characteristic of Islamic MFIs. The issue of risk management for *waqf*-based Islamic MFIs still remains to be discussed.

CHAPTER 4

ISLAMIC MICROFINANCE AND ISLAMIC VOLUNTARY SECTORS IN INDONESIA

4.1 INTRODUCTION

Indonesia (capital city: Jakarta) is the world's largest archipelago with over seventeen thousand islands spanning more than 5000 km (around 3,200 miles) eastward from Sabang in northern Sumatra to Merauke in Irian Jaya. Indonesia is a country of various ethnic groups. The national motto is "unity is diversity." If a map of Indonesia was put over one of Europe, it would stretch from Ireland to Iran; compared to the United States, it covers the area from California to Bermuda.[10]

Figure 4.1 Maps of Indonesia

Indonesia also has the world's largest Muslim population (88 per cent of 237.6 million people) and as such there is considerable potential for the development of Islamic microfinance institutions and the mobilization of Islamic voluntary sectors through *zakah, infaq, sadaqah* and *waqf*. Although the Indonesian economy is supported by micro, small and medium-seized enterprises (MSMEs), the prospects of developing microfinance institutions to support the poor in establishing businesses through *waqf* are favourable.

[10] http://www.indo.com/indonesia/archipelago.html. retrieved on 2nd of July, 2010

According to the Indonesian Ministry of Religion, there are 366,595 *waqf* land units, 2,686.5 million sq meters in total.[11] These *waqf* assets can potentially help poor people, although the majority of land-based *waqf* has yet to be used for productive purposes. Mosques, regular schools, Islamic schools, lands for cemetery, and orphanages are the common forms of *waqf* assets in Indonesia. In social and economic perspectives, existing *waqf* assets have not played a very important role for alleviating social and economic problems in Indonesia yet. To support the development of *waqf*, the Indonesian government inaugurated Act No. 41/2004 regarding *waqf* and government Regulation No. 42/2006.

This chapter addresses the unique characteristics of microfinance institutions and their problems. Features of two *waqf* institutions are also presented in this chapter to show their complementary roles in the current practices of Islamic voluntary sector in Indonesia.

4.1.1 Microfinance in Indonesia

Microfinance institutions are financial intermediaries, which have core businesses in financing, capital accumulation, risk mitigation, payment and remittance systems and also provide funds for people at the lowest strata of society. For Indonesia's MFIs, not all these people (i.e low income earners, micro entrepreneurs and poor inhabitants) can be served as clients. They mostly serve the first two groups of people and it is rare to serve the extreme poor. Indonesia's larger 'financial system' approach means that most Indonesian MFIs are motivated by profit rather than social amelioration.

Indonesia's large population, 237 million people in 56 million households, spreads with many compositions range income (Asean Banker, 2007). Middle to high income households with average yearly income range from $5,000 - $10,000 are the target highly competitive market of traditional retail banking by both local and foreign banks. The new target markets for microfinance/micro banking are low-income and the extreme poor households with average yearly income less than $3000. The former can be approached by commercial or profit-oriented motives and the latter can be approached by subsidy-oriented motives with government or NGO support. According to a Bank Indonesia household survey conducted in 2008 (see table 4.1 below), Indonesian households' assets can be divided into the following classes; fixed assets 76.81%, non-financial assets 15.57% and financial assets 7.62%.

[11] Sources: Directorate of Waqf, Ministry of Religion, Republic of Indonesia (2007)

Indonesian households’ debt is mostly from banks constituting 78%, non-bank 12% and others 10% with the debt servicing ratio of banks being 72.11% and non-banks 33.08%. Households’ loan purposes are business 24%, car/motor 16%, property 14%, consumption 13%, education 8%, health 3% and others 4%. These numbers show that there is a significant opportunity for MFIs to grow, moreover, households’ repayment capacity range from 6.31% to 28.62% with debt to assets 3.78% and debt to net worth 4.03%.

Table 4.1 Indonesian Household Survey

Assets		Liabilities	
Fixed Assets	76.81%	Debt from bank	78%
Non Financial Assets	15.57%	Debt non bank	12%
Financial Assets	7.62%	Debt other	10%
Total	100%	Total	100%
Ratios			
Debt services ratio bank		72.11%	
Debt services ratio non-bank		33.08%	
Repayment capacity range		6.31% - 28.62%	
Debt to assets		3.78%	
Debt to net worth		4.03%	
Loan’s Purposes			
Business	24%	Consumption	13%
Car/motor	16%	Education	8%
property	14%	Health	3%
Others	4%		
Total		100%	

Sources: Bank Indonesia household survey in 2008

Microfinance markets are interesting in terms of profit and scale. According to CGAP’s presentation ‘Making sense of Microcredit Interest Rate’, the yield on gross portfolio by scale of operation for large MFIs is 37%, medium MFIs 42.5% and small MFIs 42.8%. Four main types of financial institutions are engaged in the microfinance sectors (Jansson, Rosales, & Westley, 2004): (1) Commercial banks and other financial institutions opting for a strategy of ‘downscaling’[12], (2) Commercial banks and non-bank financial institutions specialized exclusively in microfinance, (3) cooperatives, and (4) NGOs. BPR (Bank Perkreditan Rakyat/rural bank) and BPRS (Bank Perkreditan Rakyat Syariah/Islamic rural bank) can be categorized as type number 2 and BMT (*Baitul Maal wa Tamwil*/Islamic Cooperative) can be

[12] This type favours the creation of an internal unit specialized in microfinance sectors to reach a niche target. This unit is not the main activity of the banks.

categorized as type number 3. Fierce competition between microfinance providers creates the competitive cost of funds for micro-entrepreneurs not only from micro-finance institutions such as BPR, BPRS, cooperative, BMT but also from the big banks with their micro-banking division such as BRI (Bank Rakyat Indonesia), Andara, Mandiri, Mega, Mayapada, BTPN (local banks) and Citibank, Danamon and HSBC (foreign banks). These large banks with their micro banking division can be categorized as type 1. However, BRI, a state commercial bank, fully supported by Indonesian government, is a dominant player. There are two strategies employed by big banks in developing micro-banking, direct to the micro clients and indirect to the clients but through other MFIs.

4.1.1 Criteria of Micro, Small and Medium

The Deputy of Economy and Finance Coordinator on operational standards and credit procedure's (2009) definition of MSMEs are:

- Micro business is a productive business owned by individual and or company which (a) owns net profit maximum IDR 50.000.000,00 (USD 5,000) excluding land and business building; or (b) owns annual sales maximum IDR 300.000.000,00 (USD 30,000)
- Small business is a productive business owned by individual or company but not part of medium/large business either in terms of shares or ownerships which : (a) own net profit between IDR 50.000.000,00 (USD 5,000) and IDR 500.000.000,00 (USD 50,000) excluding land and business building, or (b) own annual sales between IDR 300.000.000,00 (USD 30,000) and IDR 2.500.000.000,00. (USD 250,000)
- Medium business is a productive business owned by individuals or a company but is not part of medium/large business either in terms of shares or ownerships which; (a) own net profit between IDR 500.000.000,00 (USD 50,000) and IDR 10.000.000.000,00 (USD 1,000,000) excluding land and business building, or (b) own annual sales IDR 2.500.000.000,00 (USD 250,000) and IDR 50.000.000.000,00 (USD 5,000,000)

4.1.2 Microfinance Institutions in Indonesia

In Indonesia, the first microfinance institutions were established mostly in the rural areas: The first rural bank was established in 1895. In 1910, there were over 13,000 rural banks. Bank Rakyat Indonesia (BRI), a state owned bank, was established in 1984 and BPR (Badan Perkreditan Rakyat/rural bank) was established in 1988. However, it is challenging to measure the scope, actors and impact in the microfinance market because of data limitation. The Indonesian microfinance market is diverse and incorporates not only the main players such as BRI units, BPRs and the Pegadaian (pawnshop), but also the Regional Development Bank (BPD), Baitul Maal Wa Tamwil (BMT) and other commercial banks including Bank Danamon, Bank Niaga, Bank Central Asia, (*Microfinance Industry Reports - Indonesia*, 2009).

During the Asian financial crisis many large companies collapsed leaving a considerable amount of debt in the banking sectors. According to a 2005 report by the Asian Foundation, SMEs have been an important *"engine of growth"* for the Indonesian economy since 1997 (Musnidar & Tambunan, 2007). Since that time, banking sectors have put more of their investment portfolio into MSMEs and some of them became actively involved in microfinance through a linkage programme initiated by Bank Indonesia. This encouraged the big commercial banks to enlarge their lending to MSMEs. Commercial banks took this opportunity by opening micro-service units in early 2003 which was also considered unfair for BPRs in term of scale of economy and regulation. However, the potential of the micro-credit market is still big[13]. It is not only banking sectors that have enthusiastically embraced the microfinance market, the Pegadaian (pawnshops with special privileges regulated by law) have also aggressively taken part as a state-owned company. Pegadaian's (pawnshops) customers are obliged to pay a predetermined fee for keeping the collateralized goods physically kept by Pegadaian employees in their storehouses.

According to Ismawan and Budiantoro (2005), Indonesian approaches to microfinance can be categorized into four kinds: savings-led microfinance, credit-led microfinance, micro-banking and linkage model (Ismawan & Budiantoro, 2005). In savings-led microfinance, membership and active participation are pivotal. Financial mobilization is based on capacity of the poor, membership based and assisted by self-help groups (SHGs), Credit Union (CU), and *Koperasi Simpan Pinjam*/*KSP* (savings and credit cooperative). In credit-led microfinance, the key financial resource is not from savings mobilization of the poor but from another resource intended for the poor. BRI (People's Bank of Indonesia) and BPR (rural banks) are examples of banks designed to conduct micro-finance services. It is noteworthy that BRI was recognized as a global microfinance institution giant in the Microfinance Summit 2005. The linkage

[13] Adapted from a local newspaper, Suara Merdeka, in a polemic debate according the commercial penetration into the BPR market in the middle of 2004

model, initiated by central bank Bank Indonesia, is the starting point for collaborative ventures between commercial bank and BPRs since 2000. Both institutions have different natures that can organize and linked for mutual benefit: commercial banks have large amounts of capital and BPRs have longer experience dealing with micro-entrepreneurs. Existing institutions provide operating foundations both informal social organization KSM/*Kelompok Swadaya Masyaraka* (self-help group) and formal finance institutions (bank). BPRs that lack funds but have more access to the poor can get access to financial support while commercial banks, which have more funds, can increase their number of clients (outreach). Supported by Bank Indonesia, this collaboration is widely well-known as *Pola Hubungan Bank dan Kelompok Swadaya Masyarakat/ PHBK* (Bank-Self-Help Groups Linkage) in 1988.

The Directorate of Economics and Monetary Statistics of Bank Indonesia Jakarta divides rural credit banks into three sub-groups namely: (a) BPR non-rural, i.e. new BPRs, petty traders/village banks, BKPD, and employee banks, (b) BPR rural, i.e. village banks, *paddy banks*, and (c) LDKP. The key success of rural financial intermediation systems in Indonesia comes from the design of their organization. Research conducted by Chaves and Gonzales-Vega explains that system monitoring; managerial discretion over transactions conducted at market terms, policies to protect portfolio value, and no dependency-creating subsidies, compatible incentives such as performance based compensations (profit sharing, collection fees) and efficiency wages are essential factors of MFI's mechanism design (Chaves & Gonzales-Vega, 1996). They also found that networks of semiautonomous units, which are the advantages of BRI units, use local information and mechanism of contract enforcement that lowers the transaction costs. If commercial banks can be owned by state companies or privately, most of BPR's owners are private individuals. The first BPR (Badan Perkreditan Rakyat/rural bank) established in 1988 with minimum capital requirements were 50 million IDR or equivalent to US $ 29,000. Since then, there have been three major types of BPR; newly established institutions, converted conventional BPR and other converted MFI.

The directorate of *Sharia'h* Bank, Bank Indonesia implements a comprehensive linkage model for Islamic microfinance. This linkage model foresees three types of intervention: "for-profit financial assistance, not-for-profit financial assistance and technical assistance for developing micro-enterprises. Islamic commercial banks get for-profit financial assistance for either their own division or jointly with the rural banks (BPRS) and/or BMTs" (Obaidullah, 2008b: 79-80). Non-profit-financial assistance is provided by Islamic commercial banks in the form of *zakah, infaq, sadaqah* and *waqf*. These funds are utilized to fulfil the basic consumption needs of the poor and to provide both training for unskilled micro-entrepreneurs and start-up capital for micro-entrepreneurs. Bank Indonesia provides technical assistance funds to various business development services providers and consultants in collaboration with universities. During 2006-2007, Bank Indonesia collaborated with Lembaga Manajemen Fakultas Ekonomi /LMFE (Management Studies Centres), University of Padjadjaran Bandung conducted a pilot project involving *Shari'ah* linkage for Islamic microfinance institutions in West Java and Yogyakarta Provinces. LMFE conducted this research and also provided support (spiritual, technical and managerial) for micro-entrepreneurs who obtained micro financing from Islamic rural banks.

4.1.2.1 Bank Rakyat Indonesia (BRI) Microbanking

BRI, one the best known institutions and the largest MFI in the world, is a state bank and since 2008 has been the best bank based on credit rating. As one of the biggest five MFIs in the world (Microcredit Year, 2005) in terms of lower-income people and their loans, "the unit division of Bank Rakyat Indonesia (renamed 'Bank BRI' in 2004) had a total of 3.44 million micro borrowers in its 'Kupedes' loan programme with total loans outstanding at December 2006 of Rp. 27.3 trillion (USD 2.73 billion). Among other sources, this lending was funded by more than 30 million savers who had deposited Rp 38.68 trillion (USD3.87 billion) in SIMPEDES accounts" (*Microfinance Industry Reports - Indonesia*, 2009: 11). With a maximum amount of USD 500 (5 Million IDR) and maximum tenure of two years, BRI units also have a non-collateralized loan for lower-income clients. The division of BRI originally called '*Unit Desa'* or 'village unit' is the key success on demand-based financial products and the development of individual 'Units'. Bank BRI provided services such as loan products, savings products, insurance, and money transfer services/remittances.

One of the popular individual loans, KUPEDES, requires collateral and can be used for working capital and investment purposes. The savings product, SIMPEDES, permits unlimited withdrawals, attracts competitive interest rates and is also guaranteed by the government. A wide ranging scope and a large number of clients have generated more innovative programmes to attract more clients from rural areas. "For example, as a way to encourage more clients to open savings accounts, BRI launched bi-annual lotteries for SIMPEDES account holders" (*Microfinance Industry Reports - Indonesia*, 2009: 11). BRI can be categorized as a commercial bank operates in the market with a small amount of money per transaction but has a large volume with one hundred million Indonesian people living in rural areas. BRI is also based on individual-liability loans which can be explained with high repayment performance than social networks among borrowers. A pre-existing relationship within communities and the use of testimony from respected community figure as social collateral on the borrower's loan are some of BRI's success ingredients (Robinson 1992; 1994). Therefore, the group-lending scheme has proven less successful in Indonesia.

4.1.2.2 BPR (Badan Perkreditan Rakyat)/ Rural Credit Banks

During the nineteenth century and Dutch colonies in Indonesia, rural credit banks were established, namely Lumbung Desa, Bank Desa, Bank Tani, and Bank Dagang Desa. The main objective of these banks was to help workers not to fall into the trap of high interest rates from moneylenders. Post-independence, some types of small financial institutions were established in the rural areas such as Bank Pasar (Market banks), Bank Karya Produksi Desa (BKPD). In the beginning 1970s, Lembaga Dana Kredit Pedesaan (rural credit fund institutions) were established by the local government. Subsidized credit to SMEs has been practiced since the 1970s. The credit programmess are called small investment credit (*Kredit Investasi Kecil,* KIK) and permanent working capital credit (*Kredit Modal Kerja Permanen, KMKP).* In 1988, the President of the Republic of Indonesia decreed Paket Kebijakan (Policy package) October 1988 (PAKTO 1988) through President's decision no.38. This decree gave momentum to establishing rural credit banks.

4.1.2.2.1 Position of BPR in the Indonesian's Financial System

BPR is a financial intermediary institution for lower-income people and the poor which is firstly regulated by law and then organized and supervised by a central bank. The target markets of BPR are mostly rural and suburban people who are not served by big commercial banks. BPR is characterized by easy access and simple administrative procedure for simple villagers. Mostly, BPRs are located close to market (rural population and small business) and focus on people's unique needs in that particular area.

As a supervisor of BPR, Bank Indonesia has facilitated linkages between commercial banks and BPR. Bank Indonesia uses CAMEL (Capital, Asset, Management, Equity and Liquidity) criteria when ranking the BPR. BPR itself must financially healthy, credible and have a good reputation.

4.1.2.2.2 Regulation of BPR

PAKTO 88 is considered to be a turning point for the Indonesian economy when a monetary and banking deregulation policy was launched on October 28th 1988 to widen scope for investors who wanted to enter financial and banking industries in Indonesia. This deregulation permitted low minimum levels of paid up capital to establish a bank and director and board commissioner without prior banking experience. This was also valid for commercial banks and BPR. Since then the number of BPRs and commercial banks have increased rapidly. However, as competition increased in line with the number of banks, the community benefitted more from convenient banking services. A negative impact occurred in the 1990s when credit was misused by some business groups of various private-owned banks.

To support MSMEs as an underpinning pillar of the Indonesian economy, the government encouraged big private and state-owned companies to share a few portions of their profit to finance MSMEs. Therefore, through a Corporate Social Responsibility/CSR programme, private and state-owned corporations prefer direct lending to MSMEs, rather than using BPRs. Gaining political advantages by being “good neighbors” to surrounding MSMEs is one of the reasons behind direct lending with low interest rates (6% interest rate of credit). Meanwhile, the BPR provides credit with an interest rate of 30% per annum. For example, Telkom Co, Pertamina Co, Krakatau Steel Co, Indonesia Harbor Co and other stated-owned companies disbursed revolving soft loans at 6% p.a. As a result, it is difficult for BPR to compete with the big state-owned corporations in terms of the interest rate of credit in particular areas.

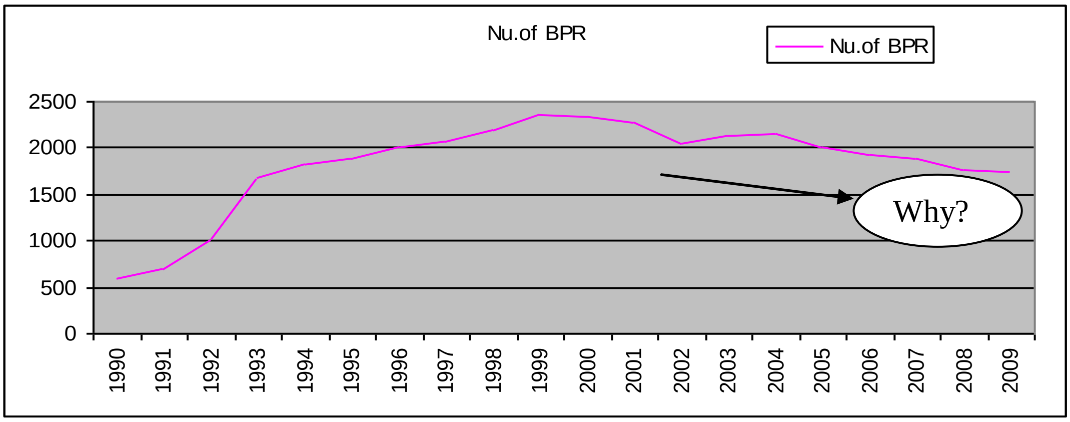
The National Banking Act No.7/1992 has been amended to National Act No.10/1998 as regulation for BPR. In the Act it is clearly stated that BPR as a type of bank which provides financial services for MSMEs and people in rural areas whether conventional or Islamic /*Shari’ah*. In that Act is also declared that other small financial institutions such as Bank Desa (rural bank), Lumbung Desa, Bank Pasar, Bank Pegawai, LPN, LPD, BKD, BKK, KURK, LPK, BKPD, and other similar institutions can be changed to be a BPR under certain conditions as a prerequisite regulated by Peraturan Pemerintah (PP) /government regulation. Furthermore, government regulation No.71/1992 offered small financial institutions the opportunity to convert to BPR with by 31st October 1997. Until the deadline, not all institutions could meet sufficient prerequisites and convert to BPR. Since that time, BPR have been supervised by the Bank of Indonesia and are subject to banking legislation and regulation. Since August 2004, the required minimum capital to establish BPR has increased from Rp. 1 billion to Rp. 5 billion. Finally, according to banking architecture policy- the required minimum capital for a BPR would be Rp. 10 billion in the year 2010. Meanwhile, in 2010, the minimum requirement for a commercial bank will be Rp. 100 billion.

4.1.2.2.3 Decline in the number of BPRs

According to Bank Indonesia, BPR insolvency is caused by increasing non performing loan (NPL), and fraudulent activities. Before Pakto 1988 there were 423 BPRs which increased to 1.512 by 1992, 2,262 by 1998 and reached to 2,355 at the end of 2001. However, in 2002 there was a decline in their number to 2,141 and then at the end of July 2006 only 1,935 were left. These declines were in line with Bank Indonesia's policy to recover the BPR industry. Bank Indonesia dismissed the operation of BPRs with unsalvageable structural problems but gave a second chance to healthy BPRs with limited capital to merge with each other in order to increase capital and efficiency.

From 2001 to July 2006, 249 BPRs were dismissed and the remaining 306 BPRs were merged into 26 BPRs (post merger); 95% of merged BPRs were owned by the local government. Nevertheless, during the crisis, the proportion of bankrupt BPRs was lower than the proportion of bankrupt commercial banks during the crisis. Figure 4.2 shows the growth and decline rate of BPRs from 1989 to 2010. However, Java Island dominates the largest number of MFIs, particularly the BPR. More than 70% of the total number of BPRs operates in Java. There is a decreasing trend of the proportion of BPRs in Java. Bank Indonesia statistics (1991-2003) and (2005-2009) show these decreasing proportion figures respectively.

Figure 4.2 Growth of BPR from 1989 to 2010 in Indonesia



Sources: Bank Indonesia and BPS (Biro Pusat Statistik)

4.1.3 Islamic Microfinance Institutions

Bank Indonesia is the legal institution that regulates and develops banking in Indonesia mandated by the constitution through Act 10 of 1998 and Act 23 of 1999. As such it develops Islamic banking in Indonesia including Islamic microfinance institutions through BPRS. This legal basis provides Bank Indonesia with the capacity to introduce *shari'ah* compliant financing. Islamic MFIs are established on the partnership concept, which shares both profit and risk jointly.

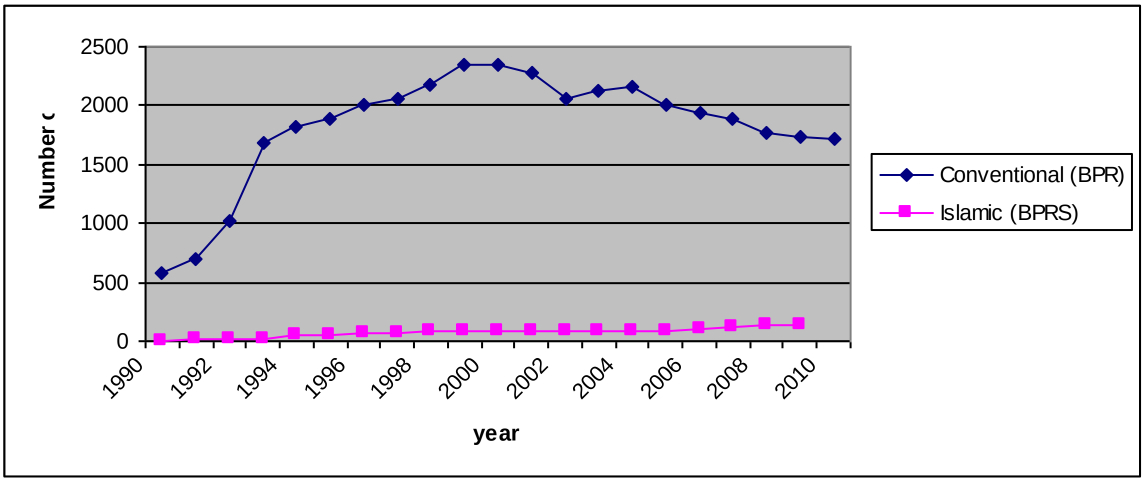
4.1.3.1 Bank Pembiayaan Rakyat Syariah (BPRS)/Islamic Rural Bank

Bank Pembiayaan Rakyat Syariah (BPRS) is regulated by National Act No.7/1992, amended into National Act No.10/1998 (*Peraturan Bank Indonesia tentang Badan Perkreditan Rakyat*, 2004: 3). There are three types of Islamic banking institutions in Indonesia; fully-fledged Islamic commercial banks, Islamic banking units of commercial banks and Islamic rural banks (BPRS). BPRS is supervised by the central bank, Bank of Indonesia. "BPRS were first licensed in 1991, after a technical team based on decision of Ulama on the prohibition of *Riba* was formed and steps were taken to established Islamic commercial and rural banks" (Seibel & Agung, 2005b: 15).

These dual systems, conventional and Islamic, do not only operate in the banking sector, but also provide for microfinance in the form of conventional rural banks (Bank Perkreditan Rakyat or BPRs) and *Sharia'h*-compliant rural banks (Bank Perkreditan Rakyat Syariah or BPRSs). Karim *et.al* 2008 found some interesting results on Islamic MFIs in Indonesia. Compared to their conventional counterparts, BPRS *Shari'ah* compliant products such as *murabaha* create higher transaction costs. Nevertheless, compared to their peers – MFIs in Asia – BPR and BPRS are far lower in terms of operational efficiency and ROA. In adddition surprisingly, according to a Bank Indonesia report, the growth of BPRS's products has been impressive; from March to December 2007, these banks' *murabaha* receivables increased by 26 percent, *musharaka* financing increased by 27 percent, and *mudaraba* financing increased by almost 50 percent. Many factors, economic and non-economic, are involved in this growth but, however, they face several challenges in reaching sustainable scale" (Karim, Tarazi, & Reille, 2008).

According to Seibel and Agung (2005), there is no significant effect of *fatwa* from the Indonesian Ulama (MUI) on the prohibition of *Riba* according to the preferences of Indonesian Muslims towards Islamic banking. The historical data in Figure 4.3 shows that conventional (BPR) and Islamic rural banks (BPRS) have developed over a similar time span but the Islamic rural banks are far behind the conventional ones in a country with 90% Muslim population. Conventional rural banks (BPR) started in 1989 and Islamic rural banks (BPRS) have been in existence since 1991. The average growth of BPR was 137 institutions per year during a 15-year period, compared to only 6.5 BPRS per year during the slightly shorter 13-year period. Shortly, “conventional rural banks have thus grown more than 20 times faster than Islamic rural banks on a yearly basis” (Seibel & Agung, 2005a: 21).

Figure 4.3 The Growth of Conventional and Islamic Rural Banks

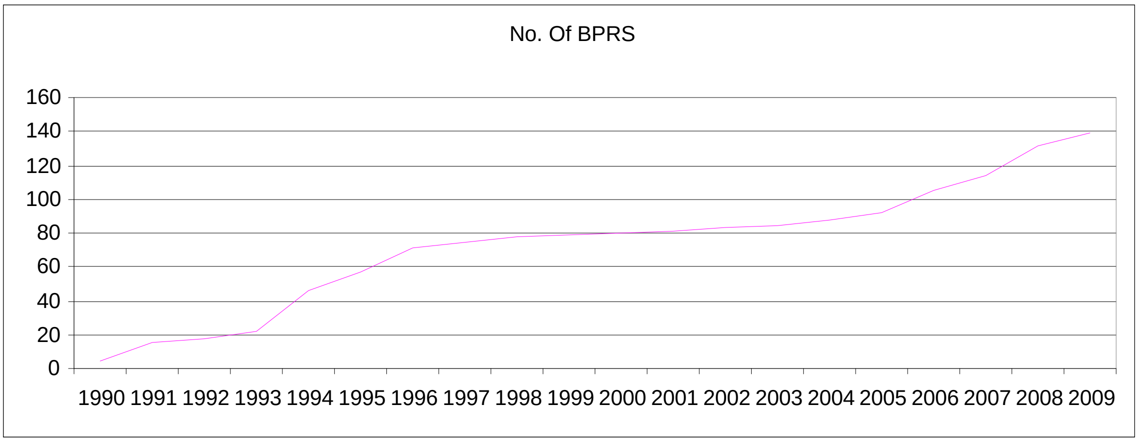


Sources: Bank Indonesia and BPS (Biro Pusat Statistik)

In figure 4.4, the growth pattern of Islamic rural banks is markedly different. After a promising start in the early 1990s, the development of Islamic micro-banks has almost come to a standstill. Following an initial period of growth until 1996, when they reached a total of 71, their number almost stagnated during and after the financial crisis, reaching 78 by 1998 and a mere 84 by 2003 (out of a total of 2,134 rural banks), and 92 by December 2005.

“With Rp 191.75 billion in total assets (December 2003), BRPS/Islamic rural banks accounts for 1.5% of the regulated BPR sector, BPRS assets was only 38% of the asset of an average BPR. BPRS account for 1.5% of loans (financing) outstanding, but only 1.2% of deposits of the total BPR sector.

Figure 4.4 Growth of Islamic rural banks (BPRS) from 1990 to 2010

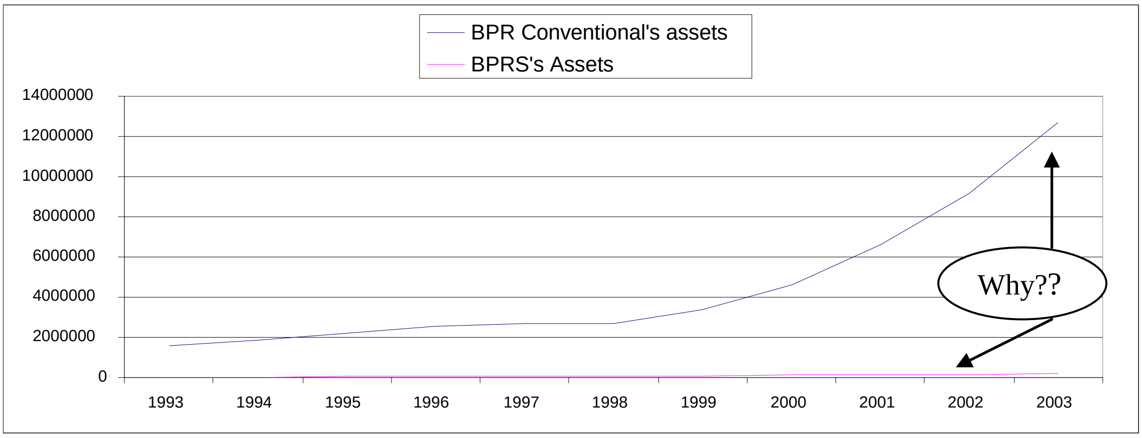


Sources: Bank Indonesia and BPS (Biro Pusat Statistik)

During the three-year period December 2000 to December 2003, the total assets of the BPR sector grew (nominally) by 173% and the assets of the BPRS by 70%, despite the fact that the total number of BPR declined by 12% from 2,419 to 2,123, while the number of BPRS increased by 5% from 80 to 84 during that period" (Seibel & Agung, 2005a: 22).

BPRS account for 1.5% of loans (financing) outstanding, but only 1.2% of deposits of the total BPR sector "in December 2003 (Seibel & Agung, 2005a: 22). As per December 31, 2004, the BPRS accounted for 84 head offices they have successfully accumulated their assets up to Rp. 85.2 billion and own 2.85% of the total BPR assets in Indonesia. Figure 4.5 shows a big gap between BPRs' and BPRS' assets.

Figure 4.5 Differences between BPR and BPRS in term of assets



Sources: Bank Indonesia and BPS (Biro Pusat Statistik)

Seibel (2008) found that there are several reasons for the poor performance of Islamic micro banks in Indonesia: (1) Governance and management problems: many have been established by absentee owners for moral reasons, with an emphasis on social banking, and are managed by retired conventional bankers, who lack dynamism and Islamic banking expertise — with dire consequences for performance. (2) Inadequate internal control (by absentee commissioners) and a lack of external auditing (due to small size below the limit where auditing is required). (3) Lack of popular demand for Islamic banking services and emphasized on the informal sector, to the neglect of more profitable market segments. (4) Lack of mastery of overly complex Islamic banking practices. (Seibel, 2008: 94-95)

4.1.3.2 Baitul Maal wa Tamwil (BMT)

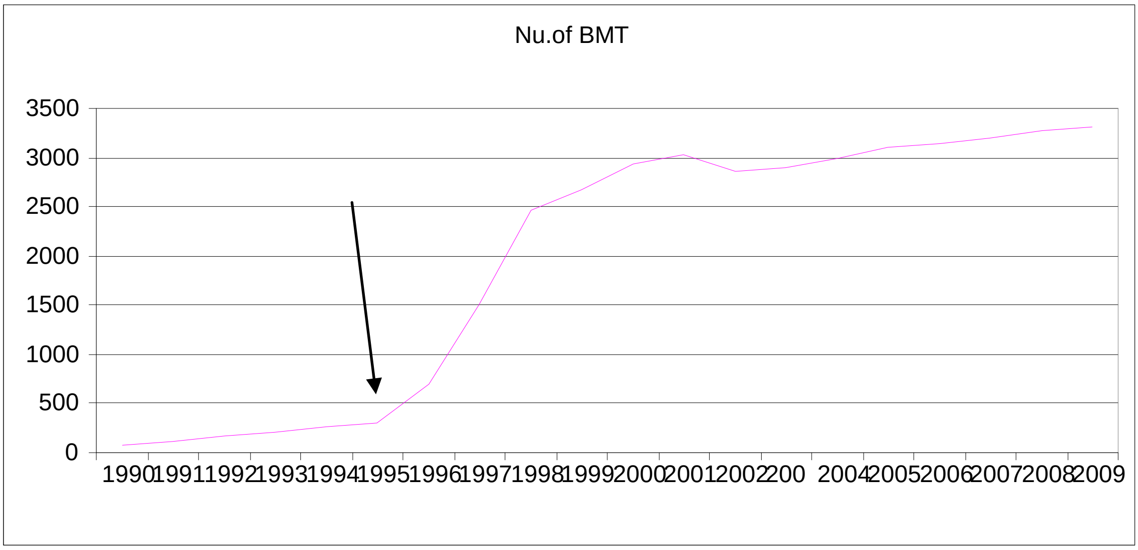
Fast growing microfinance institutions are those that gain support politically and are socio-religiously accepted. One of these institutions serves the grassroots segment, majority of which are Muslims, by implementing *Sharia'h* compliant financing called *Baitul Maal wat Tamwil* (BMT). Beyond the reach of Bank Indonesia, BMTs are cooperatives and have grown rapidly in the aftermath of the banking crisis, reaching more than 3,000 units.

The development of Islamic banking has been paralleled by that of Islamic financial cooperatives, or BMT. The first Islamic cooperative, Ridho Gusti, was established in 1990 in Bandung. After 1995, when PINBUK started promoting Islamic cooperatives under the new label of BMT, they increased in number over several stages: an initial period of moderate growth up to 1995; the promotion of rapid growth by PINBUK starting in 1995, with large jumps in numbers during the crisis years of 1997 and 1998; a slowing down of growth in 2000; followed by stagnation and then a slight decline, as Figure 4.6 below shows (Seibel & Agung, August 2005: 19).

"BMT (*Baitul Maal wat Tamwil)*, comprising about 95% of Islamic cooperatives, affiliated to Nadhatul Ulama (NU), which is, with almost 40 million members, the largest Islamic mass organization in Indonesia. However, NU does not play an active role in guiding and supervising BMTs, which are under the guidance of PINBUK. It should be noted that statistics on BMT usually include the BTM (unless otherwise stated). "BTM *Baitul Tamwil Muhamadiyah*, comprising about 5% of Islamic cooperatives, guided since 1999 by Muhamadiyah, which is the second-largest Islamic mass organization in Indonesia with some

25 million members. BTM are informally supervised by PPEM" (Seibel & Agung, August 2005: 13)."

Figure 4.6 Growth of *Baitul Maal wa Tamwil* (BMT)



Sources: Author's modification from Seibel & Agung data (2005)

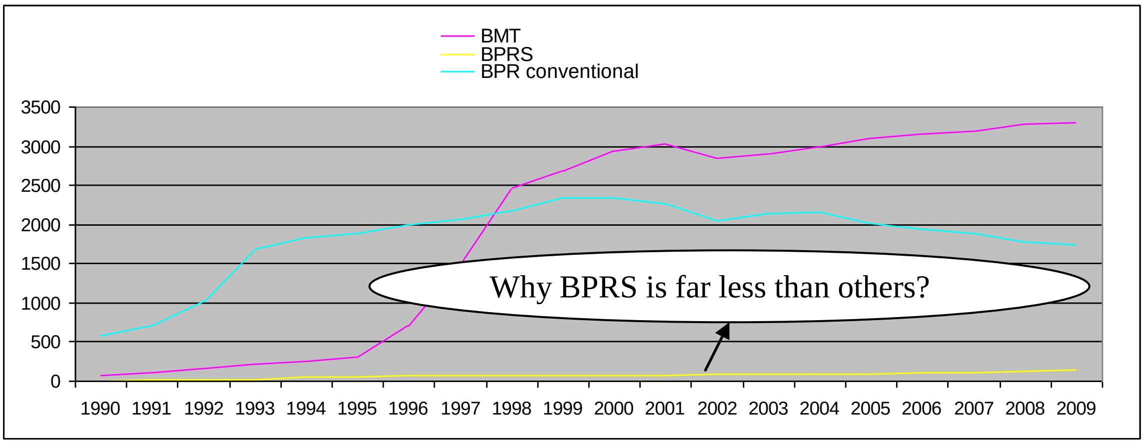
Islamic microfinance cooperatives suffer from the same regulatory and supervisory neglect as the rest of the sector. There is not much difference between Islamic and conventional cooperatives. "At most one-fifth of Islamic cooperatives are in reasonably good health. The majority is dormant or non-performing; most of the remaining ones exist for the purpose of receiving funds from the government" (Seibel, 2008: 95).

The Ministry of Cooperatives does not register cooperatives as Islamic or conventional and provides no information and special assistance to Islamic cooperatives. In sum, the outreach of Islamic cooperatives is negligible, their overall performance poor (Seibel, 2008: 96-97):

- There is a lack of regulation, supervision and reliable reporting.
- The large majority of Islamic cooperatives are dormant or technically bankrupt.
- Their outreach is negligible, accounting for 7.2 per cent of all microfinance cooperatives, but less than 1 per cent of borrower outreach of the sector.
- Their loan portfolio (much of it overdue) accounts for 1.1 per cent of the financial cooperative sector and 0.19 per cent of the microfinance sector.
- The savings of the depositors are at great risk.
- Overall there is little difference in performance between conventional and Islamic cooperatives, the latter having inherited most of their problems from the former.
- Fresh money pumped into the sector by donor or government agencies without effective regulation and supervision will further aggravate their downfall, as has been historically the case of the state-supported cooperative sector.

Based on Seibel's findings below, the gap in Figure 4.7 highlights the cause of problems.

Figure 4.7 The Growth of Baitul Maal wa Tamwil (BMT), BPR & BPRS



Sources: Author's modification from Seibel & Agung data (2005)

4.2 NON-PROFIT ORGANIZATION SECTORS IN INDONESIA

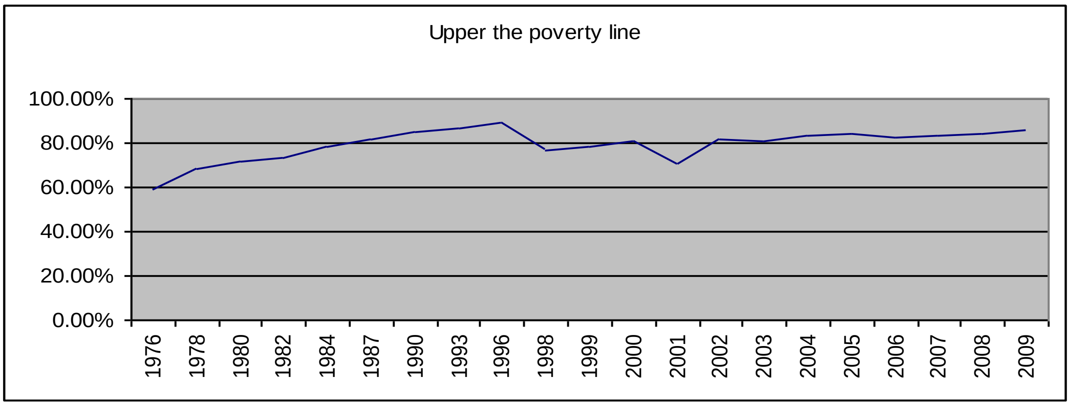
4.2.1 Legal and Regulatory Framework for Non-Profit Organizations in Indonesia

In the area of non-profit organizations in Indonesia, the policy on non-profit organization and the taxation system for the non-profit sector are important and have inspired a series of legislative Acts. According to Act no. 7/1993, all foundations that provided social services in the fields of religion, education, health, and culture were possibly eligible for tax exemption. Though, in line with Act no. 10/1994, tax exemptions for foundations working in these fields are restricted to grants, donations, presents, in heritance and government subsidies. The modification of these Acts was made by the Indonesian government (during Abdurahman Wahid's administration) through *Act no. 17/2000* on the Third Revision of *Acts no. 7/1983* on income tax. A taxable income deduction factor is a significant result of amendment the Law and it followed Act no. 38 of 1999 on *Zakat Fund Management* issued by the previous one (Habibie's administration).

4.2.2 Voluntary Sectors in Indonesia

The percentage of Indonesia's income per capita above the poverty line can be seen in Figure 4.8. These people are potential groups who are expected to play significant role in the voluntary sector. However, according to Ibrahim Rustam (2000), involving 25 CSRO (independent and non profit) in the survey refers to private NGO. 65% of CSRO revenues come from international sources and 35% domestic sources. Individual giving in financing NPO in Indonesia is less than 15% without including other religious groups. *Zakat Infaq and Sadaqah* (ZIS) are forms of individual giving rate based on religious association.

Figure 4.8 Indonesian's Income per capita from 1976 to 2008



Sources: Bank Indonesia and BPS (Biro Pusat Statistik)

In social fundraising, the role of the mass media is significant. High levels of transparency and accountability motivate donors, most of whom prefer to remain anonymous, to donate their money through mass media. Before 1998, during the Suharto Era, the development of NGO sectors was slow because of limited conducive environments, particularly in the regulatory sector. The President himself had many foundations, which contributed to social giving. After 1998 and the reform movement in Indonesia, philanthropic activities started to develop conducive regulatory environments.

Very few of organization or institution which regularly conducted research or survey about Indonesian's giving rate or philanthropy in Indonesia, PIRAC (Public Interest Research and Advocacy Centre) is one of them. At the APPC Conference, Bali 2001, 14 foundations, consisting of 9 MNC (Multinational company), spent more than Rp 6 million on charity and development grants in the first two months (PIRAC, 2002: 15). PIRAC have collected the information and conducted some surveys about the rate of giving or philanthropy both individual and organization in Indonesia in 2002, 2004 and 2007.

PIRAC conducted research concerning 'the role of media in philanthropy activities in Indonesia' in 2011[14]. This research revealed that there were 150 media which pooled the donation more than Rp 367 billion (USD 36.7 million) for victims of Tsunami in Aceh in 2004. The role of media and their care towards the needy also continued in pooling the donation for the victims of earthquake in West Java in 2009, flood in Wasior (2010), Tsunami in Mentawai (2010) and then Volcano eruptions and earthquake in Jogjakarta (2010).

Not only individual, the private sector has also developed four types of corporate participation in philanthropic giving in Indonesia:

1. Direct corporate involvement
2. Corporation creates its own foundation
3. Consortium between corporations and social organization
4. Employee of Corporation involved (GE and Citibank)

Number 4 can be said to involve participation of individual employees in philanthropic activities.

4.2.2.1 Donation to Individuals

Indonesia has a tradition called "*gotong royong*" (literally meaning "community-driven team work). However, this tradition is "an integral part of Indonesian character, stemming from cultural traditions, religious wisdom, and a strong sense of community (Rusdiana & Saidi, 2008). Based on the research conducted by PIRAC in 2002, there are four basic features of donations to individuals; (1) giving donation to relatives of the donors 67%, (2) giving donation to friends 36%, (3) giving donation to beggars 87%, (4) giving donation to crime victims 44%. Overall, the rate of giving of Indonesian people was 98% (it means that 98% of respondents give their money to charity at least during a year). Based on this research, beggars constituted the largest recipient, followed respectively by donor's relatives, victims of crimes and then friends. Small donations to beggars in the street are due to an uncomfortable feeling of pity. Religion is a strong motivational factor behind donation. Islam, as the majority religion in Indonesia, teaches and motivates the individual to share their money to those who are in need. Based on the Pirac survey in 2002, the upper class income earners donate $81/annum, middle class income earners donate $36/annum and the lowest class income

[14] Summary Report of Pooling the Donation by Media and Its Accountability (2012). www.pirac.org

earners donate $17/annum. These small donations cannot be separated from the influence of the low salary rate and regional minimum wage in Indonesia.

In 2004 and 2007, PIRAC supported by Ford Foundation also conducted several surveys concerning “the pattern and potency of community donation”. This survey involved 2500 respondents from eleven big cities in Indonesia. The population of this survey was the middle-upper class who has capacity to donate their money. If rate of giving in 2002 was 98%, in 2004 was 99.8% and in 2007 was 99.6%. In 2002 and 2004, 16% of respondents set aside their money deliberately for donation and in 2007 increased around 43.7% of respondents (PIRAC, 2007).

In 2007, PIRAC also conducted a survey concerning ‘The potency and behavior of community in paying zakah”. This survey involved 2000 respondents from 11 big cities in Indonesia. The result showed that 95.5% of *muzakki* (Muslims who obliged to pay *zakah*) paid their obligation in paying *zakah*.

4.2.2.2 Donation to Religion-Based Organizations

As one of Islamic pillars, giving *zakah* is compulsory for Muslims. With an 88% Muslim majority population 84% of Indonesian respondents admitted that they had never given donation to religion-based organization and only 16% had seldom given donation during the last couple of years (PIRAC, 2002: 29). Giving donations to other social organizations besides the religious-based is relatively low. If donors gave their money to social organizations, they chose the organizations which were closest to their self-interest. Some reasons behind why Indonesians donate money are the need to express feelings of compassion for one another, a sense of social solidarity and to fulfill religious command (PIRAC, 2002: 34).

Fourteen corporations spent more than 6 billion IDR for charity and development grants in the first two months of 2001 alone. These 14 corporations consist of nine multinational corporations or MNCs (64 percent) and five national corporations (36 percent). In terms of fund allocation, MNCs contributed about 70 percent, while national corporations contributed about 30 percent. (PIRAC, 2002: 15)

Religious command, social solidarity, feeling of compassion, and trust to an organization respectively are main reasons for people to donate their money (PIRAC, 2002, 2004 and

2007). Based on survey in 2007, the respondent main motivations behind giving were religious command (97%), social solidarity (87%), feeling of compassion (90%), and trust to organization (47%) respectively (PIRAC, 2007).

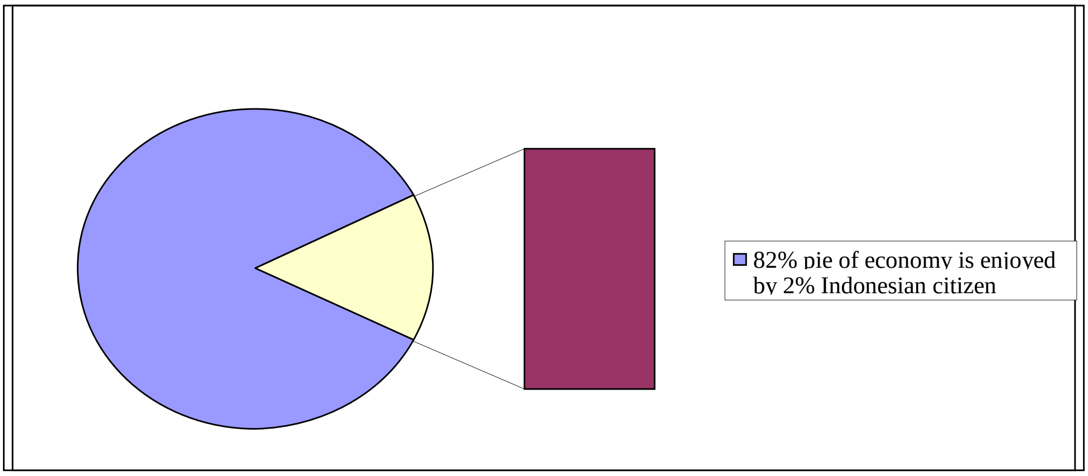
4.2.2.3 Refuse to give?

There are two main reasons why people refuse to donate their money: there is not enough money for daily basic consumption and lack of trust.

A. There is not enough money to donate

From the economist's perspective, the majority of Indonesia's economic pie dominated by only 2% of the richest people (equal to 4.8 million people). Asmoro reported that 2% of the richest Indonesians control 82% of total deposits in the Indonesian banking system (Asmoro, 2010). He took this figure from the data issued by the Indonesian Deposit Insurance Corporation (IDIC) on bank deposits as of April 2010 whereas the total number of accounts "below IDR 100 million (USD 10,000)" reached nearly 89 million or 98% of the total number of Indonesians with bank accounts in Indonesia. On the contrary, 2.1 million accounts or 2% of the total number of accounts have balances "above IDR 100 million (USD 10,000)".

Figure 4.9 Indonesia's Economic Pie



This fact shows that the wealth in Indonesia is concentrated in the few hands. From this the next questions emerges: Of this 2%, how many people are Muslims? This question is not easy to answer as there is no data available to answer it sufficiently. However, it is well known in Indonesia that many Chinese entrepreneurs who control the economy in Indonesia as part of old regime policies. Even if they were Muslim, how much do they care about donating their money to needy people? Therefore, hoping that the rich will donate their money regularly for religious reasons such as *waqf* is impractical.

However, if about 20% of the Indonesian population lives under the poverty line, there are still 65% who can be expected to be a potential *waqif*. Even if 10% of them were to donate money it would create a substantial sum as it would include the donations of 24 million people. If they were to donate regularly, even only £1/month, that would be £24 million per month or £288 million per year. Although this gigantic amount of money could boost the economy, in reality it is not an easy thing to implement in the real world.

B. Lack of Trust

Trust is big issue in daily life in Indonesia. This is observable in a general lack of trust in government, public sectors and towards donors. This is because of cases of street fund raisers often using fictitious organizations and then using donated funds for themselves rather than for social purposes. These frauds happened on account of the absence of an integrated database of fundraising organizations in Indonesia. Only a few religious organizations are famous and well-known by society, the rest are not recognized by the public. Furthermore, fraud often happens because of the donor behavior, some do not care about the small amount of money that they donated and do not check whether the organization is legitimate.

The Pirac survey (2002: 40) revealed that giving is an independent decision that has nothing to do with the donor’s status in the family. Giving patterns after the Asian crisis were the same as patterns beforehand especially for the higher class income earners. Donor rarely donates his/her money to a single fund raising organization. Media campaigns also have a significant role in influencing people to donate their money and generate more funds. Of the four major sources of funds; individual, corporate, government and earned income from sales of product and services, the survey shows that individual giving-religious based reason is the most popular source of funds.

4.2.3 *Waqf* as one of Islamic Voluntary Sectors

4.2.3.1 Regulation on Waqf

Productive *waqf* management has been fully arranged under National Act no.41 /2004 on *Waqf* and government regulation no. 42/2006. To improve and develop national *waqf*, the UU No. 41 Tahun 2004 (National Act # 41/2004) on *Waqf* directed the establishment the Indonesian *Waqf* Board (IWB). Article # 47 point (2) states that The Indonesian *Waqf* Board is an independent institution. Article # 48 states that the IWB is located in the capital city of Indonesia and, if necessary, IWB can establish its local representative offices in either a province or a city. Since 2011, local IWBs have been established and the chairman of the IWB also inducted the local members.

4.2.3.1.1 Waqf Law based on Indonesian Act no. 41/2004

According to Indonesian National Act no. 41/2004 on *Waqf*, the *waqf* deeds are legitimate if based on *Shari'ah* law. The pledge of *waqf* cannot be nullified. The benefit of *waqf* is dedicated to public welfare and religious interests. The compulsory elements of *waqf* are *waqif, nazir, waqf* assets, pledge of *waqf*, the beneficiary, and the duration of *waqf*. Individuals, organizations and corporations can be a *waqif* or a *nazir*. The duties of *nazir* are to manage, develop, supervise, protect the *waqf* assets and report their duties to the Indonesian *Waqf* Board. In order to do their duties, the *Nazir* gets a salary equivalent to a maximum 10% of assets *waqf* net profit.

The assets can only be *waqf* assets if the *waqif* has legal ownership of that particular asset. The assets *waqf* can be land, building, plant, money, gold, securities, vehicles, rights and other perpetuity articles based on *Sharia'h* compliance. *Waqf* pledges must be stated or written in front of PPAIW with a minimum of two witnesses. These witnesses must be adult Muslims in a healthy condition. *Waqf* assets in the form of money, or cash *waqf* should be paid through Islamic financial institutions recognized by the Ministry of Religion. The Minister of Religion and Indonesian *Waqf* Board has a duty to administer the application of *waqf* assets. *Waqf* assets cannot be used as collateral, bequests or criminal proofs, donating, selling or exchanging to the other forms except when assets are used in the broad public interest in city planning and architecture, but still in line with the National Act and *Sharia'h* Law and with the Minister and Indonesian *Waqf* Board's permission. The other condition that must be satisfied as a prerequisite to replace the status of *waqf* assets is that the value and benefits of new *waqf* assets must be at least the same or larger than the previously. The duties of the *Nazir* are to manage and develop *waqf* assets productively conducive to overall *waqf* aims, functions and purposes.

To perform their duties, the *Nazir* needs to collaborate with Indonesian Deposit Insurance Corporations (IDIC), an independent legal institution established the Republic of Indonesia Law No.24 of 2004 on Deposit Insurance Corporation (DIC) dated the 22nd of September 2004, which insures *Sharia'h*-based products. The dismissal and replacement of *Nazir* must be done by The Indonesian *Waqf* Board. The reasons for dismissal include death, at the *Nazir's* request, incompetence or illegal activities. During the dismissal process, the Indonesian *Waqf* Board assures the *waqf* assets are run productively by a temporary *Nazir*.

IWB collaborates with communities, mass organizations, experts, international institutions and both local and national government bodies. IWB also considers the Minister of Religion and *Majelis Ulama* Indonesia's advice in the decision-making processes.

4.2.3.2 Waqf Management in Indonesia

The *waqf* board has become an important institution in supporting the development of Islamic communities. Most mosques, Islamic schools and other Islamic institutions were built on *waqf* land but have yet to demonstrate a significant effect on society as a whole. This can be attributed to the particular nature of the *waqf* lands, as most of them only suit being utilized for their initial purposes as declared by the associated *waqif*, such as small and regular mosques with no additional space for other productive uses. In fact, there are some lands with abundant extra spaces. Nevertheless, as the *nazirs* lack creative flair, the lands become less productive, and, in some cases, funds have to be raised by neighboring communities to cover the maintenance costs of *waqf* assets.

In Indonesia, there are very few *waqf* lands that can be managed productively through a few businesses for the benefit of the poor. The use of the assets has so far provided significant benefits to religious interests, but less positive impacts on the people's welfare. Therefore, if this keeps being practiced without more productive management of the assets, the *waqf* function as a means for initiating people's welfare cannot be realized.

The overall performance of the Indonesian economy in terms of poverty alleviation has recently been discouraging. In 2010, there are more than forty million Indonesian people living under the poverty line. Many efforts have been made by the government to prevent the situation from getting worse. One of them was to seek foreign debt. Foreign debt, recently, is considered to have reached a dangerous level, the government has not been able to appropriately solve economic and social problems. It has been predicted that the country would take years to pay the debt off, and would certainly worsen the lives of the under-poverty-line people.

Under these circumstances, in addition to well-known Islamic economic instruments (*zakah, infaq* and *sadaqa), waqf* is a potential alternative instrument to solve the socioeconomic problems of Indonesia. There is a strong tendency in public opinion towards management of *waqf* assets for merely religious purposes, rather than for people's welfare, because of a lack of appropriate information on *waqf* laws, on characteristics and purposes of the *waqf* assets, and on responsibilities of *Nazirs.* Mostly *Nazirs* perceive that *waqf* assets are only for religious interests. It is necessary to change the paradigm of *waqf* management in order to empower this Muslim economy. Therefore, Indonesian *waqf* board is aware that the time to manage the *waqf* assets in more productive ways has come.

This section provides an overview of the current practice of two *waqf* fund management institutions in Indonesia. Since fatwa of *Majelis Ulama Indonesia* (MUI) about Cash *Waqf* in 2002 has been launched, there are some *waqf* institutions which collect the *waqf* fund/ cash *waqf*. But only a few which registered their institution to IWB. However, based on the national act about *waqf* fund, every *waqf* institution has to register its institution and *nazir* to IWB and *waqf* funds have been collected by few assigned Islamic Banks called LKS-PWU (Lembaga Keuangan Syariah Penerima-Wakaf Uang/*Shari'ah* Financial Institution-Cash *Waqf* Receiver). Although in reality, hundred *zakah* institutions and religious organizations which collect the *waqf* fund under their programs but they are illegal according to national act. Nevertheless, most of *waqf* institutions in Indonesia still manage *waqf* assets such as mosque, school, hospital, and other *waqf* properties as their main portfolios.

Based on that reason, the researcher only chose two registered *waqf* institutions out of four registered *waqf* fund managements. However, *waqf* fund management is still a new institution and need more socialization to public. Various features of Indonesian *Waqf* Board (IWB) and Tabung Wakaf Indonesia (TWI) the largest *waqf* institutions located in West Java province are discussed next.

4.2.3.2.1 Indonesian Waqf Board (IWB)

To improve and develop the national *waqf*, a productive *waqf* management has been fully arranged by the National Act 41/2004 on *Waqf*. This act led to the establishment of the Indonesian *Waqf* Board (IWB), an independent institution whose elected members perform their duties for three years and can be reelected with a maximum of two consecutive terms.

Legal Issues of Indonesian Waqf Board (IWB)

According to article # 40 point (1) National Act no. 41/2004 on *Waqf*, the duties and responsibilities of IWB are as follows:

- To improve *Nazirs'* capability for managing and developing *waqf* treasury.
- To manage and develop both national and international *waqf* treasuries and abandoned *waqf* treasuries.
- To provide approvals and permissions for *waqf* assets' status.
- To officiate, dismiss, and replace *Nazirs.*
- To provide consideration, approval and/or license for correct alteration and status of *waqf* treasury.
- To provide advice and consideration for the government in the making of *waqf* policies.

On the same article, point (2) states that in doing its duties, IWB collaborates with communities, mass organizations, experts, international institutions and both local and national government bodies.

Profile of Indonesian Waqf Board (IWB)

The vision of the Indonesian *Waqf* Board is "towards a trusted independent institution, with high capacity and integrity to develop national and international *waqf* assets". Its mission is to enhance its status as a professional institution capable of realizing the potency and economic benefits of *waqf* assets for the sake of religious interests and human empowerment.

Strategies to accomplish the Indonesian *Waqf* Board's vision and mission include:

- To increase competency, national and international networks of the Indonesian *Waqf* Board.
- To compose regulation and *waqf* management policies.
- To enhance public awareness and willingness to contribute *waqf.*
- To boost professionalism and honesty of *Nazirs* in managing and developing waqf assets.
- To coordinate and develop *Nazirs.*
- To improve *waqf* asset administration.
- To monitor and protect *waqf* assets.
- To collect, manage, develop both national and international *waqf* assets.

The main duties of IWB are to manage *waqf* assets through Nazir both nationally and internationally and also to collaborate with communities, mass organizations, experts, and international institutions. The Indonesian *Waqf* Board consists of divisions, responsible for accomplishing the vision, mission and strategy of the Indonesian *Waqf* Board. They include the Division of *Nazir* Development, Division of *Waqf* Management and Empowerment, Division of Institutional Development, Division of Public Relations and Division of Research and Development.

Unresolved Conflict of Interest of IWB

IWB has performs two functions. As a *waqf* regulator, IWB decides, officiates, dismisses, replaces and improves *Nazirs*. IWB also approves *waqf* assets and considerations for the government when making *waqf* policies. As an executor and administrator, IWB also collects, manages, and develops *waqf* assets either from national or international sources. At times, these double functions can overlap and create a conflict of interest in practice.

Conflicts of interest appear where the IWB interests' for a particular *waqf* asset clashed with the other *waqf* institutions. Although such potential conflicts were realized in the early stages of regulating a *Waqf* Law, legislators kept these two functions under IWB's responsibility. The main reason for this was funding issues. The Indonesian government did not want to use the national budget to support IWB, although the establishment of IWB apparently was based on national law which obliges to cover IWB's operational costs. In the formative phase of IWB, the Indonesian government provided a special budget for its first ten years as a part of the Ministry of Religion's annual budgets. This initial funding was used for the preliminary management phase. After this initial ten year period, IWB had to be financially independent. Therefore, in the second phase of development, IWB created a *waqf* productive asset (a hospital), which was expected to generate income for the third phase of management.

In Indonesia, double functions like this are not new. BAZNAS (Indonesian *Zakah* Board) had the dual roles of regulator and executor for *zakah*. In terms of receiving and managing *waqf* funds and the *waqf* assets from the *waqifs*, IWB competes with other *waqf* institutions. As a regulator, these two functions enable IWB to regulate a particular policy, which only suits IWB itself and its own interests as a Nazir. IWB acts as *waqf* regulator and *Nazir* at the same time.

The dual tasks of the IWB raise several questions. Can good governance emerge from this situation? Is it possible for IWB to monitor and dismiss itself? There also appears to be confusion when translating Indonesian National Law on *Waqf* in the areas of corporate governance and codes of ethics. Ironically, although it governs the largest Muslim majority country in the world, Indonesia's government does not put too much interest in resolving these issues. Established by statute, the IWB should have been given the appropriate funds by the Indonesian government. Unfortunately, instead of sharing the national budget for the operational costs of IWB, Indonesian's legislative assembly preferred to give it two functions.

The *Waqf* Law also stated that Islamic commercial banks are the *waqf* fund receivers. Since 2009, *waqf* funds have been collected by few assigned Islamic Banks called LKS-PWU (Lembaga Keuangan Syariah Penerima-Wakaf Uang/Shari'ah Financial Institution-Cash *Waqf* Receiver). In doing its duties, the IWB collaborates with communities, mass organizations, experts, international institutions, and both local and national government bodies. Giving permissions to a few Islamic banks to collect the *waqf* fund created unfair circumstances towards other credible and qualified *Nazirs* from noted *waqf* institutions experienced in managing *waqf* assets. But in order to develop Islamic banks in general, this discriminatory policy can be seen as a way to increase the role of Islamic banks to further their *Sharia'h* financial activities. Finally, the IWB should not need to keep or receive the *waqf* funds alone for reasons of transparency and accountability.

Products of IWB in Terms of Regulations

The first stage of IWB establishment focused on organization consolidations, collaborated with the relevant bodies/institutions, collected, solved the *waqf* problems and legal disputes. Based on the case of *waqf* disputes in the community and high demand for new regulations and policy on *waqf*, the IWB also defined regulations:

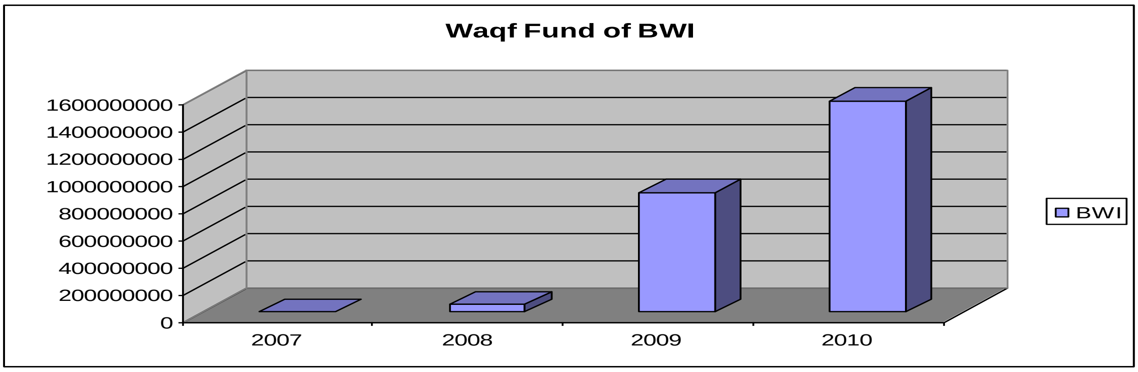
1. PMA no. 4 /2009 on administration and registration of c*ash waqf*
2. The regulation for registration of cash *waqf nazir*
3. IWB's Regulation No.1/2009 on cash *waqf* management
4. IWB's Regulation for registration and replacement of *waqf* lands' *nazirs*
5. IWB's Regulation on exchange and amendment of *waqf* assets' status
6. IWB's Regulation on IWB's local representative

Many cases related to *waqf* lands, buildings and funds have been solved by the IWB since 2008. Exchange of *waqf* assets (*istibda*l) such as lands or buildings were based on the IWB's permissions under reasonable considerations, mainly productivity and value creation. Time, human resources and the wide range of *waqf* asset distribution are the main constraints for the IWB. IWB's local representatives are permitted to use the regional offices by the Ministry of Religion. Similar to IWB, the operational costs of IWB's local representatives, based on Waqf Law no.41/2004, are borne by regional offices' annual budgets.

Assets of Indonesian Waqf Board

Established relatively recent in 2007, the Indonesian *Waqf* Board (IWB) does hold not many *waqf* assets (building, estates, lands, etc) yet but it has *waqf* funds (money, cash certificates, unmovable assets) of about IDR 2,432,427,250,00 or USD 24,324 million (based on the financial report of IWB for Des 2010). An IWB's member predicted the expected value of *waqf* assets and *waqf* funds for the next five years to be around IDR 20 billion (USD 2 million) each. This prediction is based on the high growth of *waqf* funds over the last two years. The amount of collected *waqf* funds from the last four years are shown in Figure 4.10.
IWB also manages *waqf* lands areas (2.348m^2) and a special hospital for maternity and children built on *waqf* land in Serang, Banten. With an area of 1500 m^2, this hospital has eight clinics for outpatients and fifty maternity wards.

Figure 4.10 The Amount of Waqf Funds under IWB's Management



Sources : Indonesian Waqf Board (2010)

Governance/Management of IWB

IWB has thirty members selected by the President. There are six Advisory Council Members, seven boards of executives, six divisions with two or three members to each division.

4.2.3.2.2 Tabung Wakaf Indonesia (TWI)

TWI is part of Dompet Dhuafa Republika (DDR) a well-known *zakah* management institution (Lembaga Amil Zakat) established on 8th of October, 2001 based on the decision of Minister of Religion of Republic of Indonesia number 439. Established by Dompet Dhuafa in July 14, 2005, TWI has a commitment to develop productive *waqf*. TWI uses the legal name of Yayasan Dompet Dhuafa Republika and has been registered by the Indonesian *Waqf* Board (IWB) as a *Nazir* on 16th of June 2011. The purpose of the establishment of TWI as a *waqif* is to collect, manage and distribute *waqf* assets. Nevertheless, DDR is legally only as a *zakah* institution (*Amil*) not a *waqf* institution (*Nazir*) because of complicated legal issues. DDR's vision is to use *waqf* to bolster the *ummah*'s economy whereas its mission is to support economic growth and optimalize the role of *waqf* in society.

Profile of Tabung Wakaf Indonesia (TWI)

TWI also supports the existing development of social programmes and economic empowerment provided by *zakah*, *infaq* and *sadaqah* through trusteeship and professionalism initiated by Dompet Dhuafa. The vision of TWI is to be a leading and credible institution in fundraising and managing *waqf* fund/assets productively, professional and trusting so that it actively improves social welfare

The mission of TWI is as follows:

1. To enhance society's understanding and awareness of the potential and pivotal roles of *waqf* and its contribution to social welfare.
2. To gather broadly the society resources to bring *waqf* contributions.
3. To ensure *waqf* assets can be optimized in order to produce profit and benefits for social welfare.
4. To synergize related elements of *waqf* stakeholders.

There are three sectors (health, education and social) that are beneficiaries of *waqf* funds under TWI's management. Funds are amassed from the profit of *waqf* productive investments. The organization structure of TWI includes three councilors and a director who runs daily activities, helped by three managers (asset development, operational and fundraising).

The mechanism of Tabung Wakaf Indonesia (TWI) in managing the *waqf* fund can be described as; (1) fundraising *waqf* funds, (2) managing investment portfolio and (3) distributing the profits from *waqf* investments to the beneficieries (*mauquf alaih*). In fundraising activities, TWI has started to fundraise either movable or unmovable *waqf* assets since 2001. Using *mudarabah, musharakah, ijarah,* and *murabahah contracts,* TWI invests *waqf* funds professionally. As Monzer Kahf (2003) said, the modern way to develop *waqf* fund is through a professional investment of conduct in line with *Sharia'h* law. In managing the *waq*f fund, TWI uses combines productive and non-productive approaches. TWI distributes *waqf* profits to the education, health and social sectors.

TWI receives *waqf* donations in the form of cash *waqf* (money), pure gold, dinar-dirham (gold and silver), gold jewellery, and mutual funds. These *waqf* fund/assets are registered according to their nominal values, date of donation and the beneficial targeted allocation. In general, after accumulating sufficient amounts, these *waqf* funds will be invested to productive *waqf* projects. The surplus of these investments will be distributed to the three programmes which are *Wakaf Pro Sehati*, *Wakaf Pro Cendikia* and *Wakaf Pro Hasanah*. *Waqaf Pro Sehati* (pro one-heart *waqf*) is fundraising activity which collected *waqf* were managed productively and the surplus of this productivity will distribute to free health services for the poor. The existing sub programs which joins with Dompet Dhuafa's programs as follows:

1. Eleven counters providing free health services across in Jakarta, Bogor, Bekasi, Makassar, Jogyakerta, Tuban, Palembang, Jambi and Bali.

2. Free Maternity Centre/Clinic for poor maternity mothers in Bandung
3. Two Tubercolosis Centers (TB) in Ciputat and Bekasi (West Java).
4. Twenty-seven health centers spread around in Java Islands.

In the health sectors, TWI distributes the profit of *waqf* investments to a “free health services” programme called Lembaga Kesehatan Cuma-Cuma (LKC)-Dompet Dhuafa Republika. LKC, established in 2004, is a health clinic for the poor. A recent joint project between Dompet Dhuafa and the TWI is a comprehensive hospital, which will provide free health services for the poor located in Parung, Bogor, West Java province. This hospital is expected to be operational by the end of 2012. In the near future, TWI will distribute the profit of *waqf* productive investment to an integration of hospital (Rumah Sehat Terpadu /RST). The other form of beneficiary is social funds for the needy. For example, TWI distributed the surplus of *waqf* investment by paying hospital bills for the poor who suffer thalasemia.

Wakaf Pro Cendikia (Pro Education *Waqf*) collects *waqf* and manages them productively and then distributes the surplus as free qualified education for the poor. The existing sub programmes in education are as follows:

1. Smart *Ekselesia* Boarding School for junior and senior high school for selected poor pupils from all over Indonesia.
2. *SMP Utama* is the first junior high school, with tuition fee waivers for the poor.
3. *SMK Informatika Utama* is the vocational education provider of computers especially for the poor (*dhuafa*)
4. *Sekolah Guru Indonesia* is a training centre for enhancing the quality of primary school teachers for schools in marginal areas.
5. Scholarship for undergraduate students from poor families in some noted universities in Indonesia.

Wakaf Pro Hasanah (Pro Benevolence *Waqf*) collects *waqf,* manages them productively and distributes the surplus for social activities and the empowerment of economy for the poor. The existing social sub programmes are as follows:

1. Social care services for the poor.
2. Specialized entrepreneurial training for unemployed and un-skilled younger generations.
3. Consultancy and community training in trading, crafting, farming and agriculture.

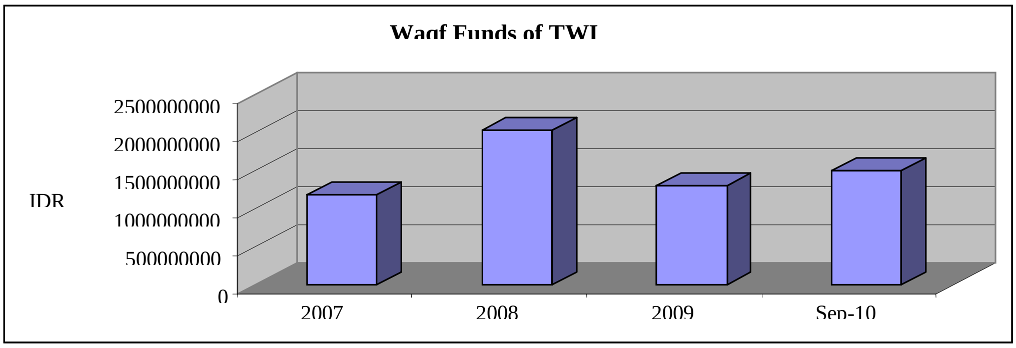
4. Enhancing economic capacity through provision of capital rotations and micro loans to poor borrowers.

Assets of Tabung Waqf Indonesia (TWI)

A. Cash *Waqf*

Tabung Wakaf Indonesia (TWI) total value of *waqf* assets (building, estates, lands, etc) IDR 13.5 billion and *waqf* funds (cash, cash certificates) totals about IDR 7.5 billion. He also said that the expectation for the value of *waqf* assets and *waqf* funds in five years time would be Rp 38 billion and IDR 22.5 billion (USD 2.25 million) respectively. The last four years figures are shown in Figure 4.11.

Figure 4.11 Amount of *Waqf* Funds under TWI's Management



Source: Tabung Wakaf Indonesia

B. Commercial Properties

TWI has various portfolios of *waqf* productive assets including three pieces of *waqf* lands in strategic areas and four *waqf* building/estates. These include:

1. Wardah Training and Meeting Centre (WTMC) Karawaci.
2. Two shops with two floors in Bekasi
3. Food court in Zamrud Estate, Bekasi
4. A shops in Depok

There are three pieces of *waqf* lands, 670m^2, 2200m^2 and 2 hectares located in strategic areas on which commercial real estate can be built.

C. Social Properties

Social properties are *waqf* assets in the form of property that can be used for social programs by Dompet *Dhuafa* or the other business partners. These include:

1. Human Development Institutions Estates
2. Free Health Services Clinics Building
3. Community Services Institutions Building
4. *Muallaf* Houses
5. Independent Institute Building
6. Integration Hospital

D. Social Business

Social business is the management of *waqf* assets productively and efficiently for optimal profits and simultaneous social benefits. The more profit, the more funds to support social and education activities for the poor. Social businesses include:

1. Islamic School *Al Syukro* Universal – Ciputat
2. Semen Cibinong School
3. *Wakala Al Waqif*
4. Dompet *Dhuafa* Futsal Court

E. Stocks (TWI's Securities)

TWI also receives *waqf* securities in the form of share of stocks from donors (*waqif*). The market value of TWI's securities on 31st Oct 2011 was IDR 258.6 million (USD 2,586) with the current composition of TWI's stock portfolios were PT. Kalbe Farma, Tbk (40.7%), PT.Astra International Tbk (21.3%), PT. Holcim, Tbk (7.1%), PT.Summarecon Agung, Tbk (3.6%) and PT. Jakarta International Hotel & Dev, Tbk (3.2%). All of these are *Shari'ah* compliant shares. The main aim of TWI's securities is to receive optimal dividends.

Governance/Management of TWI

TWI collected *waqf* funds in the form of cash and cash *waqf* certificate. Donated cash is less than Rp 1 million (US$ 100) and the *waqif* obtained cash *waqf* certificate has donated the *waqf* more than Rp 1 million. The portfolio of *waqf* fund investments contains; 40% in education, 30% health, 30% for social purposes. All operational costs for running the *waqf* assets such as schools, hospitals and libraries are financed by *zakat* funds.

4.3 CONCLUSION

A large Muslim population and high rate of poverty do not make it easy for Islamic microfinance products and voluntary sectors to develop effectively in Indonesia. In the area of microfinance, BRI is still the largest and most powerful institution because it is fully supported by the Indonesian government. BPR and two other Islamic Microfinance institutions, BPRS and BMT, struggle in fierce competition. Conventional and Islamic MFIs have mostly used the financial approach. The group-lending scheme has proven to be less successful in Indonesia. However the conventional MFIs (BRI and BPR) have shown better growth than Islamic MFIs (BPRS and BMT).

However, given the size of the Muslim population, the potential for developing Islamic MFI and voluntary sectors is considerable, as is the need for this type of microfinance. As waqf assets have not been well managed historically and their role was not made legally explicit. According to PIRAC's research, individual giving in financing NPO in Indonesia is less than 15% without including other religious groups. *Zakat infaq* and *sadaqah* (ZIS) are most common forms of individual giving based on religious grouping. The main reasons people donate money are self-interest, religious command, social solidarity, feeling of compassion and trust. This chapter also provides an overview of the current practice of two *waqf* management institutions, Indonesian *Waqf* Board (IWB) and Tabung Wakaf Indonesia (TWI) the largest *waqf* institutions located in West Java province.

CHAPTER 5

RESEARCH FRAMEWORK AND METHODOLOGY

5.1 INTRODUCTION

The previous chapters highlighted the literature on microfinance, the issue of *waqf* as a part of voluntary sector and the current implementation of voluntary and microfinance sectors in Indonesia. These two institutions, *waqf* and Islamic microfinance, work separately at the moment. *Waqf* as charity or philanthropy has not been blended in with Islamic MFI, yet. As mostly profit-oriented institutions, MFIs' structure and activities are far from the charitable activities. However, high expectations of the society in general and Muslims in particular towards Islamic MFIs do not appear to have materialized so far. As a result Islamic MFIs are perceived to be similar to their conventional counterparts and are thus criticized. Muslims are taught and encouraged to share their wealth through Islamic voluntary instruments such as *zakah, infaq, sadaqah* and *waqf.* This can be reflected in the practices of Islamic MFIs in providing services to the poor. Therefore, the combination of *waqf* funds to support the operations of Islamic MFIs would appropriately fulfill the expectations of society.

To deliver the *waqf*-MFI's idea to practice, a proper methodology is needed to investigate what the important issues in both institutions microfinance and *waqf*, in particular and external factors such as MFI's clients and regulators are in general. As stated by Gray "we may be quite familiar with a phenomenon, yet not understand how it works" (Gray, *et al*., 2007: 8). In the end, this research expects to provide a framework of how to combine *waqf* practices with the sustainability of microfinance operations. To do this, it should resolve the issues and problems related to their interconnections.

The aim of this research, as stated in Chapter One, is to investigate the scope of *waqf* and microfinance institutions in mitigating poverty and propose a framework in which they can be integrated. To achieve the aim of research, a rigorous and systematic methodology is needed to comprehend how to collect essential data from the actors of the *waqf* based Islamic MFI systems; namely MFI's clients, MFI's management team, *nazir* (*Mutawalli*), and regulator. A rigorous and systematic methodology is also needed to provide this research with sufficient information, measurable, and testable data to design a mechanism for integrating Islamic microfinance and *waqf* institutions.

A research also has a set of research objectives directly related to the research aims. According to Blaikie (2003), social research can pursue many objectives. He further states that it can explore, describe, understand, explain, predict, change, evaluate or assess aspects of social phenomena (Blaikie, 2003: 12). There are different approaches to achieving the research objectives. If the researcher tends to develop an initial description or understanding the social phenomenon, an exploratory approach is suitable but if he/she wants to know more detail including the precise measurement, description is the most suitable. Being capable of explaining what factors or mechanisms that are responsible for creating a particular phenomenon and or understanding the reasons for specific social actions are examples of research objectives.

Clear and specific research objectives help the researcher to be focused, well organized and prevent unnecessary data collection. A logical sequence combined with a consistent and rational approach should be applied in order to reveal the real problems facing *waqf* and microfinance institutions and the external factors behind them. Being realistic about time, size, budget, coverage area and specific constraints arising from the research process is also pivotal. Clear research objectives can be easily evaluated and compared to the results. In this research, elaboration of the linkage between Islamic microfinance and *waqf* institutions and identifying the important factors affecting the integration of both institutions are among the key research objectives, details of which can be found in Chapter One.

In order to pursue objectives, social researchers need to pose the appropriate *research questions* (Blaikie, 2003: 13). Punch (1998) suggests that good research questions should be clear, researchable, specific, answerable, interconnected, connected with established theory, neither too broad nor too narrow, an original contribution and substantively relevant (cited in (Bryman, 2008). Before developing research questions, the researcher should be really familiar with the area of research, based on previous experience in that area, considered techniques for enhancing creativity and thought in terms of the purposes of research (Colin Robson, 2002). Active involvement in *waqf* institutions for the last three years and conducting research on *waqf* and microfinance for many years helped the researcher become familiar with the problems and opportunities in these areas.

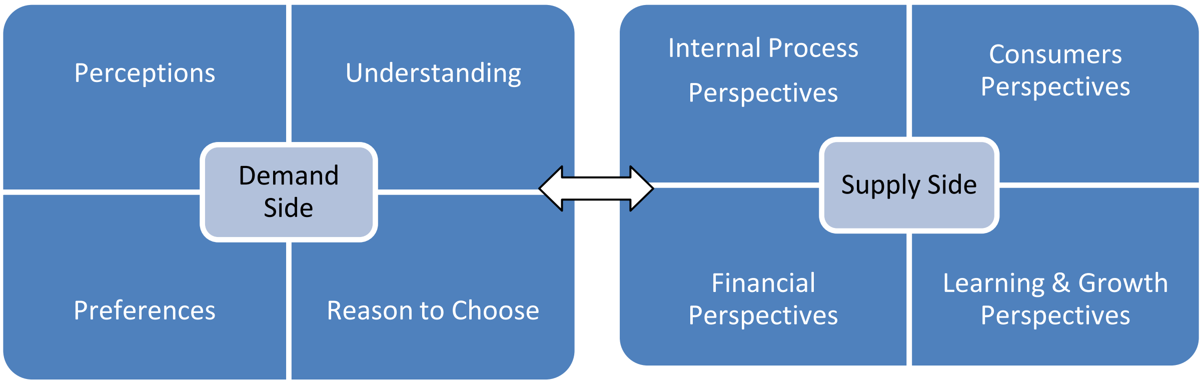
Furthermore, research questions should be able to make an adequate contribution either to the field of study or further the development of society. (Remenyi & Money, 2004: 49) assert that "settling on the precise research question will usually require several iterations" and suggest that a broad question may be a good starting point. Relevance, answerable within the time, available resources are prerequisites for research questions. There are many ways to find research questions such as brainstorming, literature review, the researcher's past experiences in particular fields, a current phenomenon, or inspiration for attending seminars or workshops on the topics of interest to the researcher. Moreover, research questions should be capable of influencing the scope, define the nature of the research and to then guide the researcher towards certain research strategies and methods. Expectations for the results should also be stated in the research questions. Once the research questions have been established, the next step is to choose the research strategy to answer the questions in a reasonable amount of time.

To accomplish the aim and objectives and address the research question, research variables and their hypothesis need to be identified. To explore the research variables, appropriate research methodology and methods need to be recognized. Using models that simplify the complexity of the real world can result in cases in which models cannot be implemented and real life problems cannot be resolved. Combining *waqf* and Islamic microfinance institutions is one such complex problem given its numerous interconnected variables. To understand these complications, this research attempts to examine the issue from different viewpoints and includes the demand side, supply side and regulator's perspectives.

5.2 RESEARCH VARIABLES AND HYPOTHESIS

In this subsection, several hypotheses were examined based on the concept and theory of microfinance as the basis for empirical analysis to increase the reability and robustness of the findings. Figure 5.1 shows the research variables which were developed and tested their hypotheses.

Figure 5.1 Research Variables



From the picture above, based on literature review, the following hypotheses are formulated:

5.2.1 Clients' Perception to the Relative Interest/Return Paid/profit rate

Hypothesis 1 : MFI's Clients' perception to their MFI's interest/return paid compared to other MFI's are equal for different type of groups of respondents

The sub-hypothesis as follows:

H_{1-1} : There is no statistically significant difference between different genders of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.

H_{1-2} : There is no statistically significant difference between different group of age of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.

H_{1-3} : There is no statistically significant difference between type of jobs of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.

H_{1-4} : There is no statistically significant difference between different type of MFI's clients and their perception about the relative interest/return paid.

5.2.2 MFI Clients' Understanding of The Concept of Islamic Microfinance Products

Hypothesis 2: The level of understanding towards the concept of Islamic Microfinance Products based on the different group of MFI's clients

The sub-hypothesis as follows:

H_{2-1} : There are no significant differences between different genders of MFI's clients regarding their lack of understanding about the concepts of Islamic Microfinance Products.

H_{2-2} : There are no significant differences among age subgroups of MFI's clients regarding their lack of understanding of the concepts of Islamic Microfinance Products.

$H_{2\text{-}3}$: There are no significant differences among the different types of MFI's clients' job regarding their lack of understanding of the concepts of Islamic Microfinance products.

$H_{2\text{-}4}$: There are no significant differences among the different types of MFI's clients' subgroup regarding their lack of understanding of the concepts of Islamic Microfinance Products.

5.2.3 Clients' Preferences for Conventional/Islamic MFI

Hypothesis 3: MFI's Clients have their preferences towards Conventional or Islamic MFI based on the different group of MFI's clients

The sub-hypothesis as follows:

$H_{3\text{-}1}$: There are no significant differences between different genders of MFI's clients and MFI's clients' preferences on Conventional/Islamic MFI

$H_{3\text{-}2}$: There are no significant differences among age subgroups of MFI's clients and MFI's clients' preferences on Conventional/Islamic MFI

$H_{3\text{-}3}$: There are no significant differences among the different types of MFI's clients' job and MFI's clients' preferences on Conventional/Islamic MFI

$H_{3\text{-}4}$: There are no significant differences among the different types of MFI's clients' subgroup and MFI's clients' preferences on Conventional/Islamic MFI

5.2.4 The Balanced Scorecard's Causal-Effect Chain

Keeping a balance between the financial and non-financial elements in the business entity is very important. Therefore, the hypotheses for the BSC's model are as follows:

H_1: Internal Process' Perspectives are positively related to Customers' Perspectives

H_2: Internal Process' Perspectives are positively related to Financial Perspectives

H_3: Learning & Growth Perspectives are positively related to Customers' Perspectives

H_4: Learning & Growth Perspectives are positively related to Internal Process Perspectives

H_5: Financial Perspectives are positively related to Customers' perspectives

H_6: Financial Perspectives are positively related to Learning & Growth Perspectives

5.3 RESEARCH METHODOLOGY

Methodology is a general approach to studying research topics and fundamental to conducting a study. "Methodology is the study of the research process itself – the principles, procedures, and strategies for gathering information, analyzing it, and interpreting it" (Gray, *et al.*, 2007: 14). Inappropriate methodology can lead to improper research results. Research methodology guides the researcher to answer research questions in an appropriate manner. However, every researcher has her/his own unique way of conducting the research. There is however no single methodology that can cover complexity of the world. The challenges which the researchers and also decision-makers (regulators) face increase continually as the systems in which they must investigate, operate and manage become increasingly complex.

Bryman and Bell (2003) state that "the inductive research approach is an approach to examine the relationship between theory and research in which the former is generated out of the latter and otherwise, the deductive method is an approach to examine the relationship between theory and research in which the latter is conducted with the reference to hypotheses and ideas inferred from the former" (Bryman & Bell, 2003: 569-570). Briefly, inductive research, a part of grounded theory, means a theory that was derived from data/observations, systematically gathered and analyzed through the research process (Strauss and Corbin 1998: 12, cited in (Bryman & Bell, 2003: 428). In this research, both inductive and deductive research approaches are inevitably combined in order to answer the research questions. The inductive elements including data gathering drawn from observation of MFI's clients, MFI managers and *waqf* managers questionnaires and semi-structured interviews. The rich information from the ground through systematically gathered data, observations and interviews was captured during the fieldwork. The deductive elements included the identification of variables derived from previous research, study literature and particular theories such as the Balanced Scorecard. In this research, the deductive method is applied to examine the MFI's performance through theory and concept of the Balanced Scorecard and also test some hypotheses related to the characteristic of MFI's client and microfinance institution performances. As such these two approaches are inextricably intertwined in order to answer the research questions.

Regarding the research questions that bind this study, the researcher realized that learning lessons from the previous studies on MFIs generally and Islamic MFIs in particular is of the utmost importance. However, careful reading of these subjects shows that the issues of each MFI are unique and depend highly on society, culture, contexts, economics and political issues where the MFIs are located. Furthermore, multiple perspectives are required in order to understanding the nature of these institutions

The next following section, research design and methods are explained in more details.

5.3.1 Research Strategy/Design

Choosing a research strategy to answer the research questions is the critical path in the research process. In investigating the real world, the researcher faces a complex, relatively poorly controlled and generally 'messy' situation (Colin Robson, 2002). A scientific attitude, systematic, skeptical and ethical must be possessed by the researcher.

Generally, there are five prominent research designs; namely experimental, cross-sectional design, longitudinal design, case study and comparative design (Bryman, 2008). According to Stake (1995), "case study research is concerned with the complexity and particular nature" cited from (Bryman, 2008: 52). In this research, semi-structured interview questionnaires can give comprehensive insight into MFIs and case studies on two *waqf* institutions can support to sustain MFIs. To answer some of the research questions, this thesis uses cross-sectional design for MFIs customers and managers and a case study of *waqf* institutions. The cross-sectional design comprises the collection of data, using questionnaires, on a series of variables related to MFI's clients' profile, loan histories and their perspectives about their own MFI and other MFIs.

5.3.2 Research Methods

The primary question that needs to be addressed is choosing the most suitable methods for a particular study. This relates to the fundamental question posed by Gelman and Cortinas (2009) in the introduction chapter on model and methods in the social science, "why do the social sciences use such different methods?"(Gelman & Cortina, 2009: 4). They state that people study different phenomena in different of fields with personal tastes, traditions and even different ideologies. Integrating them in solving applied problems needs interdisciplinary and comprehensive approaches.

The root word 'methods' came from the ancient Greeks termed '*methodos*' which means 'the path towards knowledge' and also connotes 'reflections on the quest for knowledge-gathering' (Grix, 2004: 30). Many researchers fall into the trap of allowing themselves to be led by a particular research method (*method-led*) instead of *'question-led'* research. Because of familiarity with a specific method, sometimes, many researchers modify the research questions to fit that method. Grix (2004) argues that it is against the logic of interconnectedness to determine a research method before a research question. He then suggests that methods should be seen as 'free from ontological and epistemological assumptions' and research questions should influence the choice of methods (Grix, 2004: 30). This research attempts to find suitable methods for these research questions instead of using familiar and popular research methods.

Methods are easier to explain and understand than methodology. Research methods are 'techniques or procedures used to collate and analyze data' (Blaikie, 2000: 34). Meanwhile, methodology is related to "the logic of scientific enquiry; in particular with investigating the potentialities and limitations of particular techniques or procedures" (Grix, 2004: 32)

According to King et al. (1994:5) cited in (Grix, 2004), 'the best research usually employs both methods'. Blaikie (2000) states that triangulation, combining quantitative and qualitative methods, is difficult because it involves different ontological and epistemological foundations. However, as long as the researcher carefully employs these methods and shows how one method relates to the other methods. On condition that the combination of research methods is used consistently, triangulation can be well implemented to answer the research questions.

In the next section, qualitative and quantitative methods will be explored further.

5.3.2.1 Qualitative Vs Quantitative Methods

Before selecting the most appropriate research methods, the researcher should consider time, cost and skills which are available in order to answer research questions (Remenyi & Money, 2004). In general strategies of qualitative data analysis, there are two approaches;

analytical induction and deduction. Triangulation "entails using more than one method or source of data in the study of social phenomena which can be operated within and across research strategy" (Bryman, 2008: 379). Webb *et al*,.(1966) originally conceptualized this technique as an approach to the development of measuring concepts whereby the use of one method result in greater confidence in the findings. This research uses the triangulation approach (Blaikie, 2000; Bryman, 2008; Bryman & Bell, 2003; Grix, 2004) to investigate the structure of microfinance and *waqf* institutions in Indonesia. Both qualitative and quantitative methods help the researcher to understand the problems and the systems involved. In the conceptual and empirical construction process, this research first examines the demand and supply side issues related to Islamic MFIs and then attempts to develop some policies explaining the integration of Islamic microfinance and *waqf* management in Indonesia. In the associated literature review, this study will also cover microfinance and *waqf* management experiences in different countries and historical periods. However, many research methods can be used including discourse analysis, content analysis, case studies, in-depth interview, survey, semi-structure analysis, statistical inference and archival research of historical documents.

The static picture of social life generated by the quantitative approach can be complemented by the qualitative approach which is more contextual (Bryman & Bell, 2003). Quantitative data, as concepts, comes from research questions in the form of variables operated through specific procedures that will be used to classify or measure the phenomenon being investigated (Blaikie, 2003). Therefore, using qualitative methods, the richness of information in society, contexts and other social phenomena can be gathered.

5.3.2.2 Research Method Instruments

The combination of the *waqf* voluntary sectors and microfinance institutions is a relatively new model and there is no particular theory suitable for explaining and combining these two institutions. Hence, a deductive approach cannot be implemented, as there is no theory and hypotheses to be tested. As many types of microfinance practice exist in different countries, cultures and contexts, the inductive approach is more suitable to explore the relationship between the two concepts.

Quantitative techniques including identifying general patterns and relationships between variables, testing hypotheses and theory, making predictions based on these results (Ragin 1994: 132-6 cited in (Grix, 2004). Using some quantitative data processing such as statistical packages, such as SPSS, in order to understand the phenomena and also to present data analysis is essential for some certain conditions. However, some aspects of human beings (behaviour, attitude, opinions and tastes) are difficult to measure quantitatively but these aspects are also involved significantly in making decisions, judgments and valuations. Nonetheless, Grix (2004: 117) asserts that "no one can be fully detached from any type of research – or offer a value-free analysis – precisely" because researchers have their own assumptions which completely accumulated from their backgrounds, experiences and knowledge. Therefore, these problems can be studied by using a qualitative approach to complement quantitative methods and acquire a holistic understanding of certain phenomena.

5.3.2.2.1 Data Collection Tools

There are many kinds of data collection tools: interviews, questionnaires and diaries, tests and scales, observation and using documents and secondary sources (Collin Robson, 2007). Fully structured, semi-structured, unstructured, group and telephone interviews can be used, each with advantages and disadvantages. Multiple tools complement each other perfectly to gain more information to answer research questions. Data are simply regarded as something we collect and analyze in order to arrive at research conclusions (Blaikie, 2003: 15). Even data generated first-hand by a researcher has already been subjected to some processing. As we have seen, there is no such thing as 'pure' data. A researcher may also use data that have been collected by someone else, either in a raw form or analyzed in some way. Hence, social research can be conducted that is more than one step removed from the phenomenon (Blaikie, 2003: 18).

A case study is the study of a case of a person, an organization, an office or more widely a global event. Case studies have used a wide variety of data collection methods. According to Yin (1994:1) cited in (Grix, 2004), there are three types of case-study; descriptive, exploratory and explanatory. This research chooses the exploratory case study to extrapolate MFIs and *waqf* institutions. An in-depth case study is conducted for three kinds of institutions; namely *Waqf* Board Indonesia (IWB) as an independent body selected by Indonesian government which supervises *waqf* assets and institutions, *Tabung Wakaf* Indonesia (TWI) as a private *waqf* institution that collects, manages and redistributes *waqf* assets and finally conventional and Islamic microfinance institutions which lend and manage microfinance/credits.

This research has been conducted by collecting both primary and secondary data using qualitative and quantitative research methods. Mostly, the researcher used primary data for the empirical data analysis and also to test the research hypothesis. Primary data is chosen deliberately because it is the most suitable ways to understand the field which the data is not previously available. Churchill (1983) suggests that primary data collection in most suitable for the following data type: (1) Demographic/Socioeconomics Characteristics; (2) Attitudes/opinions; (3) Awareness/Knowledge; (4) Intentions; (5) Motivation; and (6) Behaviour.

A ‘combination of open and closed questions’ provides the field information to answer the research questions. The open-ended questions provide richer qualitative data, which are not as easy to analyze as quantitative data. On the other hand, closed questions do not give the interviewee an opportunity for personal opinion and expression.

For multi-response questions, the researcher used four types of questions as identified by Veus (2004). Closed questions can be of two types: multiple answers and ranking responses. Open questions can evoke both limited and unlimited numbers of responses (Veus, 2004: 10). MFIs clients were asked to rank their decision making criteria based on for selecting an MFI as borrowers, consciously or unconsciously, have preferences when choosing an MFI. The logic of the multiple-response method can be used for ranking questions (Veus, 2004: 15).

Furthermore, Saunders *et al.,* (2000) identify different open-ended and closed-ended questions types as follows:

• **Open-ended questions**: the researcher does not provide any set of responses. Instead the respondents are free to answer in any way they choose.

• **Closed questions**: respondents should make choices among a set of alternatives given by the researcher. They help respondents make quick decisions and the researcher can code the information easily.

Closed-ended questions can be classified into the following types:

- List questions: offer the respondent a list of responses any of which they can choose. Such questions are useful when the researcher needs to ascertain that the respondent has considered all possible responses.
- Category questions: designed so that each respondent's answer can fit only one category. Such questions are useful to collect data about attributes.

- Ranking questions: ask the respondents to place things in rank order. Such questions are useful to discover the relative importance to the respondents.
- Quantity questions: asks the respondents the amount of a specific characteristic and tends to be used to collect behaviour or attribute data.
- Grid questions: enables the researcher to record the responses to two or more similar questions at the same time.
- Scale questions: often used to collect attitude and beliefs data. The most common approach is the Likert scale in which the researcher asks the respondents how strongly they agree or disagree.

To process and analyze collected data, descriptive statistics can be applied, however, statistical analysis is considered a servant tool to help answer research questions, not a master of science. Well designed data collection techniques are extremely important to get sufficient information in order to answer research questions. Blaikie (2003) suggests that measurement of events or people to discrete categories, categorical measurement, is attained either by the assignment of objects, or by the identification of their characteristics on a numerical scale, *metric* measurement. Within these *levels of* measurement are two further levels: nominal and ordinal, and interval and ratio, respectively (Blaikie, 2003: 22).

Most data sets used to explain survey results in this study consisted of various graphical and numerical summaries. Different methods are needed to display categorical data. "Sophisticated numerical transformations, for example responses to a set of attitude statements, in categories ranging from 'strongly agree' to 'strongly disagree', can be numbered, say, from 1 to 5 can occur as part of the analysis stage. " (Blaikie, 2003: 21).

A multi-method (Stiles, 2001), a multi-strategy case study (Bryman 1988, 1992; Hammersley, 1996; Morgan, 1998; Kanter, 1977; Truss, 2001) are examples of triangulation practices in research. Multi-method research design is required in order to understanding fully the nature of *waqf* institutions, microfinance institutions and the actors involved in the daily activities of these institutions.

The following methods were used in this study:

1. **In-depth semi-structured interviews** with two *waqf* institutions, seventeen board directors of MFIs and the head of BRI's microbanking were conducted in order to

develop a grounded understanding of their activities and the problems within institutions. There were two steps: (a) Preparation of Interview and (b) Process of Interview. The preparation for meeting and interviewing the MFI's managers and *Nazir* (*Waqf*'s Manager) took a long time. During the first phase, the researcher found the MFI's phone numbers in the yellow pages and made a phone call. Mostly the secretary or customer services answered the phone and asked for a formal letter to conduct research. In the second phase, a formal letter and questionnaires were sent to each MFI and *Waqf* institution while followed up by phone to get a time for meeting. After waiting for reply for two weeks, only about 20% of MFIs managers replied and were willing to participate. In the third phase, the researcher followed up by sending a short message to the manager's personal mobile phone. The researcher got these mobile numbers from journalists of local newspapers in Bandung. For BMT, the head of the group kindly shared the managers' mobile phone numbers. Most of them asked the researcher where the researcher got his/her phone numbers. Finally, only 18 MFIs managers out of 25 managers (72%) with the composition 6 BPRs, 5 BPRSs, 6 BMTs and 1 BRI's managers who willing to participate in interview sessions. Two *waqf* managers were also willing to participate.

(b) Interview Process for MFI's and *Waqf* Managers. A total of 18 semi-structured interviews were conducted out of 25 MFIs. Two *waqf* managers were involved in this research. MFI and *waqf* managers were given a set of semi-interview questionnaires which combined closed- and open-ended questions. For open questions some of managers wrote their answers directly on the questionnaires, other returned it by email. Some managers finished the questionnaires in one meeting and others preferred to finish the questions over a few days. For this condition, the questionnaires was left in his/her office and collected after a few days.

2. **Questionnaire distribution** to 650 MFI clients. The area survey was divided into six clusters, and we interviewed around ±110 randomly selected MFIs borrowers at each area. Total of 581 questionnaires out of 650 sent questionnaires qualified to be used for quantitative data analysis in this research. Hence, the return rate on questionnaires is 89.4%.
3. **Secondary data analysis** on *waqf* and MFI institutions. Prospectuses, financial reports, and supporting documents and information from websites were collected to support the findings.

4. **Case-study** on two prominent *waqf* institutions were undertaken to identify their characteristics.
5. **A focus group discussion (FGD)** with the directors/managers of MFIs, Head of BRI Micro-banking and regulators from the Indonesian Central Bank was conducted in order to open reciprocal communication between MFI players and policy makers to understand the classical problems of MFIs and the policies behind them. A simple FGD (Focus Group Discussion) was organized at the University Padjadjaran, Bandung in order to ascertain a comprehensive picture of current issues. This discussion was attended by about 150 students, 18 directors of MFIs (respondents to this research project), 15 academicians, a senior staff member of from the central bank as a regulator. Four main speakers, the director of BRI Shari'ah (BRIS), the director of BPN Shari'ah (BPNS), a senior division head from the central bank and one lecturer presented papers. After four speakers shared their papers for 15 minutes each, there were Q&A and discussion sessions for 30 minutes.

5.4.3 Research Population and Sampling

Conducting a census would have been the best way to collate information from each individual of the population but would have been costly and time-consuming. As such, a group of Islamic and conventional MFIs clients, a group of Islamic and conventional MFIs managers and a group of nazirs of *waqfs* from the research population for this study.

There are several conditions which the researcher should be aware of regarding sampling. There are thousands of microfinance institutions spread over the three time zones in Indonesia with different types of ethnic groups residing there. Thus, it is difficult, if not impossible to take a random sample of the population. There is insufficient information from secondary sources suitable for fulfilling the research questions. Therefore, using primary data on MFI's performance and structure from a particular city, Bandung, was the only reasonable way to approach the research questions.

However, Bandung is one of hundreds of cities in Indonesia and Bandung cannot represent the characteristics of Indonesia in general. However, almost all ethnic groups in Indonesia can be found in Bandung. People who live in Bandung are multi-cultural with varying education backgrounds. Bandung has the highest density of population in Indonesia. More than one thousand micro, small and medium enterprises underpin Bandung as a tourist destination and an education city in Indonesia.

The second reason why the researcher chose Bandung is that Indonesia is a large country with a population of about 237.6 million spread over more than 17,000 islands with three time zones. It would be impossible for the researcher to conduct a survey covering Indonesia in general due to limited budgets, time and personnel. The third reason is that the researcher has lived in Bandung for more than 20 years and thus is familiar with the specific character of the people, cultures, the way of life, the dynamic environment and other information needed to conduct an appropriate investigation.

5.4.3.1 Sample Frame and Determination of Sampling Methods

A sample is part of the population that is selected for investigation (Bryman, 2008: 169). A simple, well designed and structured sample, as representative as possible of the population, can give accurate information about the population and also help to reduce bias. An error in estimations based on a sample is inevitable as the whole population is not sampled. This discrepancy is called a sampling error.

There are probability and non-probability samples. A probability sample is a randomly selected sample in which each unit of the population has a known chance of being selected. Furthermore, there are four types of probability sample i.e. simple random sample, systematic sample, stratified random sampling and multi-stage cluster sampling (Bryman, 2008). On the contrary, non-probability sample does not use the random selection method to take a sample so there are chances for some units to be selected more than once.

Based on the dispersion of MFI borrowers over a large area of Bandung, we used multi-stage cluster sampling. The population in the city and regency of Bandung is around 3,178 million but the population of MFI's clients is unknown. There is no accurate data on MFI clients because many clients are registered with more than one institution. Therefore, Bandung was divided into six clusters and ±110 MFIs clients were randomly selected in each area. The researcher has modified the sampling strategy and used the nonprobability sampling which is more suitable for unknown population (Zikmund, 2003, Saunders *et al*., 2007). Time and cost were relevant considerations in determining the sample size which is ±110 MFIs/cluster. The client data of BRI, BPR and BPRS which are supervised by the central bank can be traced and it is easily known if they have a double registration. In reality, there is no single rural bank concerned about status of clients with regards to other commercial/rural banks as long as the clients fulfill their borrower requirements, especially regarding collateral. Furthermore, no-one can trace them if they are also registered with the BMT, other cooperatives and self-help groups because BMT and cooperatives are supervised by the Department of Cooperatives.

There are four types of sampling design; convenience sampling, probability sampling, systematic sampling and quota sampling (Griffiths, Stirling, & Weldon, 1998). For this study, nonprobability sampling designs were preferred because these designs are suitable for unknown MFI clients' population. Client lists were given by MFI officers to the researcher. Based on this information, the interviewers selected clients with purposive sampling approach. In the beginning, the respondents were chosen randomly based on the list. However, after one month the surveyors visited the respondents in traditional markets spread across the city. In the field, random sampling technique is hard to apply due to many reasons such as respondent's reluctance to be interviewed, the difficulty to arrange a meeting time, and spending more money and time. Most traders in traditional markets are MFI clients. The other place where it is easy to find MFI clients is in government institutions. Institutional collaborations with an MFI are common. This kind of collaboration reduces risk for the MFI because the monthly credit payment is directly debited from borrowers' monthly salaries.

Akin to MFI clients, the approach taken to collect the information from MFI and *waqf* managers also used nonprobability. Non-probability sampling with a purposive or judgmental sampling technique was adopted. According to Saunders *et al.* (2007: 230), non-probability sampling is more frequently used for a case study strategy and works with very small samples.

As discussed earlier, the researcher could not select respondents from MFI's managers randomly due to the limitation of MFI's involved (18 MFIs) and the availability of time and number of MFIs in Bandung area. To arrange a meeting with MFI's managers and get the intended information took quite a long time. After sending letter, email and making phone calls to 25 MFIs around Bandung area, only 18 managers gave positive responses and were willing to be interviewed.

Choosing only two *waqf* institutions to be in the sample was another issue. They are very few noted and credible *waqf* institutions that have transparent information on professionally managed websites. There are not too many *waqf* institutions as it is a highly specialized field with very unique characteristics.

5.4.3.2 Pilot Testing

A pilot study is an essential part of the research design process. A pilot study should be conducted before administering questionnaires and semi-structured interviews. Not only did the researcher ensure the survey questions operate well, but he/she should also ensure that the research instrument as a whole functions well (Bryman, 2008). Furthermore, pilot survey should be carried out before deciding on the sample size (Griffiths, *et al.,* 1998: 235). Before distributing the questionnaires to targeted respondents, the researcher conducted a pilot study for two weeks in the field and tested whether the respondents could understand the questions on the questionnaire and reply appropriately.

After conducting the pilot study, changes were made to the format of some questions for MFI clients. After pilot testing, there were 25 questions including the general profile of MFI's clients. When doing the pilot testing, the interviewer was given a tape-recorder to record the conversation. Unfortunately, MFI managers were reluctant to do the interviews when the conversation/interview was recorded. Surprisingly, almost all of them stated their objection concerning the tape-recorders. Therefore, the interviewer decided not to use the recorder but write down as much as possible in a minute-book.

Initially, there were 37 questions for MFI managers. After pilot testing, the researcher removed five irrelevant questions and was finally left with 32 questions including the institutional profile. The other set of questionnaires for MFI managers were managers' perceptions of customer perspectives. There were no alterations required for *waqf* manager interview questions and the 11 questions concerning *waqf* institutions remained unchanged.

5.4.4 Quantitative Data Analysis

Various methods should be considered carefully before choosing the appropriate methods most suited to analyze the data. Sophisticated methods that prove to be irrelevant in answering our research questions and do not with the data should be avoided. Marchi (2005) states that in doing a study some basic important questions must be raised: What are the parameters or basic assumptions of the model? Where do the variables come from? Is the form of empirical research quantitative or qualitative or both? (Marchi, 2005: xxi).

It must be noted that the number of MFIs and *waqf* institutions in the sample is relatively small and does not fulfill the assumption of normal distribution. Therefore, to analyze the data with non-normal distribution and small numbers, non-parametric statistics were used. This was not the case for MFI clients, as 581 respondents is a sufficiently large number for parametric analysis but because of using the non-probability sampling technique (non-random sampling) in collecting data, non-parametric testing is considered more lenient. Additionally, many variables in the questionnaires were based on discrete categories. Therefore, non-parametric is the most appropriate inferential statistic testing for the empirical data analysis.

In this research, MFI's clients were asked to rank their priorities in determining the reasons to choose a MFI. Cross-tabulation, Kruskal-Wallis and The *Mann–Whitney U test* are used to analyze group and categories in order to make comparisons between two or more among groups within the same categories or otherwise. Cross-tabulation is used to see the relationship between groups and categories and compared them within the same categories (Zikmund, 2003). In this research almost all empirical data were analyzed by cross tabulation to compare different type of MFIs with various categories.

The Kruskal-Wallis one way analysis of variance is used to analyze the ranks from two or more independent groups particularly for non-normal distribution (nonparametric statistics) (Vaus, 2004: 77). The Kruskal-Wallis test which using the K independent samples procedure must have scores on an independent variable. Independent variable divides individual into two or more groups. It has a similar function to the Mann-Whitney U-test in order to measure the differences between samples in a group or category. The difference lies in the number or groups. Whereas the Mann-Whitney U-test is used for two categories, Kruskal Wallis analysis is used for three or more categories or groups (Field, 2005; Pallant, 2007). In this study, the Kruskal-Wallis test was used to determine whether there are any statistically significant differences in terms of lack of understanding levels between four Islamic MFI's product concepts and clients' preferences across four age groups, three job types and four different types of MFIs.

Similar to the Kruskal Wallis analysis, the Mann-Whitney test (U-Test) is employed in comparative analysis in order to assess any significant difference in the responses from different gender subgroups involved in this survey. The Mann-Whitney test (U-Test) is also a distribution-free test appropriate either when the parametric requirements of the *t* test cannot be met (in particular, when the distribution of the population on the variable being considered is not normal) or with ordinal-level variables. It is a test that is equivalent to the independent t-test for parametric statistics. Hence, the data may be metric but the procedure is non-parametric (Blaikie, 2003: 197). Because of using non-probability sampling method which made the MFI's clients data being tested by nonparametric statistics. In this statement, Blaikie states that in the terms of their quantity and characteristics, data can be called parametric but if their distribution is not normal so that the non-parametric statistics can be applied or otherwise. This test is used when members of two categories, i.e. gender can be ranked in terms of their scores on the same variable. It is an appropriate measurement for differences between two independent samples from the same populations (Field, 2005). In this research a Mann-Whitney U Test was used to determine whether there was statistical difference between gender with the various categories.

Chi-square (χ^2) is a nonparametric test that determines whether a relationship between the two variables can be considered for a goodness-of-fit and also independent. Chi-square (χ^2) tests of significance are often used in contingency table analysis when at least one of the variables concerned is at the nominal level. Associational analysis is an elaborate form of description in which the patterns or connections between variables are investigated. Spearman's rank correlation coefficient (rS) measure of association is used with a small number of objects, events or individuals that are given unique rankings on two variables (Gray, *et al.*, 2007: 321). The Pearson correlation coefficient (r), *a well-used measure of association*, can be tested for statistical significance (Gray, *et al.*, 2007: 428).

The other issues related with applying inferential statistic instead of multivariate analysis or even econometric models. Since this research has focused on the exploration of demand and supply of MFIs, multivariate analysis and econometrics are not relevant with the research objectives. Data gathered were also cross-sectional instead of using time series data which are commonly used for econometrics models. There is no research objectives which focuses to predict the outcome of the dependent variable based on the fluctuation of independent variables in this research. Therefore, there is no need to apply multivariate and econometrics approach to answer the research questions and fulfill the research objectives.

5.4.4.1 Weighting and Scoring

Rating is one of strategy for weighting index items when each index item contributes equally to the overall score (Gray, *et al.*, 2007). In the indexes of balanced scorecard perspectives for an MFI, the various questions asked may be designed but no one perspective is deemed to be more important than the rest. Each item in the index has an equal chance of contributing to the total. Nonetheless, sometimes some questions or elements of the composite measure are judged to be worth more than others. In such cases, the weighting of index items is desirable.

The weighted scoring method, known as "weighting and scoring", is one of the appraisal resources tools. Weighted and scoring is widely used in multi-attribute or multi-criterion analysis. The Department of Finance and Personnel of Northern Ireland (DPFNI) also uses the weighted and scoring methods (WSM) to do appraisal and evaluation (DPFNI, 2012). Furthermore, the WSM allocates weights to each of the scores to reflect their relative importance and the allocation of scores to each option to reflect how it performs in relation to each attribute.[15] Thus, a weighted score for each option can be used to indicate and compare the overall performance of the options.

The process of deriving weights and scores (DPFNI, 2012) is illustrated as follows:

1. Identify relevant attributes
2. Assign weight attributes to reflect their relative importance
3. Score options to reflect how each option performs against each attribute
4. Calculate weighted scores
5. Test results for robustness
6. Interpret results

The judgment for the assignment of weights is made by the researcher, based on theory or on prior estimates of the behaviour that the index is designed to measure (Gray, *et al.*, 2007: 384). Various scoring formats are frequently used in social research. Starting with the simplest form, a positive answer (one indicating the presence of the variable under investigation) might be

[15] www.dfpni.gov.uk/eag-the-weighting-and-scoring-method - Accessed on 2nd April 2012.

assigned a score of 1, and a negative answer, a score of zero and then the most intricate numbering schemes. Some type of questions for MFI's managers used the scoring format mentioned above. The other types of questions for MFI's clients and managers used 'the forced ranking techniques'. In the forced ranking technique, respondents are asked to arrange a fixed set of items in order of importance (Gray, *et al.*, 2007).

Gray (2007), furthermore, provides an example whereby a researcher may instruct respondents to assign numbers 1–6 (1 being most important) to each of the following characteristics of an "ideal date". Similar to Gray's example, MFI clients were asked to rank economic and non-economic variables in order of their importance. Other than the variables mentioned above, MFI clients and managers were also asked to rank the four types of MFIs. The advantage of this format is that each item may be ranked against the others. Although we can determine whether a respondent thinks that one variable is more important than another or vice versa, the forced-ranking format does not enable us to discover the importance of each item for the respondents in a personal sense (Gray, *et al.*, 2007).

Since the Balanced Scorecard (BSC) provides the more "balanced" and "integrative" financial and non-financial perspectived of a microfinance institution, it is used to compare the performance of MFIs in our samples. BSC approach is used mostly to observe a particular organization's overall performance over time, but in this study, it was used to compare the performance of microfinance institutions based on four of the BSC's elements with cross-sectional data.

We used scoring methods as a measurement tool to analyze the BSC elements with the following steps:

1. The result of semi-structured interviews with MFI managers was processed into particular scores and compared to each other on four BSC elements.
2. These scored elements were standardized and averaged for each group of MFIs. Standardization means that all the scores were divided by the highest score in each category so that the highest value after standardizing was 1 and the lowest was 0.
3. MFIs were grouped and then ranked within a reference group (of other the same type of MFIs).
4. For "yes/no" questions, answer 'no' was scored 0 and answer 'yes' was scored 1.

5. For “multiple choice” questions, scoring started from 0 to 5 with details as follows: Answer A was scored 0, B was scored 1, and so on. A weighted total score can be derived by multiplying the scores by their numbers of different ranking of various different criteria, categories, priorities or products (Ahmed, 2011).

5.4.5 Qualitative Data Analysis

In general, there are three activities of qualitative data analysis: data reduction, data display and conclusion (Miles & Huberman, 1994). The process of selecting, focusing, simplifying, abstracting and transforming the data from written-up field notes or the data collection process are part of data reduction. One of the main reasons for conducting qualitative research is because a problem / issue need a complex approach and to be explored in detailed understanding of the issue (Creswell, 2007). Miles described qualitative data as an ‘attractive nuisance’, because of the attractiveness of its richness but robust analytic paths are hard to find (Miles, 1979 cited in (Bryman & Bell, 2003: 425).

In this study, as discussed in sub section 5.4.3, the interviews with MFI managers used inductive approaches with particular tools, coding and comparison. A case study as an intensive analysis of *waqf* institutions and a combination of interview and documentary data collections, was also processed with qualitative data analysis. The coding process reviewed field notes from in-depth interviews.

5.4.6 Data Validity and Reliability

The collection of data or the result of a study are deemed reliable if the researcher observes essentially the same results when a measurement is repeated under the same conditions (repeatable).Validity refers to whether or not something actually measures what it claims to measure or the integrity of the conclusions that are generated from a piece of research (Bryman, 2008; Collin Robson, 2007). They then say that ‘if it is not reliable, it cannot be valid because validity presupposes the reliability but on the contrary a measure can be reliable without being valid’ (Bryman, 2008; Krippendorff, 2004; Collin Robson, 2007). Consistency in measuring concepts in the social sciences (such as customer perspectives, institution performance, process, growth) is pivotal in terms of reliability issues. Stability, reproducibility and accuracy are the criteria for data which are claimed to be reliable (Krippendorff, 2004).

Data are called stable if a respondent answered with the same answers for the same questions, which were given to him/her on different occasions. The data is also reproducible and replicated in general wide-based terms for use by others. Accuracy can be tested by the reliability test.

According to Bryman (2008), there are three validity matters i.e., internal, external and ecological validity. Internal validity relates to the causality or relationship between variables, whether independent or dependent. External validity relates to how representatively samples explain the behavior of the population. Ecological validity deals with the capability of instruments to summarize the opinions, behaviors, attitudes, perspectives, values, daily life conditions and knowledge of those studied as articulated in their usual environment. In this study, three validity issues were anticipated from the beginning of the research process i.e. determining sampling criteria, determining research variables, choosing suitable methods for data collection and analysis. However, the measurement should represent the concepts to be called valid. Therefore, it is highly recommended that before collecting the actual data, the researcher ensures that the content and measurement of variables in the questionnaires is reliable and valid (Vaus, 2004). The pilot project minimised most problems with regards to validity and reliability matters. To increase reliability, in the pilot testing, it was ensured that questionnaires were well designed in order to be simply understood by all types of respondents.

5.4.6.1 Cronbach's Alpha Test

Cronbach's alpha coefficient measures the internal consistency reliability which refers to the "degree to which the items that make up the scale -hang together-" (Pallant, 2007: 95). Cronbach's alpha coefficient test is conducted to determine the consistency of a respondent's answer for one item compared to other scaled items (Vaus, 2002). In this research, MFI's managers' answers in in-depth-interviews, their perceptions and preferences are compiled, weighted and scored in particular scaled items. All scores are categorized into particular BSC's perspectives. Internal consistency reliability of these scores was measured by Cronbach's alpha. The results of Cronbach's alpha ranged between zero and one. The higher the score of the test, the more reliable the scale will be (Pallant, 2007; Vaus, 2002). According to Pallant and Vaus, it is deemed reliable if the result is at least 0.7 (highly internal consistency). The result of this study's interviews with MFI managers based on the Balanced Scorecard (BSC) showed a Cronbach's alpha coefficient of 0.844 (see the Table 5.1).

Table 5.1 Result of reliability test

Reliability Test for MFIs			
		N	%
Cases	Valid	18	94.7
	Excluded[a]	1	5.3
	Total	19	100.0

a. Listwise deletion based on all variables in the procedure.

Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.782	.844	25

Questionnaires for the supply side used the weighting and scoring methods for the BSC elements. Cronbach's alpha coefficient indicator for all questions in this study was 0.844 after considering the 25 items that used the scale. The value of 0.844 is above Cronbach's alpha coefficient 0.7. Therefore, the scale used in this research has a good level of internal consistency and is also reliable.

The methodology and methods suitable for addressing the research questions and achieving the research aims and objectives are summarized in Table 5.2 below.

Table 5.2 Summary of Research Methodology and Methods

	MFIs		**Waqf**
	Supply (Institutions)	**Demand (Clients)**	**Supply (Institutions)**
Methods	Semi-Structure Interview Questionnaires	Questionnaires	Semi Structure Interview Secondary Data
Number of Observations	Conventional : BRI (1) and BPR (5) Islamic: BPRS (6) and BMT (6)	Clients/Borrowers 581 samples	Waqf Institutions (2) IWB and TWI
Analysis	Statistic Non Parametric, Weighted & Scoring	Mann U , Kruskal Wallis, NonParametric	Qualitative
Variables/ Findings	The Balanced Scorecard	Perception, Preferences, Reasons, Rankings	Profile Analysis
Results	Comparative Analysis		
	Conclusions & Recommendations		

5.5 CONCLUSIONS

This chapter comprehensively discussed the research methodology and methods used in this study. The chapters highlighted the process of determining the proper methodology and methods used with the intention of achieving the aim of this research. Three groups of respondents, MFI clients, MFI managers and *Waqf* managers (*Nazir*) were facilitated by a series of questions in order to elicit opinions. In-depth semi-structured interviews, distributing questionnaires, secondary data analysis, case-study, and a focus group discussion were selected as data collection methods.

This chapter also discussed how to reveal unique profiles and characteristics of clients on the demand side and institutions on the supply side by using appropriate methods. Thus, subsequently, how respondents' perceptions, preferences, reasons, choices could be measured with the proper tools were also discussed. Quantitative and qualitative methods are used for comparative analysis in this study. Various matters relating to population, the sampling process and the experiences and lessons learned during fieldwork were also discussed. The discussion of the research process culminated with an assessment of its validity and reliability.

CHAPTER 6

PROFILES, PERCEPTIONS, UNDERSTANDING, PREFERENCES AND REASONS OF MFI'S CLIENTS IN CHOOSING A MFI : DEMAND SIDE DATA ANALYSIS

6.1 INTRODUCTION

This chapter reports results from the MFI demand side variables: client profile, existing patterns of loan, understandings of Islamic products, perceptions, preferences, rationale for selection of a particular MFI and overall MFI ranking by clients. In addition, the perceptions and preferences of MFI clients are also presented in order to recognize and understand the demand side of microfinance sectors. This survey examines the profile of MFI clients of conventional and Islamic MFIs. As indicated in Chapter Five, the questionnaires were sent to 650 MFI clients in Bandung and a total of 581 MFI clients responded to the questionnaires. Data on the general profile such as gender, age and job were sought. Furthermore, data highly related to client's history with an MFI are also provided in order to support the analysis.

The chapter is organized as follows: a profile of MFI clients, followed by their perceptions, understanding and preferences. In the last section, clients' reasons for choosing an MFI and their perspectives as regards the MFI's ranking are also presented.

6.1.1 Profile of Microfinance Clients

Some basic profiles of MFI clients in the sample are presented as follows. Table 6.1 below shows that in general the proportion of males (56%) in the sample is larger than that of the females (44%). The majority of the respondents of BMT, BPR and BPRS were male. Although BRI shows that females were more than men, the gap was slightly different. These findings are in line with the characteristics of MFI clients in Indonesia. Females and males have the same opportunity as long as they qualify to get a micro-loan through a similar screening process.

Table 6.1 Gender of MFIs

Gender of MFI's Client			
MFIs	**Female**	**Male**	**Total**
BMT (IsMFI)	43	64	107
BPR (ConvMFI)	43	100	143
BPRS (IsMFI)	53	70	123
BRI (ConvMFI)	115	93	208
Frequency	254 (43.7%)	327 (56.3%)	581

The majority of MFI clients' ages range was between 30 and 41 years old (56.5%), followed by clients aged between 42 and 52 years old (28.5%), younger and up to 30 years old (13%) and only 2% of the sample aged over 53 years old (see table 6.2). Each MFI shows a similar proportion of patterns of clients' age group.

Table 6.2 Age of MFI's clients

Age of MFI's Client					
MFIs	**< 30**	**30 – 41**	**42 - 52**	**>53**	**Total**
BMT	15	64	26	2	107
BPR	29	85	27	2	143
BPRS	18	68	34	3	123
BRI	14	110	78	6	208
Total	76 (13%)	327 (56.5%)	165 (28.5%)	13 (2%)	581

Note: BMT = Islamic MFI (Is) BPR = Conv MFI (C) BPRS = Islamic MFI (Is) BRI = Con MFI (C)

Data shows that MFIs tend to give loans to younger clients especially by BMT, BPR and BPRS. But it is completely different with BRI in which the proportion of the group aged 30-41 years old is almost equal to the group 42-52 years old. This fact can be explained partly by observing the data in Table 6.3 regarding the job of MFI's clients.

Most BRI clients are permanent employees in the government or private sectors. For clients with permanent jobs, the range of ages between 30 and 52 do not make a difference because they can pay the loan with their permanent salary every month. BRI can give a client a lower interest rate as long as the government or company offices have prior mutual understanding or an agreement with the BRI. For these purposes, BRI requires a guarantee from a government or company treasurer that every month their salary would contribute towards the loan payment directly. This can be done by BRI as it is a state bank, which puts it at an advantage to overcome the fierce competition among MFIs in Indonesia.

Table 6.3 Job Types of MFI's Clients

Job Type of MFI's Client				
MFIs	**Government employee**	**Private**	**Others (informal)**	**Total**
BMT (Is)	7	54	46	107 (18.4%)
BPR (C)	11	66	66	143 (24.6%)
BPRS (Is)	5	62	56	123 (21.2%)
BRI (C)	85	39	39	208 (35.8%)
Frequency	108	221	221	581
Valid Percent	18.6%	38%	43.4%	100%

Table 6.3 shows that the majority of clients' jobs in the sample are not as government (18.6%) or private company employees (38%) but other informal jobs (43.4%) such as petty traders, micro entrepreneurs and peasants. It is clear from Table 6.3 that BMT, BPR and BPRS do not choose government employees as their target market but they chose private and informal sectors. These MFIs are active in the high-risk market but with potential higher returns.

Government employees, BRI's target market, have particular characteristics: a fixed income, the lowest risk (almost zero because the monthly salary goes directly to BRI account as a loan payment) and low cost (officially almost zero cost because BRI had a MOU with the government/company).

Table 6.4 shows that the majority of loans had durations of less than one year (50%), followed by duration of 1-2 years (18.5%), 2-3 years (13.5%), 4-5 years (10.6%), more than 5 years (5.3 %) and 3-4 years (2.5%) respectively. Unfortunately, according to the chi square test, there was no statistically significant difference between different type of MFIs and different durations of loan provided by MFIs whereas p-value 0.19 is bigger than the significance level 0.05.

Table 6.4 Duration of MFI's Loan

Duration of MFI's Loan (in year)							
	<1	**1-2**	**2-3**	**3-4**	**4-5**	**>5**	**Total**
BMT	44	20	14	3	18	8	107
BPR	85	19	16	2	11	10	143
BPRS	62	25	14	3	15	4	123
BRI	99	42	33	7	18	9	208
Total	290 (50%)	106(18.5%)	77(13.5%)	15(2.5%)	62(10.6%)	31 (5.3%)	581

The short-term loan is a majority type of BMT and BPR. Short-term loan implies that the clients use the loan for emergency or consumption needs. It is unlikely that they would be able to build a robust small business in a year or less and that yielded results in profits. BPRS and BRI distribute more apportion the loan in terms of duration. The duration of loans also affects the cost of loan as a consequence.

Table 6.5 Size of MFI's Loan (in million IDR)

MFIs	**Loan's Size (in Million IDR)**					**Total**
	< 5	**5 - 44**	**44 - 83**	**83 - 122**	**>122**	
BMT	54	47	5	1	0	107
BPR	98	39	4	2	0	143
BPRS	45	61	9	7	1	123
BRI	52	103	45	8	0	208
Total	249 (42.86%)	250 (**43%**)	63 (10.84%)	18 (3.1%)	1 (0.2%)	581

Table 6.5 presents various sizes of MFI clients' loans. The largest loans were between 5 million IDR (US $ 500) – 44 million IDR (US$ 4400) (43%) and less than 5 million IDR (US $ 500) (42.86%). BMT and BPRS' focus on loans was less than 44 million IDR (US$4400). BPR focused on small loans of less than 5 million IDR (US$500). BRI provided a wide range of loans from less than 1 million IDR to more than 83 million IDR (<US$100 – > US$ 8300).

Table 6.6 below shows that only 4.7% of clients received loans five times or more, 10.7% of clients received loans four times, 10.3% of MFI clients in this survey received loans three times, 16.2% of clients received loans twice and 58.1% of clients received a loan once. The chi-square test shows that there was a statistically significant difference between the different type of MFIs and the frequency of loans given by each MFI with p-value less than the significant level 5%.

Table 6.6 Frequency of Loans

Frequency of Loans							
		Once	Twice	Three times	Four times	≥ Five times	Total
MFI's name	BMT	52	22	16	13	4	107
	BPR	120	9	6	4	3	142
	BPRS	75	17	12	13	6	123
	BRI	90	46	28	29	15	208
Total		337 **(58.1%)**	94 (16.2%)	62 (10.3%)	59 (10.7%)	28(4.7%)	580

Most of first-time clients took out loans from BPR. This was followed by BRI, BPRS and BMT respectively. In other words, only a small number of clients took repeated loans from MFIs.

Table 6.6 above shows that BPR gave loans to 120 respondents once and only 9 respondents received loans twice, 6 respondents received loans three times, 4 respondents received loans four times and 3 respondents received loans five times or more. This data makes BPR deal with clients of the highest risk and as a consequence of that, BPR charges the borrowers a higher interest rate for return (see Table 6.8 for further information about the interest rate). BRI, BPRS and BMT also showed the same pattern as BPR but in lower scales and moderately. BRI shows a relatively stable pattern.

Table 6.7 Purposes of Loan

Purposes of MFI's Loan						
		Working capital	Fixed assets	Work cap + fixed assets	Household consumption	Total
MFI's name	BMT	23	55	16	13	107
	BPR	17	99	12	14	142
	BPRS	39	52	21	11	123
	BRI	57	78	35	38	208

Purposes of MFI's Loan						
		Working capital	Fixed assets	Work cap + fixed assets	Household consumption	Total
MFI's name	BMT	23	55	16	13	107
	BPR	17	99	12	14	142
	BPRS	39	52	21	11	123
	BRI	57	78	35	38	208
Total		136 (23.5%)	284 (49%)	84 (14.4%)	76 (13.1%)	580

When MFI clients are asked about the purpose of their loans (see Table 6.7), 49% answered that their loan purposes were for fixed assets, 23.5 % for working capital only, 14.4% for buying fixed assets and working capital. 13.1% of the respondents used the loan for consumption purposes.

In reality, when the researcher interviewed clients about the real purpose of the loan, most said they needed loans for emergency purposes (covered hospital costs for family members, admission school payments for kids, other debt payments, etc) and consumption (as a down payment for a motorcycle, a new TV, hand phone, etc). If they wrote 'working capital or fixed assets' purposes on the application form, it was just for administration purposes only. In the questionnaires for MFI's Clients, the researcher put some lines for open answers to anticipate the unpredictable information/facts from the fieldwork. Therefore, the researcher obtained the rich information regarding the issues above. These findings are suitable with the result of linkage program for Islamic bank and microfinance in 2006 whereas the usage of micro loan was not related to its written contract/*akad* (Bank Indonesia's Report, 2006).

The main reason for this was to get a loan as soon as possible submitting a document such as an education certificate, estate ownership document, car/motor ownership certificate, employment status document or other valuable documents as collateral. Without putting down clear collateral, it would be impossible to get a loan.

Table 6.8 demonstrates the average MFI interest rate. Interest rates vary from one MFI to another in Bandung and also among clients in a single MFI as well.

Table 6.8 Average of interest rate/cost of fund

Monthly average and Standard Deviation of interest rate/cost of fund			
	Type of MFIs	Monthly Average Rate	Standard Deviation
MFI's interest rate	BPR (C)	2.73%	1.18%
	BPRS (Is)	2.02%	0.7%
	BMT (Is)	1.68%	1.01%
	BRI (C)	1.46%	0.8%

This figure was obtained based on the answers of MFI clients in fieldwork. The researcher asked clients how much money they have to pay for monthly payment of their debt and their loan period. The level of competitiveness among MFIs in Bandung particularly BPRs, BPRS, BMTs and other forms of cooperatives to attract clients is high but they still cannot beat BRI's interest rate. BRI is a state bank fully supported by the Indonesian government with many cross subsidy programs. The above table indicates that BPR, BPRS and BMT must compete with each other to attract new potential clients and also still maintain existing clients who have a good track record.

6.1.2 Clients' Perception to the Relative Interest/Return Paid

In Table 6.8 above, the monthly average and standard deviation of interest rate/ cost of funds between MFIs were presented. BRI on average had the lowest interest rate, respectively followed by BPRS, BMT and BPR. Interestingly, when clients were asked about their perceptions about the rate of their interest rate compared to other MFIs, 48.4% clients felt his/her MFI rate was equal to other MFIs, 46.3% clients perceived her/his interest/profit rate was lower than other MFIs and only 5.3% who said that his/her rate was higher than others (see Table 6.9 below). In reality their interest/profit rates was much higher than their perception. It seems that they tried to convince themselves that they had selected the cheaper MFI. In brief, the client's perception of interest rate/cost plus in *murabahah* transaction on average was lower or equal to the actual rate.

Table 6.9 shows that even though BPR had the highest interest/profit rate, its clients perceived the interest rate to be equal to other MFIs although Table 6.8 shows otherwise; BPR's rate was much higher than others.

Table 6.9 Clients' Perception of Relative Interest/Profit Rate Paid based on different MFIs

Client's Perception of Relative Interest/Profit Rate compared to other MFI's					
		Lower	Equal	Higher	Total
MFI's name	BMT	72	29	6	107
	BPR	28	101	14	143
	BPRS	45	73	5	123
	BRI	124	78	6	208
Total		269 (46.3%)	281 (48.4%)	31 (5.3%)	581

Chi-Square Tests			
	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	83.555[a]	6	.000
Likelihood Ratio	87.725	6	.000
N of Valid Cases	581		

Akin to BPR, BPRS clients demonstrated the same perception but it was in reality higher than BRI. Surprisingly, most BMT clients perceived the BMT's rate to be lower than other MFIs (67.3%). Whereas in reality, BMT's rates were higher compared to both BRI and BPRS, the majority of BRI's clients said that BRI's rate was reasonable and lower than others which in line with Table 6.8. Statistically, the significance level of this perception was 0.00 for chi-square which is less than the required alpha level of 0.05. This means that there was a statistically significant difference between different types of MFIs and the MFI's client perception of the relative interest/profit rate.

Table 6.10 shows female and male perceptions of their interest/profit rate compared to other MFIs, 44.5% of female clients felt the MFI rate to be equal to other MFIs, 52.35% of female clients perceived the MFI rate to be lower than other MFIs and only 3.15% said that her MFI's rate was higher than others. 51.4% of male clients stated their MFI's rate to be equal to other MFIs, 41.5% of them perceived it lower than others MFIs and only 7.1% thought that their MFI's rate was higher than others.

Table 6.10 Clients' Perception of Relative Interest/profit Rate Paid based on Gender

Client's Perception of Relative Interest/profit Rate compared to other MFI's					
		Lower	Equal	Higher	total
Gender of MFI's Client	Female	133 (52.35%)	113 (44.5%)	8 (3.15%)	254
	Male	136 (41.5%)	168 (51.4%)	23 (7.1%)	327
Total		269	281	31	581

Chi-Square Tests			
	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	9.027[a]	2	.011
Likelihood Ratio	9.244	2	.010
N of Valid Cases	581		

Again in reality, the majority of their interest/profit rates were much higher than their perception. In brief, client's perception of interest/profit rate/cost plus in *Murabahah* transactions on average was lower than or equal to the actual rate. The significance level of this perception was less than the required alpha level of 0.05 where 0.011 for chi-square. This means that there was a statistically significant difference between the different gender groups of respondents and their perception of the relative interest/profit rate.

Table 6.11 Clients' Perception of Relative Interest/Profit Rate Paid based on Ages

Client's Perception of Relative Interest/Profit Rate compared to other MFI's					
		Lower	Equal	Higher	Total
Age of MFI's Client	< 30	31 (40.79%)	41(53.95%)	4 (5.26%)	76
	30 - 41	149(45.56%)	168 (51.37%)	10 (3.07%)	327
	42 - 52	83(50.3%)	69(41.8%)	13 (7.9%)	165
	53+	6 (46.1%)	3 (23.1%)	4 (30.8%)	13
Total		269	281	31	581

Chi-Square Tests			
	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	26.332[a]	6	.000
Likelihood Ratio	18.763	6	.005
N of Valid Cases	581		

Table 6.11 above shows the range of clients' age and their perception of the rate of their interest/profit rate compared to other MFIs. The majority of clients aged under 41 years old stated that their MFI's rate was equal to other MFI's rate. 40.79% of clients aged < 30 years and 45.56% of clients aged between 30 and 41 years old felt their MFI's rate was lower than other MFIs. 50.3% of clients aged between 42 and 52 years old stated their MFI's rate to be lower than the others, 41.8% believed that their rate was equal to others and only 7.9% said it was higher than others. Interestingly, 46.1% of the older clients (>53 years old) stated that their MFI's rate was lower than others, 23.1% stated it equal to others and 30.8% stated otherwise, higher than others. According to statistical test, the relationship of two variables, age and clients perceptions, was significant with significance level of less than the required alpha level of 0.05 where 0.00 for chi-square.

Table 6.12 shows MFI's clients perception of their MFI rate compared to other MFIs based on their job type. The majority of clients (54%) who are government employees stated that their MFI's rate were lower than other MFI's rates. 38.9% also said that their MFI's rate was equal to other MFIs and only 6.5% felt their MFI's rate was higher than other MFIs.

Table 6.12 Clients' Perception of Relative Interest/Profit Rate Paid based on Type of Jobs

Client's Perception of Relative Interest/Profit Rate compared to other MFI's					
		Lower	Equal	Higher	Total
Job of MFI's Client	Govt. employee	59 **(54.6%)**	42 (38.9%)	7 (6.5%)	108
	Private	90 (40.7%)	113 (**51.1%)**	18(8.2%)	221
	Others (informal)	120 (47.6%)	126 **(50%)**	6 (2.4%)	252
Total		269	281	31	581

Chi-Square Tests			
	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	13.349[a]	4	.010
Likelihood Ratio	14.070	4	.007
N of Valid Cases	581		

The majority of clients working in an informal sector stated their MFI's rate to be equal to other MFIs, 47.6% believed their rate to be lower than others and only 2.4% said it was higher than others. The same patters occurred for private employees where 51.1% believed their

MFI's rate to be equal to others, 40.7% said that their MFI rate was lower than other MFIs and only 8.2% thought their MFI's rate to be higher than other MFIs. According to the statistical test, the relationship of two variables, type of jobs and clients perceptions, was significant with a significance level less than the required alpha level of 0.05 whereas 0.010 for chi-square.

6.1.3 MFI Clients' Understanding of The Concept of Islamic Microfinance Products

The survey included questions about the clients' understanding of Islamic microfinance products. In general, the majority of MFI clients did not understand financing modes and the concept of Islamic banking or microfinance products as can be seen in Table 6.13 below.

The *Murabahah* concept is the most popular and familiar for MFI clients. Nonetheless, it was only understood by 26.85% of them. BPR and BRI, two conventional MFIs, show a gap between clients who understood and clients who did not. This is different to the cases of BPRS and BMT where both of these Islamic MFIs have an almost equal number of clients who understood and who did not. A total of 80.72 % of respondents did not understand the *mudarabah* concept.

Only BMT shows an almost equal balance between respondents who understood and who did not. Akin to two Islamic banking products above, *musharakah* showed the same pattern with the previous products. BMT demonstrated slightly different numbers between clients who understood and who did not. For *Ijarah* products, only a small number of clients understood the concept, most of which did not recognize it as an Islamic banking product. In general (see table 6.13), more than 81.4% of the respondents stated that they did not understand the concepts of *murabahah, mudarabah, musharakah,* and *ijarah*.

In the next subsection, the researcher investigates further the subgroups of respondents who lack understanding of Islamic microfinance concepts. For this, inferential statistical analytical tools for non-parametric data analysis, the Mann-Whitney U-test and the Kruskal-Wallis-tests were used to examine respondent gender, age, job, and MFI's type of clients.

Table 6.13 Understanding of Islamic Banking Products

Understanding of *Murabahah*				
		Yes	**No**	Total
MFI's Clients	BMT (Is)	54 (50.5%)	53 (49.5%)	107
	BPR (C)	4 (2.8%)	139 (97.2%)	143
	BPRS (Is)	69 (56%)	54 (44%)	123
	BRI (C)	29 (14%)	179 (86%)	208
Total		156 (26.85%)	425 **(73.15%)**	581
Understanding of *Mudarabah*				
		Yes	**No**	Total
MFI's Clients	BMT (Is)	52 (48.6%)	55 (51.4%)	107
	BPR (C)	3 (2.1%)	140 (97.9%)	143
	BPRS (Is)	36 (29.3%)	87 (70.7%)	123
	BRI (C)	21 (10.1%)	187 (89.9%)	208
Total		112 (19.28%)	469 (**80.72%**)	581
Understanding of *Musharakah*				
		Yes	No	Total
MFI's name	BMT (Is)	46 (43%)	61 (57%)	107
	BPR (C)	0 (0%)	143 (100%)	143
	BPRS (Is)	25 (20.4%)	98 (79.6%)	123
	BRI (C)	11 (5.3%)	197 (94.7%)	208
Total		82 (14.12%)	499 **(85.88%)**	581
Understanding of *Ijarah*				
		Yes	**No**	Total
MFI's Clients	BMT (Is)	32	75	107
	BPR (C)	0	143	143
	BPRS (Is)	35	88	123
	BRI (C)	14	194	208
Total		81 (14%)	500 (**86%**)	581

6.1.3.1 The Level of Understanding towards the Concept of Islamic Microfinance Products based on gender of respondents

As discussed in the previous section (section 6.1.3) more than 81.4% of respondents stated they did not understand the concepts of *Murabahah, Mudarabah, Musharakah,* and *Ijarah*. The Mann-Whitney test (U-Test) was employed in the comparative analysis in order to assess any significant difference in the responses from the different gender subgroups involved in this survey. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences between genders of MFI's clients regarding their lack of understanding about the concepts of Islamic Microfinance Products.

Table 6.13.1 Mann-Whitney U Tests: The Level of Understanding towards the Concept of Islamic Microfinance Product based on Gender of Respondents

Gender of Respondents					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
The lack of understanding of *Murabahah* concept	Female	238	U test = 262.96	Z =-3.048	.002
	Male	323	U test = 294.29		
	Total	561			
The lack of understanding of *Mudarabah* concept	Female	254	U test = 278.38	Z=-2.338	.019
	Male	327	U test = 300.80		
	Total	581			
The lack of understanding of *Musharakah* concept	Female	254	U test = 283.96	Z= -1.476	.140
	Male	327	U test = 296.46		
	Total	581			
The lack of understanding of *Ijarah* concept	Female	254	U test = 284.61	Z=-1.348	.178
	Male	327	U test = 295.96		
	Total	581			

The results of Mann-Whitney U-Tests are presented in Table 6.13.1. Based on the subgroups 'gender respondents category', the result of U-Test indicates that there is a statistically significant difference between females (mean ranking = 262.96) and males (mean ranking = 294.29) in terms of their lack of understanding concerning the *murabahah* concept whereas the significant value of 0.002 is less than the confidence level of 0.05. The same thing occurred for understanding the *mudarabah* concept. There is also a statistically significant difference between females (mean ranking = 278.38) and males (mean ranking = 300.80) in terms of their lack of understanding of the *mudarabah* concept whereas the significant value of 0.019 is less than the confidence level of 0.05. Regarding their level of understanding of these two products, *murabahah* and *mudarabah*, females showed better understanding of the concept of Islamic microfinance products than males. It can be seen that the mean rankings of female are lower than males which indicates that the former lack understanding of the concepts of *murabahah* and *mudarabah* rather than the latter.

Note that for the *musharakah* and *ijarah* concepts, there is no statistically significant difference between females and males in terms of their lack of understanding level regarding these two concepts. The significance value of 0.140 and 0.178 respectively are significantly higher than the confidence level of 0.05. In reality, *murabahah* and *mudarabah* products have a larger portion in the Islamic microfinance institution's portfolio compared to *musharakah* and *ijarah*. Therefore, it makes sense that MFI clients were more familiar with the first two products than the latter.

6.1.3.2 The Level of Understanding towards the Concept of Islamic Microfinance Products based on Age of Respondents

As discussed in the section 6.1.3, more than 81.4% of respondents stated that they did not understand the concept of *murabahah*, *mudarabah*, *musharakah*, and *ijarah*. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among age subgroups regarding their lack of understanding of the concepts of Islamic Microfinance Products.

The Kruskal-Wallis test results show that there is a significant difference in terms of lack of understanding of the four Islamic MFI product concepts across four different age subgroups. This can be proved as all the p-values in each product are lower than critical p-value of 0.05. Regarding, the understanding level of the *murabahah* concept, respondents aged between 42 and 52 (mean = 314.58) and between 30 and 41 (mean = 269.88) showed more lack of understanding than other age subgroups. The understanding level of the *mudarabah* concept, respondents aged 53 years old or more (mean = 324.65) and between 42 and 52 (mean = 320.59) showed more lack of understanding than other age subgroups.

Table 6.13.2 Kruskal-Wallis Test: The Level of Understanding towards the Concept of Islamic Microfinance Product based on the age of respondents

The Age of MFI's clients					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
The lack of Understanding of*Murabahah* concept	< 30	73	*k-w* test =256.78	Z = 18.621	.000
	30 – 41	312	*k-w* test = 269.88		
	42 – 52	163	*k-w* test = 314.58		
	53+	13	*k-w* test = 262.69		
	Total	561			
The lack of Understanding of *Mudarabah* concept	< 30	76	*k-w* test = 270.55	Z=17.815	.000
	30 – 41	327	*k-w* test = 279.48		
	42 – 52	165	*k-w* test = 320.59		
	53+	13	*k-w* test = 324.65		
	Total	581			
The lack of Understanding of *Musharakah* concept	< 30	76	*k-w* test = 274.66	Z=19.934	.000
	30 - 41	327	*k-w* test = 279.59		
	42 - 52	165	*k-w* test = 317.92		
	53+	13	*k-w* test = 332.00		
	Total	581			
The lack of Understanding of Ijarah concept	< 30	76	*k-w* test = 277.99	Z=9.597	.022
	30 - 41	327	*k-w* test = 283.53		
	42 - 52	165	*k-w* test = 310.37		
	53+	13	*k-w* test = 309.15		
	Total	581			

The table shows similar patterns for *musharakah* products. The understanding level of *musharakah* concept, respondents aged 53 years old or more (mean = 332.00) and between 42 and 52 (mean = 317.92) showed more lack of understanding than other age subgroups. The understanding level of the *ijarah* concept, respondents aged 42 and 52 (mean = 310.37) and between 30 and 41 (mean = 309.15) showed more lack of understanding than other age subgroups.

In short, the lower the mean ranking of subgroups the better understanding they had. Therefore, respondents aged 30 are less statistically significant to have a better understanding of the concept of four Islamic microfinance products than other subgroups.

6.1.3.3 The Level of Understanding towards the Concept of Islamic Microfinance Product based on Type of Respondents' Job

More than 81.4% of respondents stated that they did not understand the concepts of *murabahah, mudarabah, musharakah,* and *ijarah*. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among the three different types of respondent job subgroup regarding their lack of understanding of the concepts of Islamic Microfinance products.

Table 6.13.3 Kruskal-Wallis Test: The Level of Understanding towards the Concept of Islamic Microfinance Product based on Type of Respondents' Job

Type of MFI clients' Job					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
The lack of understanding of *Murabahah* concept	Gov. employee	106	*k-w* test = 314.60	Z = 17.808	.000
	Others (informal)	239	*k-w* test = 287.97		
	Private employee	216	*k-w* test = 256.80		
	Total	561			
The lack of understanding of *Mudarabah* concept	Government employee	108	*k-w* test = 320.10	Z= 18.240	.000
	Other (informal)	252	*k-w* test = 299.74		
	Private employee	221	*k-w* test = 266.82		
	Total	581			
The lack of understanding of *Musharakah* concept	Government employee	108	*k-w* test = 315.86	Z= 17.237	.000
	Other (informal)	252	*k-w* test = 298.57		
	Private employee	221	*k-w* test = 270.22		
	Total	581			
The lack of understanding of *Ijarah* concept	Government employee	108	*k-w* test = 309.98	Z= 20.385	.000
	Other (informal)	252	*k-w* test = 303.83		
	Private employee	221	*k-w* test = 267.09		
	Total	581			

The Kruskal-Wallis test results show that there is a significant difference in terms of lack of understanding levels of the four Islamic MFI product concepts across three different types of respondent job subgroups. This can be proved as all the p-values in each product are lower than critical p-value of 0.05.

Respondents with a job as a government employee (mean = 314.6) showed a greater lack of understanding of *murabahah* than other respondents with either informal jobs (mean = 287.97) or private employees (mean = 256.80). Respondents who have a job as a government employee (mean = 320.10) showed more lack of understanding of *mudarabah* than other respondents with either informal jobs (mean = 299.74) or private employees (mean = 266.82).

The same results occurred towards the *musharakah* and *ijarah* products. Government employees (mean = 315.86) showed greater lack of understanding of *musharakah* than other respondents with either informal jobs (mean = 298.57) or private employees (mean = 270.22). Government employees (mean = 309.98) showed a greater lack of *ijarah* understanding than other respondents with either informal jobs (mean = 303.83) or private employees (mean = 267.09).

Briefly, these findings show that the lower the mean ranking of subgroups the better understanding they had. Therefore, the respondent with a job as a private employee had a statistically significant better understanding of the concepts behind the four Islamic microfinance products than other subgroups.

6.1.3.4 The Level of Understanding towards the Concept of Islamic Microfinance Product based on type of MFI's respondents

More than 81.4% of respondents stated that they did not understand the concepts of *murabahah, mudarabah, musharakah,* and *ijarah*. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among the four different types of MFI respondent subgroup regarding their lack of understanding of the concepts of Islamic Microfinance Products.

The Kruskal-Wallis test results show that there is a significant difference concerning lack of understanding levels of four Islamic MFI's product concepts across four different types of MFI respondent. This is the case because all p-values for each product are lower than the critical p-value of 0.05. Respondents who were clients of BPR (mean = 341.15) showed a greater lack of understanding of *murabahah* than other respondents who were clients of BRI (mean = 318.30), BMT (mean = 210.09) and BPRS (mean = 203.74) respectively. Respondents who were the clients of BPR (mean = 332.00) showed a greater lack of understanding *mudarabah* than other respondents who were clients of BRI (mean = 316.64), BPRS (mean = 272.96) and BMT (mean = 207.11) respectively.

Table 6.13.4 Kruskal-Wallis Test: The Level of Understanding toward the Concept of Islamic Microfinance Product based on type of MFI's respondents

Type of MFIs					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
The lack of understanding of *Murabahah* concept	BMT	105	*k-w* test =210.09	Z =137.721	.000
	BPR	143	*k-w* test = 341.15		
	BPRS	112	*k-w* test = 203.74		
	BRI	201	*k-w* test = 318.30		
	Total	561			
The lack of understanding of *Mudarabah* concept	BMT	107	*k-w* test = 207.11	Z=114.190	.000
	BPR	143	*k-w* test = 332.00		
	BPRS	123	*k-w* test = 272.96		
	BRI	208	*k-w* test = 316.64		
	Total	581			
The lack of understanding of *Musharakah* concept	BMT	107	*k-w* test = 205.82	Z=105.212	.000
	BPR	143	*k-w* test = 340.91		
	BPRS	123	*k-w* test = 261.98		
	BRI	208	*k-w* test = 317.67		
	Total	581			
The lack of understanding of Ijarah concept	BMT	107	*k-w* test = 244.62	Z=76.375	.000
	BPR	143	*k-w* test = 331.50		
	BPRS	123	*k-w* test = 248.84		
	BRI	208	*k-w* test = 311.95		
	Total	581			

The same results were observed for both the *musharakah* and *ijarah* products. Respondents who were clients of BPR (mean = 340.91) showed a greater lack of understanding of *musharakah* than other respondents who were clients of BRI (mean = 317.67), BPRS (mean = 261.98) and BMT (mean = 205.82) respectively. Respondents who were clients of BPR (mean = 331.50) showed a greater lack of understanding of *ijarah* than other respondents who were clients of BRI (mean = 311.95), BPRS (mean = 248.84) and BMT (mean = 244.62) respectively.

According to these findings, the lower the mean ranking of subgroups, the better understanding they had. Therefore, respondents who were clients of BMT had a statistically significant better understanding of the concepts of *mudarabah*, *musharakah* and *ijarah* products than other subgroups. However, regarding *Murabahah*, respondents from BPRS showed a significantly better understanding than other subgroups.

6.1.3.5 Training Program for MFIs

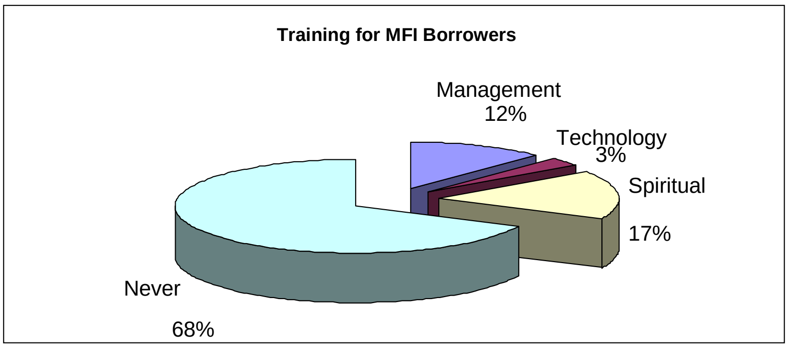
Lack of understanding about Islamic microfinance product can be understood in Table 6.14 regarding the prior training sessions that clients had received.

Table 6.14 Training per MFI's Type

Training per MFI's Type				
		Training	No training	Total
MFI Clients	BMT	60 **(56%)**	47 (44%)	107
	BPR	13 (9%)	130 **(90.1%)**	143
	BPRS	42 (34%)	81 **(66%)**	123
	BRI	66 (32%)	142 **(68%)**	208
Total		181 (31.15%)	400 **(68.85%)**	581
Chi-Square Tests				
		Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square		97.246[a]	3	.000
Likelihood Ratio		14.070	3	.000
N of Valid Cases		581		

Based on the survey, the majority of the sample never received training during the loan periods (68.85%) and only 31.15% of MFI clients received training sessions. The chi-square test shows that there was a statistically significant difference between the different types of MFIs and the availability of training for their clients with p-value of less than the significance level 5%. The data in table 6.14 above also shows that only a small number of BRI, BPR and BPRS's clients in general received training sessions. The majority of BMT's clients received training (56%). For those who received training, only 17% clients received spiritual training, 12% and 3% received management and technological training respectively (see figure 6.2 below).

Figure 6.1 Training for MFI's Clients



There was no specific training regarding the introduction of microfinance products provided by Islamic MFIs. Therefore, having high expectation for the clients to understand the differences between Islamic microfinance products and conventional was perhaps unrealistic.

The next subsection investigates which subgroups of respondents never received the training session. For this purpose, the researcher used inferential analysis statistical tools for non-parametric data analysis, the Mann-Whitney U-test to examine for respondents' gender and the Kruskal-Wallis-tests for age, job, and MFI type clients.

- **Gender**

As discussed in the previous subsection (section 6.1.3.5) more than 68.85% respondents stated that they never received a training session. The Mann-Whitney test (U-Test) was employed in the comparative analysis in order to assess any significant difference in the responses from different gender subgroups involved in this survey. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among various subgroups who never received training session.

The results of the U-Test are presented in Table 6.15. The result of U-Test indicates that there is statistically significant difference between females (mean ranking = 313.23) and males (mean ranking = 273.74) who did not receive training where the significant value of 0.000 is less than the confidence level of 0.05. In other words, the number of female who never received training sessions is larger than the number of males. The mean rankings of females are higher than males.

Table 6.15 Training per MFI Type

Gender of Respondents					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
No Training for MFI Clients	Female	254	U test = 313.23	Z = -3.501	.000
	Male	327	U test = 273.74		
	Total	581			
Age of MFI's clients					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
No Training for MFI Clients	< 30	76	*k-w* test = 303.20	Z = 5.286	.152
	30 – 41	327	*k-w* test = 298.61		
	42 – 52	165	*k-w* test = 272.18		
	53+	13	*k-w* test = 267.04		
	Total	581			
Type of MFI clients' Job					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
No Training for MFI Clients	Gov. employee	108	*k-w* test = 286.07	Z = 4.873	.087
	Others (informal)	252	*k-w* test = 279.54		
	Private employee	221	*k-w* test = 306.47		
	Total	581			
Type of MFIs					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(p)
No Training for MFI Clients	BMT	107	*k-w* test = 362.90	Z = 63.989	.000
	BPR	143	*k-w* test = 226.41		
	BPRS	123	*k-w* test = 301.56		
	BRI	208	*k-w* test = 292.18		
	Total	581			

- **Age**

As more than 68.85% respondents stated they never received the training session, the Kruskal-Wallis test was employed in the comparative analysis in order to assess any significant difference in the responses from the different ranges of age subgroups involved in this survey. This non-parametric test was used to test the null hypothesis below.

Ho: There are no significant differences among age subgroups who did not receive a training session.

The Kruskal-Wallis test results show that there is no significant difference in respondents who never received training session across the four different age subgroups. This can be proved as the p-value 0.152 is higher than the critical p-value of 0.05.

- **Jobs**

Table 6.10 shows that 68.85% respondents stated that they never received a training session. Based on this data, the Kruskal-Wallis test is employed in the comparative analysis in order to assess any significant difference in the responses from the different job types of respondents involved in this survey. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among clients of three types of job who did not receive a training session.

The Kruskal-Wallis test results show that there is no significant difference among respondents who did not receive a training session across three types of job subgroups. This can be proved as the p-value 0.087 is higher than the critical p-value of 0.05.

- **Type of MFI**

68.85% of respondents stated that they did not receive the training session. In order to further examine whether there was any significance difference in the MFI type of respondents involved in this survey, the Kruskal-Wallis test was involved in the comparative analysis. This non-parametric test can be used to test the null hypothesis below.

Ho: There are no significant differences among the four different types of respondents' MFI subgroup regarding the absence of training.

The Kruskal-Wallis test results show that there is a significant difference concerning the absence of training across the four different types of MFI respondent. This can be proved as the p-value of 0.000 is lower than the critical p-value of 0.05. Regarding the training session, respondents who were BMT clients (mean = 362.90) received more training than other respondents who were the clients of BPRS (mean = 301.56), BRI (mean = 292.18) and BPR (mean = 226.41) respectively.

6.1.4 Clients' Preferences for Conventional/Islamic MFI

Table 6.16 shows that 54.4% of respondents preferred an Islamic MFI to a conventional MFI (45.6%), despite this, the majority of respondents were in fact conventional clients. When asked about the reasons behind this, most clients answered that using Islamic products as Muslims created them tranquility, peace and confidence. Ultimately however, reasons of practicality and economizing became dominant factors. Statistically, the difference of different type of MFIs was significant for clients' preferences on Islamic MFIs with a p-value of 0.00 lower than the significance level of 0.05.

Table 6.16 Preferences of MFI Clients

Prefer Islamic MFI				
		No	**Yes**	Total
MFI's Clients	BMT	1 (1%)	106 **(99%)**	107
	BPR	116 **(81.1%)**	27 (18.9%)	143
	BPRS	35 (28.5%)	88 **(71.5%)**	123
	BRI	113 **(54.3%)**	95 (45.6%)	208
Total		265 **(45.6%)**	316 **(54.4%)**	581
Chi-Square				
		Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square		179.732[a]	3	.000
Likelihood Ratio		217.351	3	.000
N of Valid Cases		581		

It was reasonable if 99% of BMT's (Islamic MFI) clients preferred to choose Islamic MFI and also made sense if 81.1% of BPR (conventional MFI) clients preferred conventional MFI. If there were 28.5% of BPRS and 1% of BMT (both of them are Islamic MFI) clients who preferred conventional MFI, this fact seems puzzling and raises a question. It was also the case for 45.6% of BRI and 18.9% of BPR clients who preferred Islamic MFIs rather than conventional MFIs although they were completely aware that BRI and BPR are conventional

MFIs. Moreover, the proportion of BRI (conventional MFI) clients between those who preferred Islamic MFI and those who preferred conventional was almost equal.

The finding that Islamic MFI clients prefer a conventional MFI stimulates several questions. To prefer one thing and choose another appears to be inconsistent behavior. In terms of market opportunity, data from table 6.16 shows that there are new demands for Islamic MFI institutions: as much as 18.9% of BPR clients and 45.6% of BRI clients could be potential clients for Islamic MFIs. Otherwise, 1% of BMT and 28.5% of BPRS clients who were not loyal could be potentially shifted to conventional MFIs because they stated that did not prefer Islamic MFIs at all.

Table 6.17 Preference for Islamic/Conventional MFIs

Gender of Respondents					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(*p*)
Prefer an Islamic MFI	female	254	U test = 266.01	Z = -3.666	.000
	male	327	U test = 310.41		
	Total	581			
The Age of MFI's clients					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(*p*)
Prefer an Islamic/ Conventional MFI	< 30	76	*k-w* test= 311.39	Z = 3.111	.375
	30 – 41	327	*k-w* test= 291.76		
	42 – 52	165	*k-w* test= 283.50		
	53+	13	*k-w* test= 247.88		
	Total	581			
Type of MFI clients' Job					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(*p*)
Prefer an Islamic/ Conventional MFI	Gov. employee	108	*k-w* test = 295.68	Z = 11.196	.004
	Others (informal)	252	*k-w* test = 310.67		
	Private employee	221	*k-w* test = 266.29		
	Total	581			
Type of MFIs					
Variable	Subgroups	N	Mean Rank	Z, χ^2	Asymp. Sig.(*p*)
Prefer an Islamic/ Conventional MFI	BMT	107	*k-w* test = 161.21	Z = 179.423	.000
	BPR	143	*k-w* test = 394.15		
	BPRS	123	*k-w* test = 241.16		
	BRI	208	*k-w* test = 316.32		
	Total	581			

Table 6.17 shows that the variables of gender, type of jobs and MFIs have significant relationships to Islamic or conventional preferences with p-values 0.000, 0.004 and 0.00 for gender, job type and MFIs respectively. On the contrary, age was a statistically insignificant variable to determine this preference as its p-value 0.375 was higher than the significance level 0.05. Further information on the reasons for their choices for different MFIs can be seen in Table 6.18 below. In order to understand clients' preferences for MFIs their responses in the next section may give some indications.

6.1.5 Clients' reasons for Choosing MFI

In order to understand the reasons behind their decision to choose a MFI, the clients were asked to rank the MFIs based on services and finance reasons. Based on studi literature on microfinance and the preliminary research in the fieldwork, there are four service/non economy factors (nearness, easiness, speed/promptness and profile of loan officers) and four economy/financial factors (low collateral, size of loan, payment methods and low interest/cost of fund).

Table 6.18 Ranking of Clients' Reasons to Choose a MFI

Ranking of Clients' Reasons to Choose a MFI								
Services				Economy/Finance				
Nearness	Easiness	Speed	Loan Officer	Low Collateral	Loan Size	Payment Method	Low Interest	Ranking /Priority
66	(1) 316	63	7	15	15	10	108	1
117	132	(2) 173	9	26	16	8	109	2
96	72	151	20	32	21	12	(3) 178	3
(4) 140	29	138	22	83	39	46	83	4
33	6	27	31	(5) 268	99	54	57	5
26	9	14	71	82	(6) 241	111	19	6
27	10	10	109	48	73	(7) 280	17	7
76	7	5	(8) 312	27	77	60	10	8
Total 581	581	581	581	581	581	581	581	

Test & Summary of Statistics								
	Services				Economy/Finance			
	Nearness	Easiness	Speed	Loan Officer	Low Collateral	Loan Size	Payment Method	Low interest
Df	3	3	3	3	3	3	3	3
Chi-Square	24.549	37.050	81.962	24.305	28.096	.631	.718	21.338
Asy. Sig.	.000	.000	.000	.000	.000	.889	.869	.000
Std. Dev	2.177	1.4391	1.366	1.607	1.439	1.563	1.446	1.630
Mode	4	1	2	8	5	6	7	3

MFI's clients were also asked to rank these reasons according to their priorities. Table 6.18 shows the ranking of clients' reasons for choosing an MFI.

Based on the chi-square test, there were significant differences between MFI type and the reasons for choosing an MFI above except loan size and payment method as the loan size p-value was 0.889 and the payment method's p-value was 0.869 which were higher than the confidence level of 0.05. The rest have the p-value 0.000. The ranks were based on the mode of clients' priorities, as we see in Table 6.18. An explanation of the way and reasons for how the results in Table 6.18 were ranked can be found in Appendix A.

Table 6.18 above shows that easiness in process was the first priority for 316 out of 581 clients when selecting an MFI, followed by speed of the application process, low interest rate, nearness, low collateral, size of loan, payment methods and profile of loan officer which came second, third and up to eight respectively. The low interest rate/mark-up margin rate became the third priority for clients after ease and speed in the application process. Some non economy/finance factors, mostly related to services, such as ease, speed in the process and nearness to the market were more prioritized by clients compared to economy/finance factors such as low interest, low collateral, size of loan and payment method. In many interview opportunities, the surveyor got the impression that rational choice in terms of management issues and economy/finance reasons was the main reason for selecting an MFI and religious reasons came afterwards.

The findings present many implications in understanding in the behavior of Indonesian Muslim clients towards economics transactions and spiritual aspects. In economic lives, rational choice based on the economic/finance behavior appears to be dominant for clients' decision in choosing a MFI. But in reality, when respondents were asked about their preferences towards their choice for Islamic products or conventional, the majority preferred Islamic MFIs.

6.1.6 MFI's Rankings Based on MFI Clients' Perspectives

Respondents were also asked to rank MFIs based on the services and finance categories. MFIs in Bandung face fierce competition because clients have the right and wide opportunities to choose an MFI that suits his/her needs. Therefore, the majority of them are well acquainted with the reputations of other MFIs and their interest rates. They mostly used to compare each one against each other before deciding to choose a particular MFI.

In order to get the average weighted ranks in Tables 6.19, a weight of 4 was used for first priority, 3 for second priority, 2 for third priority and 1 for fourth priority. After multiplying the responses of clients by their respective weightings, they were added up to get the total score for each factor. The total score was then divided by the number of clients to get an average value. The largest average value was ranked number 1, the second biggest became number 2 and so on. The original data and a further explanation of how MFIs were ranked by the clients as seen in Table 6.19 can be viewed in Appendix A.

Table 6.19 Ranking of MFIs based on MFI's Clients Perspectives

Factors	BPR	BPRS	BMT	BRI
Shari'ah compliant	4	2	1	3
	1.71	2.84	3.40	2.22
Easiness	2	3	4	1
	2.62	2.42	1.98	3.13
Application process	3	2	4	1
	2.62	2.72	2.08	2.81
Low Interest	4	2	3	1
	2.18	2.49	2.22	3.26
Speed in process/Promptness	2	1	4	3
	2.72	2.78	2.18	2.5
Low Collateral	4	3	2	1
	2.21	2.54	2.55	2.92
Payment Methods	3	2	4	1
	2.60	2.73	2.26	2.88
Loan's Officers	3	1	4	2
	2.60	2.86	2.22	2.77
Preference	3	2	4	1
	2.38	2.70	2.16	2.93
Overall	**3**	**2**	**4**	**1**
	2.37	**2.74**	**2.08**	**2.92**

Table 6.19 shows the rating for each MFI from 581 respondents' perspectives. The results show BMT highest ranking for *Sharia'h* compliance, and BPRS as the highest rank for speed in process application and excellent relationship with loan officer categories. The other categories left BRI with the highest rank. BRI was well known as an MFI with easiness, good process of application, low interest rates, low collateral, appropriate payment methods and was overall the most preferable MFI.

6.2 CONCLUSIONS

This chapter reported information on the characteristics of the respondents and also discussed their perceptions, understanding, preferences and the reasons for choosing an MFI. The comparative analysis of four types of MFI was presented with the intention of finding the special characteristics of clients in each type of MFI.

There are more male than female respondents within the age range 30 – 41 years old. Most BRI clients are permanent employees in the government and private sectors and they are therefore less risky. BMT, BPR and BPRS do not choose government employees as their target market but clients who have informal jobs. As a consequence, they deal with high risk clients with a higher potential return. Loan duration was commonly less than one year it is unlikely to be able to build a robust small business in this time frame. Presumably, they used loans for consumption purposes. Compared to other types of MFIs, BPR deal with the highest risk clients and as a consequence, charge borrowers a higher interest rate for return. Although, in reality, the majority of their interest rate was much higher than their perception, the majority of MFI clients stated that their MFI's rate was equal to or even lower than other MFIs.

The majority of MFI clients did not understand the concepts behind Islamic microfinance products, *murabahah*, *mudarabah*, *musharakah*, and *ijarah* though BMT and BPR clients show more understanding of these concepts over BRI and BPR. This can be explained by the fact that the majority of clients did not receive training during loan periods. The majority of clients preferred Islamic rather than conventional MFI, as they ultimately were influenced by practical and economic reasons.

Some non-economic/finance factors, mostly services, such as easiness, speed of process and nearness to the market were more prioritized by clients compared to economy/finance factors such as low interest, low collateral and size of loan. Rational choice in terms of management issues and economy/financial reasons was the main reason for choosing an MFI. Religious reasons came afterwards.

These findings have many implications for understanding Indonesian Muslims' behavior towards economic transactions and spiritual fulfillment. Nevertheless, Indonesia is not an Islamic country, even as a largest Muslim population in the world. Indonesian Muslims live in an increasingly secular society, in which religion has less and less influence on their daily lives. In economic life, rational choice based on rational economic behavior perspective dominates the decision-making process whether consciously or subconsciously. Based on this survey, BRI was ranked highest for easiness, good process of application, low interest rates, low collateral, appropriate payment methods and most preferable MFI. BMT attained the highest rank for Sharia'h compliance and BPRS was highest rank for speed in application process and excellent relationships with loan officers.

CHAPTER 7

SUPPLY SIDE DATA ANALYSIS AND PERSPECTIVES OF MFI MANAGERS, *WAQF* INSTITUTIONS AND REGULATORS

7.1 INTRODUCTION

The results from the supply side of microfinance institutions and a comparison of conventional and Islamic MFIs are reported in this chapter. The profile of each category of MFI is presented first followed by the managers' views on the factors that determine why clients choose a particular MFI. These results are then compared with the demand side responses from clients reported in Chapter Six. The final section of the chapter presents the Balanced Scorecard (BSC) to show a comparative performance of different MFIs. The BSC provides a balanced analysis between the financial and non-financial factors affecting performance. As highlighted in Chapter Three, BSC is a widely adopted methodology for measuring management and performance of corporations and non-profit organizations.

7.1.1 Microfinance Institutions in Bandung Area

When this survey was conducted in 2010, there were 28 BPRs (conventional rural banks), 17 BPRSs (Islamic rural banks), 64 BRI Units and 8 BMTs operating in Bandung. Based on scrutinized analysis, a formal letter and questionnaires were sent to each MFI while followed up by phone to get a time for meeting. After waiting for reply for two weeks, only about 20% of MFIs managers replied. Questionnaires were sent to 25 MFI managers who replied the participation letter before but only 18 MFIs were available to participate. Both customers and managers were surveyed about their perceptions, preferences and then their answers were compared with each other. This section reports the results from in-depth interviews with 18 MFI managers. In the interviews with managers, detailed information on the different styles of management and current issues concerning fierce competition and regulation were sought. In this study, 6 BPRSs, 5 BPRs, 6 BMTs and 1 BRI were included in the sample. Note that BRI, in particular, had 4 branches in Bandung area with 20-40 BRI units in each branch. In an interview with the head of BRI's region in Bandung, it was revealed that all BRI units adhere to the same rules and styles of management. Therefore, there no need to ask many BRI's managers because one sample of BRI can represent a general BRI unit. In terms of level of

MFIs competition, BPR, BPRS, BMT competed with each other and also competed with BRI units.

7.1.2 Profile of Microfinance Institutions

The MFI's managers in the sample were asked to identify the existing profile of their MFI such as the average age, number of existing clients, total funding and total of human resources. A summary of different types of MFI are presented in Table 7.1 below.

Table 7.1 General Information of MFIs

General Information of MFIs' Type			
	Average Age (in years)	**Average Number of Clients (in people)**	**Average of Total Funding (in Million IDR)**
BMT	8.5	3045	3,317.83
BPR	12	4345	18,388.00
BPRS	13.3	4048	39,909.67
BRI	21	2530	31,000.00

BRI was the oldest MFI in Indonesia followed by BPR, BPRS and BMT as the new comer. In the Bandung area, the average number of BPR clients was similar to the average number of BPRS clients. BRI, as a large state bank, has numerous branches around Indonesia and Bandung is not an exception. Client numbers vary between each branch depending on the location. On the topic of total funding per MFIs, BMTs have limited funding to lend and BRI on average lent more money to its clients. BPRS and BPR, on average, have more human resources compared to BRI and BMT. BRI and BMT have more loan officers than administrative staff than BPR and BPRS.

Table 7.2 Human Resources of MFIs

Human Resources of MFIs			
	Average Number of Administrative Staff	**Average Number of Loan Officers**	**Average Number of Total Staff**
BMT	7	9	16
BPR	13	11	24
BPRS	19	15	34
BRI	3	6	9

7.2 MFI MANAGER'S PERCEPTIONS ON CLIENT PERCEPTIONS WHEN CHOOSING A MFI

An MFI is certainly not an exception to the premise that customer satisfaction is related to expectation fulfillment. This section examines the reasons customers choose an MFI and the perceptions of MFI's managers/chief executive officers (CEO) of why customers might select a particular MFI to assist with their business needs. Additionally, this section examines customer preferences for services and facilities from a potential MFI.

To expand their market share, an MFI must begin by determining the inherent view within the institution relative to customer service. The MFI manager sets the standard by which an MFI establishes its goals and objectives. In order to set an appropriate standard, there must be perceptions of what existing or prospective MFI's clients want and need. Therefore, it is not only important to obtain client input as to the services and products they desire, but it is equally important to receive manager's perceptions of the clients' wants and needs to avoid situations where the institution fails to live up to clients expectations due to failed communications.

For an MFI, customer/client expectations fulfillment is a pivotal issue that need to be addressed in order to compete commercially. Hence, it is not only essential to obtain MFI clients' perspectives in term of services and products they desire, but it is also crucial to know MFI managers' perceptions towards MFI' clients wants and needs. Failure to recognize clients' expectation creates misleading policies that ultimately alienate the customer. There are ten questions concerning MFI's managers' perceptions of clients' desires and expectations. The sections below presented the answers and results of analysis of the questionnaires.

7.2.1 MFI Manager's Perceptions of the Customer's Reasons For Selecting a MFI

MFI managers were asked to rank the eight services and economic/finance factors that clients use for selecting a MFI presented in Chapter Six (see Table 6.18). This was done to compare the rankings of managers with those of the clients.

Easiness and processing speed are the first two priorities for both MFI managers and clients. According to clients, a low interest rate is more important than low collateral but MFI managers perceive otherwise. The nearness of MFI's location was fourth and more important than low collateral ranked fifth by clients whereas it was perceived less important by MFI's managers (see the seventh priority of managers' perceptions).

Table 7.3 Ranking of MFI's Manager Perceptions Vs Ranking of Clients' Reasons For Choosing a MFI

Ranking of MFI's Managers Perceptions of Clients' Reasons For Choosing a MFI								
Services				**Economic/Financial**				
Nearness	**Easiness**	**Speed**	**Loan Officer**	**Low Collateral**	**Loan Size**	**Payment Method**	**Low Interest**	**Ranking /Priority**
0	(1) 7	3	2	1	0	1	4	1
1	2	(2) 9	2	2	1	0	1	2
4	5	4	0	(3) 3	0	1	1	3
2	4	0	1	3	3	3	(4) 2	4
1	0	1	1	3	(5) 6	4	2	5
1	0	0	3	3	3	(6) 5	3	6
(7) 7	0	0	3	0	2	2	4	7
2	0	1	(8) 6	3	3	2	1	8
Total 18	18	18	18	18	18	18	18	
Vs								
Ranking of Clients' Reasons For Choosing an MFI								
Services				**Economy/Finance**				
Nearness	**Easiness**	**Speed**	**Loan Officer**	**Low Collateral**	**Loan Size**	**Payment Method**	**Low Interest**	**Ranking /Priority**
66	(1) 316	63	7	15	15	10	108	1
117	132	(2) 173	9	26	16	8	109	2
96	72	151	20	32	21	12	(3) 178	3
(4) 140	29	138	22	83	39	46	83	4
33	6	27	31	(5) 268	99	54	57	5
26	9	14	71	82	(6) 241	111	19	6
27	10	10	109	48	73	(7) 280	17	7
76	7	5	(8) 312	27	77	60	10	8
Total 581	581	581	581	581	581	581	581	

Both clients and managers agreed that loan officer characteristics were not a priority when choosing a MFI, hence, they put this category in the last priorities/ranking. Regarding the size of loan and method of payment, MFI's managers' and clients' opinions are slightly different but do not affect decision making to a great extent. In conclusion, although MFI managers or chief executive officers were given the same questions and criteria as clients, the results turned out to be slightly different for each group.

7.2.2 Clients' Willingness to Pay Monthly Interest/Mark-up Rates

Table 7.4 below shows the clients' willingness to pay monthly based on MFI manager's perspectives.

Table 7.4 Clients' Willingness to Pay Monthly Finance Charges

	MFI Managers Perceived Client's Willingness to Pay				Average Finance Charges	
	0.5 -1%	**1%-2%**	**2%-3%**	Total	**Managers' Perceived**	**Clients' Financial charges***
BMT	1	2	3	6	1.875%	1.68%
BPR	-	3	2	5	1.9%	2.73%
BPRS	2	4	-	6	1.25%	2.02%
BRI	-	1	-	1	1.5%	1.46%
Total	3	10	5	**18**		
	16.7%	55.5%	27.8%	**100%**		

* see table 6.8

Table 7.4 shows that 55.5% of MFI managers perceived that MFI clients could afford to pay monthly interest rates/mark-ups of between 1% and 2%. 27.8% of managers perceived clients were still willing to pay between 2% and 3% and the rest of them thought that clients can only afford to pay monthly interest of between 0.5% and 1%. Therefore based on this perception, it makes sense then if most MFIs interest rates ranged from 1% to 2% per calendar month. MFI managers' perceptions above corresponded to the MFI clients' perceptions (see Table 6.8). BRI and BMT's interest rate (mark-up) ranged from 1% to 2% while BPRS and BPR had an average interest rate (mark-up) of between 2% and 3%. Unfortunately, there is no single client respondent from the surveys who stated that his/her MFI gave interest rates at less than 1%. If any, according to MFI's managers, it most certainly was a part of the government subsidy's program and can always be provided by BRI as a state micro-banking institution.

The average willingness to pay mark-up margins from six BMT managers was 1.875%. Based on 107 BMT's clients' data from our survey, the average mark-up margin on their loans was 1.68%. Thus, BMTs charged less than the BMT managers' perceived clients' willingness or ability to pay the loan cost. Similar to BMT managers, BRI managers' perceptions of clients' willingness to pay interest rate were higher (1.5%) than the average monthly interest rate paid by 208 clients (1.46%) from our survey in Chapter Six. BMT and BRI managers charged their clients based on the clients' capability to pay.

This was not the case for BPR and BPRS. BPR managers perceived that their clients were willing to pay about 1.9% of interest rate per month, but in reality, 143 BPR clients said that they paid an average interest rate of around 2.73% per month. Similar to BPR, BPRS managers also perceived their clients' willingness to pay around 1.25% of mark-up margin per month but the reality from the fieldwork shows that 123 BPRS clients paid the cost of loan equivalent about 2.02% per month. BPR and BPRS charged their clients cost of loan higher than what their managers perceived the clients' willingness to pay monthly.

7.2.3 Financial Charges Compared to other MFIs

MFI managers' perception of their own interest rate compared to other MFIs can be seen in Table 7.5 below.

Table 7.5 Managers and Clients' Perceptions of Finance Charges

	Managers' Perception	MFI's Clients Perception*
Lower	33.3%	46.3%
Similar	61.1%	48.4%
Higher	5.6%	5.3%

*see Table 6.9

Table 7.5 shows MFI managers' perceptions to be slightly different from the clients' perception (see Table 6.9). 46.3% of clients perceived that their MFI's interest rate was lower than other MFI's, when only 33.3% of MFI's managers perceived this. On one hand, 48.4% of clients perceived that their MFI interest rate was equal to another MFI, on the other hand, 61.1% of MFI managers perceived it to be equal. 5.3% of MFI clients and 5.6% of MFI managers thought that their MFI's interest rate was higher than other MFI.

7.2.4 MFI Rankings

The interviewer asked the managers to rank the MFI from 1 (the cheapest) to 4 (most expensive) and the results are shown in Table 7.6. BRI was the cheapest followed by BPRS which was the same as the valuation from clients. There was a different perception in valuing BPR and BMT between managers and clients. BMT was perceived by clients to be cheaper than BPR whereas MFI managers perceived the opposite.

Table 7.6 Managers and Clients' Rankings of Interest Rates/Mark-ups

Ranking	Managers' Perception	Clients' Perception*
1 (the cheapest)	BRI	BRI
2	BPRS	BPRS
3	BPR	BMT
4 (the most expensive)	BMT	BPR

*see Table 6.20

7.2.5 Payment Methods

All BPR, BPRS and BRI managers answered that monthly payment was the main method of repayment used by their MFI. Five BMT managers answered that their MFI used to employ different frequency types of payment methods including daily, weekly and monthly options depending on clients' requests. This fact was also confirmed by clients when the researcher interviewed them during fieldwork.

7.2.6 The Need for Training Programs for Customers

In this section, the researcher sought information about MFI managers' perceptions of the necessity for training MFI clients. Table 7.7 below shows managers' opinions regarding the necessity to provide management, technical and spiritual training to support clients and the facts from the field related to lack of training for clients of each type of MFI as described in the previous chapter. The question below was multiple choices which the managers could answer with more than one option (training).

Table 7.7 Training Needs for Clients based on MFI's Managers Point of Views

MFI's Managers Point of View				Clients' Answers*	
	A = Management	B = Technical	C= Spiritual	Training	No Training
BMT	3	0	4	60 **(56%)**	47 (44%)
BPR	5	4	4	13 (9%)	130 **(90.1%)**
BPRS	6	2	6	42 (34%)	81 **(66%)**
BRI	1	1	1	66 (32%)	142 **(68%)**
				181 (31.15%)	400 **(68.85%)**

*see table 6.14.

Table 6.14 shows that 68.85% of clients did not receive training during the loan period. Therefore, MFI managers' points of view concerning the necessity to provide clients with some type of training, whether management-technical-spiritual, as shown in Table 7.7, correspond.

7.2.7 Perceptions of Islamic or Conventional MFIs

Regarding the clients' preferences toward an Islamic MFI or conventional MFI, MFI's managers had the following perceptions are shown in Table 7.8.

Table 7.8 Managers Perception towards Clients Preference's for a MFI

	Managers' Perception about Client's Preferences	Client's Preference*
Islamic MFIs	72.22%	54.4%
Conventional MFIs	11.11%	45.6%
No Response	16.67%	0%

*see Table 6.16

It is surprising to discover that MFI managers' perceptions of MFI clients' preferences for an Islamic MFI (72.22%) were far more than in reality (54.4%). Even this perception came from conventional MFI's managers. This was also true of manager's perceptions of clients' preferences for conventional (11.11%) which was far smaller than clients' preferences (45.6%).

These results show that there are positive signals for developing Islamic MFI. With many potential demands for Islamic MFIs in a Muslim majority country like Indonesia, in addition to the fact of MFI's managers' perceptions, there is considerable scope for conventional MFI to convert to Islamic MFIs in the future. Over the last ten years in Indonesia, conventional banks have started to convert to be Islamic banks or opened dual windows, Islamic and conventional from starting points to move further towards becoming an Islamic bank. In 2005, BRI also established BRI *Sharia'h* (BRIS) to accommodate Muslim demands for Islamic microfinance products and services.

7.2.8 Clients' Understanding of Islamic Microfinance Products

In the previous chapter, it was noted that *murabahah* is the most popular and familiar Islamic finance concept for MFI clients. Nonetheless, it was only understood by 26.85% of clients.

Table 7.9 Understanding of Islamic Microfinance Products

MFI Type	MFI's Managers' Perception		MFI's Clients' Responses	
	Understanding about *Murabahah* concept			
	Understand	**Total**	**Understand**	**Total**
BMT	6 (100%)	6	54 (50.5%)	107
BPR	0 (0%)	5	4 (2.8%)	143
BPRS	4 (66.7%)	6	69 (56%)	123
BRI	0 (0%)	1	29 (14%)	208
	10 **(55.5%)**	18	156 **(26.85%)**	581
	Understanding about *Mudarabah* concept			
	Understand	**Total**	**Understand**	**Total**
BMT	5 (83.3%)	6	52 (48.6%)	107
BPR	0 (0%)	5	3 (2.1%)	143
BPRS	2 (33.3%)	6	36 (29.3%)	123
BRI	0 (0%)	1	21 (10.1%)	208
	7 **(38.9%)**	18	112 (19.28%)	581
	Understanding about *Musharakah* concept			
	Understand	**Total**	**Understand**	**Total**
BMT	1 (16.7%)	6	46 (43%)	107
BPR	0 (0%)	5	0 (0%)	143
BPRS	2 (33.3%)	6	25 (20.4%)	123
BRI	0 (0%)	1	11 (5.3%)	208
	3 (16.7%)	18	82 (14.12%)	581
	Understanding about *Ijarah* concept			
	Understand	**Total**	**Understand**	**Total**
BMT	0 (0%)	6	32	107
BPR	0 (0%)	5	0	143
BPRS	2 (33.3%)	6	35	123
BRI	0 (0%)	1	14	208
	2 (11.1%)	18	81 (14%)	581

The survey results for 581 respondents (see table 6.13) shows that only 26.85% of respondents understood the *murabahah* concept but 55.5% of MFI managers perceived (see table 7.9) that clients to know about it.

The survey also revealed that 19.28% of respondents understood *mudarabah* but from the managers' point of view, they were not supposed by MFI's managers to know so little, 38.9% of them believed clients understood it. The huge gap between what the clients understood and what the MFI managers perceived about their knowledge regarding microfinance products mean that the popularity of these products has been terribly underestimated by MFI managers.

MFI managers thought that two particular products were familiar to MFI clients but in reality these products are completely unknown.

Unrealistic expectations were not the case for the *musharakah* and *ijarah* concepts. Only 16.7% of MFI managers stated that clients understood musharakah and 11.1% of MFI Managers stated the clients understood *Ijarah.* The result of the survey showed that 14.12% and 14% of respondents understood both concepts. In this case MFI managers have an accurate perception of their clients' knowledge of Islamic microfinance products.

7.2.9 MFI Ranking Comparison between MFI Managers and Clients

Not only were MFI clients also asked to rank MFIs based on the categories below, MFI managers were also asked to rank their rivals. They mostly used to compare other MFIs before deciding to choose a particular policy or strategy. During interviews, the researcher discovered that every type of MFI has their own association and conducted regular meetings. In these meetings, they used to discuss new regulations or policies from Bank Indonesia or the Ministry of Cooperatives, especially for BMT, which would affect their daily business operations. Therefore, given that they had already known each other they had enough information to rank themselves properly compared to other MFIs.

Table 6.19 in the previous chapter shows the ranking for each type of MFI from 581 respondents. The results, based on customer perspectives, put BMT at the highest rank for *Sharia'h* compliance, and BPRS as the highest ranked for speed in processing applications and excellent relationship with loan officers. The other categories left BRI with the highest rankings. BRI was well known as an MFI with easiness, good application process, low interest rates, low collateral, and appropriate payment methods and was the most preferable MFI with good in overall performance.

Table 7.10 shows the ranking for each type of MFI from MFI's managers' perspectives. According to managers' point of view in determining the MFI rankings, there were different results compared to Table 6.19. BPRS and BMT got the highest ranking for *Sharia'h* compliance and BMT was ranked first for low collateral and most preference of MFI categories. BPR got the highest rank for speed in application process criteria. The rest of them still put BRI as the winner.

Table 7.10 Ranking of MFIs based on MFI Manager's Perspectives

Factors		BPR	BPRS	BMT	BRI
Shari'ah compliant	Rank	4	1	1	3
	Score	1.39	3.4	3.4	1.72
Easiness	Rank	2	3	4	1
	Score	2.67	1.83	1.78	3.72
Application process	Rank	3	2	4	1
	Score	2.33	2.667	2.2	2.78
Low Interest	Rank	3	2	4	1
	Score	2.17	2.5	1.44	3.89
Speed in process/Promptness	Rank	1	2	3	4
	Score	2.78	2.72	2.61	2
Low Collateral	Rank	3	2	1	4
	Score	2.3	2.5	3.56	1.67
Payment Methods	Rank	2	3	4	1
	Score	2.78	2.4	1.78	3
Loan's Officers	Rank	4	1	2	3
	Score	2.06	2.89	2.83	2.28
Preference	Rank	3	2	1	4
	Score	2.2	2.83	3.33	1.72
Overall	Rank	**4**	**2**	**3**	**1**
	Score	**1.89**	**2.78**	**2.2**	**3.17**

Table 7.11 shows the differences between MFI's managers and clients perspectives. These differences were realized to be biased as the number of MFI managers was not equal for all four types of MFI, particularly in the base of BRI which only had one vote. The final conclusion for MFIs rankings by clients and managers was also different. Managers ordered the highest rank starting from BRI, BPRS, and BMT to BPR respectively, clients gave BRI the highest rank followed by BPRS, BPR and BMT consecutively.

Table 7.11 Ranking of MFIs based on MFI Manager's and Clients' Perspectives

Categories	MFI's Managers' Rankings				MFI's Clients' Rankings*			
	BPR	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**
Sharia'h compliance	4	1	1	3	4	2	1	3
Easiness	2	3	4	1	2	3	4	1
Application process	3	2	4	1	3	2	4	1
Low Interest	3	2	4	1	4	2	3	1
Prompt in process	1	2	3	4	2	1	4	3
Low Collateral	3	2	1	4	4	3	2	1
Payment Methods	2	3	4	1	3	2	4	1
Loan's Officers	4	1	2	3	3	1	4	2
Preference	3	2	1	4	3	2	4	1
Overall Performance	**4**	**2**	**3**	**1**	**3**	**2**	**4**	**1**

*see table 6.19

The empirical data above provided interesting insights into what clients expect from a potential MFI, as well as the MFI's managers/Directors/chief executive officers' perceptions of clients' expectations. The result of this finding is that some MFI managers' perceptions are slightly different to those of their clients.

7.3 THE BALANCED SCORECARD (BSC) APPROACH

Financial elements are important for a MFI's operating in a market environment but non-financial elements are also equally important. The Balanced Scorecard (BSC) provides the "balanced" and "integrative" financial and non financial perspectives of a microfinance institution such as internal business processes, growth and learning, financial and customer perspectives as described further in Chapter Three. The linkages between the four perspectives create a well-designed and balanced strategy to improve a microfinance institution's performance. Most of the usage of the BSC approach is to observe a particular organization's overall performance over time, but in this research, it was used to compare the performance of microfinance institutions based on four of the BSC's elements with cross-sectional data.

The results of empirical findings on 18 MFIs based on the concept of the BSC in measuring the performance of an institution are described in Chapter Three. The following unique elements are only suitable for particular MFIs in particular place:

1. **Twelve elements of internal process**: (1) Human Resources, (2) Structure Organization, (3) MFI's Vision Determiner, (4) Daily operation controller, (5) Staff' Compensation, (6) Loan Officer's Compensation, (7) Comparison of salary, (8) Staff' Turn Over, (9) Line of Authority, (10) Work's Duplication, (11) Performance evaluation, (12) Transparency and Accountability.
2. **Eight elements of learning and growth**: (1) HR Department, (2) Clear policies, (3) Advertised Job opportunity, (4) Minimum Staff Criteria, (5) Min Staff experiences, (6) Training for Staff, (7) Annual Training Budgets and (8) Average NPL.
3. **Ten elements of customer's** factors in choosing a MFI: (1) *Sharia'h* Compliance, (2) Easiness, (3) Application Process, (4) Low interest/cost of capital, (5) Speed/Fast, (6) Low Collateral, (7) Payment Methods, (8) Loan's Officers, (9) Preference and (10) Overall performance.
4. **Six elements of financial performance**: (1) ROA, (2) ROE, (3) OSS, (4) Outreach-Breadth, (5) Outreach-Worth to clients and (6) Outreach-Depth.

7.3.1 The BSC Measurement

In this section, data from managers' questionnaires were processed into particular scores and compared to each other on the four BSC elements. These scored elements are standardized and averaged per group of MFIs. Standardization means that all the scores were divided by the highest score in each category so that the highest value after standardizing was 1. For further information, Appendix C1 and C2 show the difference in value between before and after standardizing. A MFI would first be ranked within its reference group (of others of the same type of MFI). In the end, MFI performance can be examined with either quantitative data (absolute) alone or in a combination of quantitative and qualitative information. Qualitative information in this section is the addition informational from MFI's managers captured in open questions. The data from these questions are summarized in Appendix D.

7.3.1.1 Internal Process Perspectives

Appropriate internal process objectives should be clearly determined by microfinance institutions. For example, reducing the time process of a loan is important in order to decrease its cost and intensify corporate governance. There are at least three dimensions inside a MFI: a vertical dimension between owners and management, a horizontal dimension between the MFI and its customers, and an external governance dimension (Mersland & Strøm, 2009, p. 662). In this study, three dimensions were included in MFI daily operations.

The variables in internal process perspectives in general are the following: structure organization, compensation, clearness of job description, control and performance evaluation. The internal process perspectives for microfinance institutions related to variables are contained in table 7.12 below. There were 19 questions regarding internal process perspectives. Twelve questions were closed questions and the rest were open questions. Data from closed questions were scored, standardized and averaged for each type of MFI and open-question data was processed by narrative explanations.

Table 7.12 Internal Process Perspectives Average Scores

Internal Process	BPRS	BPR	BMT	BRI
(IP1)Total Human Resources	0.39	0.4	0.17	0.33
(IP2) Structure Organization	1	1	1	1
(IP3) MFI's Vision Determiner	1	1	1	1
(IP4) Daily operation controller	1	1	1	1
(IP5) Staff's Compensation	0.83	0.8	0.67	1
(IP6) LO's Compensation	0.83	0.8	0.67	1
(IP7) Comparison of Salary	1	0.8	0.58	1
(IP8) Staff's Turn Over	1	1	1	1
(IP9) Clear of Line of Authority	1	1	1	1
(IP10)Work's Duplication	0.67	0.2	0	1
(IP11)Performance Evaluations	1	1	1	1
(IP12) Transparency & Accountability	1	1	1	1
Score	**10.72**	**10**	**9.083**	**11.33**

(IP1) Human Resources

Managers were asked to provide data about employee numbers. A MFI with less than 15 employees was scored 0, 16-30 employees was scored 1, 31-50 employees was scored 2 and more than 50 employees scored 3. Every MFI in the sample was scored, standardized and averaged according to its group. It should be noted that BPRS group had 6 BPRSs, BPR group had 5 BPRs and BMT group had 6 BMTs. The average score of BPR represents the total score of BPRs divided by the number of BPRS samples. For human resources factor, BPR got the highest score (0.4) and BMT got the lowest score (0.17). Because of the small scale of their businesses, BMTs need more clients and then more human resources to scale up their business. BRI (0.33) and BPRS (0.39) had moderate numbers of employees. The bigger score means the bigger the scale of MFI business.

(IP2) Structure of organization

In an in-depth interview, interviewer found that all MFIs have a clear organizational structure, a picture of which was hung on every MFI headquarters' wall. Score 1 for an MFI with a clear structure organization and score 0 for those which have an unclear structure of organization. Every MFI in the samples has a clear structure of organization, thus all of them were scored 1.

(IP3) Vision

Every MFI also has a stated vision for its institution therefore, all MFIs were scored 1.

(IP4) Daily operations

All MFIs were directed by a Director or CEO and so were all scored 1. These findings show that all MFIs meet the standards of a professional institution.

(IP5) Staffs Compensation and Salary

Managers were asked to fulfill how much money they gave to staff in the forms of monthly salary, incentives and allowances. These three components were added together as a take home paid income per month. Unfortunately, not all MFIs give these three components to their staff, some only gave monthly salary with incentives or allowances. The total results were scored in four ways: less than minimum regional wage (<1.5 million IDR) = 0, from 1.5 million IDR to 3.5 million IDR = 1, from 3.5 million IDR – 6 million IDR = 2 and more than 6 million Rp = 3. Every MFI in the sample was scored, standardized and averaged in a group. Table 7.12 shows that BRI was the highest (score 1) and followed by BPRS (score 0.83), BPR (score 0.8) and BMT (0.67) respectively.

(IP6) Loan Officers' Compensation and Salary

Managers were also asked to fulfill how much money they gave to loan officers in the form of monthly salary, incentives and allowances. These three components were added together as a take home paid income per month. Similar to the staff, not all loan officers get these three components from their MFIs some only gave monthly salary with incentives or allowances. In this research, similar to the evaluation of MFI staff, there were four scores as follows; less than minimum regional wage (<1.5 million IDR) = 0, from 1.5 million IDR to 3.5 million IDR = 1, from 3.5 million IDR – 6 million IDR = 2 and more than 6 million IDR = 3. Every MFI in the sample was scored, standardized and averaged in a group. Table 7.12 shows that BRI was the highest (score 1) and followed by BPRS (score 0.83), BPR (score 0.8) and BMT (0.67) respectively.

(IP7) Comparison of Salary

On the subject of salary, we compared MFI's salary to other banking and business sectors with the same level. Score 0 for MFI's salary less than other economy sectors, 1 for the same and 2 for more than other economy sectors. The findings of the comparison show that most BPRSs and BRI got score 2 which means that BPRSs and BRI employee' salaries were approximately higher than the average similar industry while BPR and BMT were approximately equal to the average salary in the same level of industry got score 1. After standardizing and averaging in each group, BRI and BPRS got final score 1, BPR got score 0.8 and BMT got score 0.58 which means approximately equal to the average salary in the same level of industry.

(IP8) Staff' Turn Over

All managers stated that staff/officer turnover rate is low and almost zero, hence, all MFIs were scored 1. If the staff' turnover rate was high, the score would be 0.

> **(Open Question IPa)** There were some factors which motivated staff to continue working in a MFI. The answers of each manager for this question could be more than one. Some of them were a sense of mission (33%), professional pride (39%), loyalty to the institution (33%), an appropriate salary (17%) and others. When the reviewer asked the managers about other aspects which drove them to join their MFI, some of them mentioned comfortable workplace, feeling secure, welfare system, a hope for future and a good interpersonal/relationships among team as important factors. For further information see open question lists in Appendix D.

(IP9) Clarity of Line of Authority

Clarity of authority included administration, marketing and loan approval authority. All managers stated and also demonstrated a clear line of authority; hence, all MFIs were scored 1, otherwise 0.

(IP10) Work's Duplication

Managers were asked to explain whether there were some work duplications in their office. They confessed that sometimes there were overlapping and duplicating tasks due to a lack of human resources and tight deadlines. Score 1 means that there was no significant overlapping and task duplication, otherwise they were scored 0. BRI is the best for this part (score 1) and otherwise BMTs were the worst. In some BMTs, BPRs and BPRSs, there were many overlapping and duplicated tasks. After scoring each MFI, then, standardizing and averaging them, the final score for BRI was 1, followed by BPRS 0.67, BPR 0.2 and BMT 0.

(IP11) Performance Evaluation

During the in-depth interviews, the interviewer received very similar responses from all managers that the performance of administration staff, loan officers and managers were routinely evaluated. Hence, all were scored 1.

(Open Question IPb) On the topic of management performance, the researcher asked managers to state three key indicators for each MFI which were regularly evaluated. The answers were similar: meeting targets (94%), proper administration tasks (39%), financial performance (17%), non performing loan/NPL (56%) and others (team work, religious, loyalty) were the key performance indicators for MFI management teams.

(Open Question IPc) In evaluating staff performance: administration (56%), the degree of accuracy of financial reports (44%), discipline (33%), targets (22%), honesty (17%) and others such as responsibility, loyalty and absence were the key indicators of staff performance.

(Open Question IPd) Regarding the key indicators on the performance of the loan officers which were regularly evaluated, most loan officers mentioned that the fulfillment of targets (94%) such as the size of loan and non performing loan/NPL (100%) were the most important points in yearly evaluation besides responsibility, good relationships and honesty.

(Open Question IPe) Most MFIs assigned a committee who had the authority to approve a loan but for a particular amount of loan, the commissioner who made an approval decision. A committee comprised a manager/director, loan officers and an operational team. In a few MFIs, in small ones in particular, a loan above US$2,500 must have been approved by the commissioner but in large MFIs, above US$5,000 loan which involved the commissioner. For further information, see the open question answers in Appendix D.

(IP12) Transparency and Accountability

On the topic of transparency and accountability, all MFIs had their own internal audit and published a financial report quarterly for the public. Especially for a MFI which has assets of more than 5 billion IDR, having an external auditor is a prerequisite of running the business based on Bank Indonesia regulation. Additionally, all MFIs used a particular management information systems software for operating daily transactions. Therefore, for transparency and accountability all MFIs got the same score of 1.

Overall score for Internal Process Perspectives is 11.33 out of a maximum of 12 for BRI (the best), followed by BPRS with 10.72, BPR with 10 and BMT (the worst) with 9.083, respectively.

7.3.1.2 Learning and Growth Perspectives

Learning and growth perspectives variables in a MFI concern the availability of human resources of a department, clarity of policies, professional systems of recruitment, minimum criteria for staff, sufficient budgets for training and staff development and the awareness of staff performance towards non-performance loans (NPL). Ten questions concerning learning and growth perspectives were asked of MFI managers. Eight questions are close questions and 2 questions are open questions. The answers to closed questions were ranked using a given score and for open questions, the answers were summarized in narrative form.

Table 7.13 Learning Growth Perspectives Average Scores

Learning & Growth (LG)	**BPRS**	**BPR**	**BMT**	**BRI**
(LG1) H&R Department	0.67	0.8	0.5	1
(LG2) Clear policies	1	1	0.83	1
(LG3) Advertised Job opportunity	0.5	0.5	0.5	1
(LG4) Minimum Staff Criteria	0.5	0.25	0.42	1
(LG5) Min Staff experiences	0.5	0.3	0.25	1
(LG6) Training for Staff	0.56	0.4	0.55	1
(LG7) Annual Training Budgets	0.72	0.47	0.2	1
(LG8) Average NPL	0.67	0.53	0.67	0.67
Score	**5.12**	**4.25**	**3.94**	**7.67**

(LG1) H&R Department:

BRI has a human resources department but not all branches of BPR, BPRS and BMT have it. From the sample, 20% of BPR, 50% of BMT and 1/3 of BPRS did not have special human resources department. Score 1 goes to the MFI that has human resources department, otherwise they are scored 0. Therefore, BRI scored 1, BPR scored 0.8, BPRS scored 0.67 and BMT scored 0.5.

(LG2) Clear Policies

All MFIs in the sample have a clear policy which is set out in written personnel manuals except for one out of 6 BMTs. Score 1 goes to MFIs that have a clear written policy, otherwise they are scored 0. As a result, BRI, BPR, BPRS scored 1 and BMT was scored 0.83.

(LG3)Advertised Job Opportunity

As a big commercial bank, BRI always advertises job vacancies in the mass media whether local or national. Only 50% of BPRS and BMTs and 40% of BPR did it regularly. For this category, score 1 is for a MFI which advertised its job vacancy and score 0 is for a MFI which did not advertise its job vacancy. Hence, BRI got score 1, BPRS and BMT got score 0.5 and the last BPR was scored 0.4. In the interview process, the interviewer received explanations regarding the reasons behind this figure. MFIs which did not open the job position to the public preferred to recruit staff with whom they are already well acquainted. Some respondents stated that honesty and integrity are crucial and mostly proved along with time of relationships.

(LG4) Minimum Staff Criteria

All MFIs have minimum criteria with regards to the qualification of their staff. Some MFIs state senior high school graduation as minimum criteria, whereas other MFIs require a Diploma or Bachelors degree as a prerequisite to apply for the position. With the assumption that hiring bachelors is better than a diploma or senior high school graduation, score 2 goes to the bachelors, score 1 goes to diploma and score 0 goes to senior high school graduation holder. As a result, BRI scored 2, followed by BPRS, BMT and BPR with scores of 1, 0.83 and 0.5 respectively. After standardizing and averaging, the final score for BRI was 1, followed by BPRS, BMT and BPR with scores 0.5, 0.42 and 0.25 in a row.

(LG5) Minimum Staff Experiences

Not all MFIs predetermined a minimum of years of experiences to apply for a position. Some MFIs put zero years experience as minimum criteria, whereas the other MFIs put one year or two-years experience as a prerequisite. With the assumption that hiring candidates with two-years of experience is better than one year or zero experience, score 2 goes to two-years of experience, score 1 goes to one-year experience and score 0 goes to zero experience. As a result, BRI scored 2, followed by BPRS, BPR and BMT with scores 1, 0.6 and 0.5 respectively. After standardizing and averaging, BRI scored 1, followed by BPRS, BPR and BMT with scores 0.5, 0.3 and 0.25 consecutively.

(LG6) Training for Staff

All MFIs but BMT were legally obliged by the central bank, Bank Indonesia, to send their employees (management team, staffs/loan officers) to attend training sessions throughout the year. The minimum yearly budget for training is 5% of a MFI's yearly personnel budget. Therefore, a MFI which sent its staff for training more than 10 times a year scored 3. Then, score 2 goes to 6-10 times a year, score 1 for 4-5 training sessions per year, score 0 goes to 3 or fewer training sessions per year. BRI has a specific program and budget for training supported by BRI's training centre. As a result, BRI scored 3, followed by BPRS and BMT with the same score 1.67 and the last was BPR with a score of 1.2. After standardizing and averaging, BRIs scored 1, followed by BPRS and BMT with the same score 0.67 and the last was BPR with score 0.4

> **(Open Questions-LGa)** Concerning the training program, 61.6% of MFIs stated that the training programs were institutionalized within their institutions and 39% stated otherwise, the training programs were not institutionalized within their institutions.

(LG7)Annual Training Budgets

According to central bank regulation from Bank Indonesia, it is compulsory for MFIs to spend 5% of the personnel budget on training. Therefore, the training budget for each MFI is different and depends on the size and the whole personnel budget for each MFI per calendar year. As BMT is not under Bank Indonesia's supervision but under that of the Ministry of Cooperatives, it does not have to meet this compulsory 5% and can freely manage budgets for training in proportion to their needs and targets. A MFI which has many branches mainly has a special training centre with the curriculum made suitable to its needs (tailor-made training). For this aspect, BRI scored 1, followed by BPRS (0.72), BPR (0.47) and BMT (0.2) respectively.

> **(Open Questions- LGb)** Training was held in the forms of in-house training 61.1%, training institutions 72.2% and tailor made training 11.1%. 39% of MFI institutions combined two types of training, in-house and training institutions.

(LG8) Average Target & NPL

The target, whether in Rupiah (IDR) or the number of clients for a loan officer per year, varies depending on the policy of each MFI's management. In some MFIs, the director or committee sets the target per group of loan officers and not per individual. In an interview, there was a group of loan officers with a yearly target of 1000 clients. It looked like a big number, but in Bandung, a high density city in Indonesia and even the world (2010) with more than 13,000 people per square kilometer this is a reasonable target. The normal density per square kilometer is 500 populations whereas in 2009, Bandung had an average density 13.345/km^2. Some MFIs also gave a special bonus or commission to loan officers who achieved the target or more.

When the reviewer asked how long it took for a loan officer to achieve the target, the answers varied from 3 months to 12 months. A loan officer is not allowed to acquire new clients if her/his existing clients have a non-performance loan (NPL) 5% or more. She/he has to maintain the non-performing loan (NPL) below 5% in order to get new clients which mean more bonus or commissions. Non-Performance Loan (NPL) of MFIs varied but still in a narrow range. A MFI with a NPL more than 5% scored 0. A MFI with a NPL from 3% to 5% was scored 1 and with NPL less than 3% was scored 2. For these categories, BRI scored 1, followed by BPRS, BPR and BMT who scored 1.16, 0.8 and 0.5 respectively. After standardizing and averaging, the final scores for BRI, BPRS and BMT were 0.67, followed by BPR with a score of 0.53.

> **(Open Questions-LGc)** When the researcher asked managers how long it took for loan officers to reach full potential or capacity on average. 28% said 3 months, 28% said 6 months, 17% said 12 months and the rest said one, seven, eight, ten months depending on the situation especially the economy.

The overall score for Learning and Growth Perspectives is 7.67 out of a maximum of 8 for BRI (the best) followed by BPRS with a score of 5.12, BPR with a score of 4.25 and BMT with a score of 3.94 (the worst) respectively.

7.3.1.3 Customer Perspectives

The quantitative and qualitative stages were pivotal for a number of reasons. Within this context, it was important to learn customer/clients perspectives, and the qualitative research stage provided such an opportunity. In addition to using quantitative methods to get empirical data, an in-depth face-to-face interview technique was used to explore the emotional dimensions of customer's opinions.

Table 7.14 Customer/MFI Clients' Perspectives

Customer/Clients Perspectives (CP)	**BPRS**	**BPR**	**BMT**	**BRI**
(CP1) *Sharia'h* Compliance	0.75	0.25	1	0.5
(CP2) Easiness	0.5	0.75	0.25	1
(CP3) Application Process	0.75	0.25	0.5	1
(CP4) Low Interest/Cost of Capital	0.75	0.5	0.25	1
(CP5) Speed/fastness	0.75	1	0.5	0.25
(CP6) Low Collateral	0.75	0.25	0.5	1
(CP7) Payment Methods	0.75	0.5	0.25	1
(CP8) Loan Officers Profile	0.75	0.5	0.25	1
(CP9) Preference	0.75	0.5	0.25	1
(CP10) Overall Performance	0.75	0.5	0.25	1
Score	**7.25**	**5**	**4**	**8.75**

The questionnaires related to customer perspectives were composed of ranking questions which asked respondents to place the microfinance institutions (BPR, BPRS, BMT and BRI) in rank order according to several criteria. Such questions are useful to discover the customer/clients perspectives on many issues regarding products and services. Every respondent scored in the following manner: the best 1, good 0.75, average 0.5 and the worst 0.25. Customer perspectives data comes from Chapter Six and the scores were counted in Appendix B.

According to customer perspectives, BMT is the best MFI for *sharia'h* compliance followed by BPRS, BRI and BPR respectively. Regarding the most available and relatively easy to find criteria, BRI was scored highest followed by BPR, BPRS and BMT in that order. Correspondingly, for credit application process, BRI received the highest followed by BPRS, BMT and BPR. As a state commercial bank fully supported by the Indonesian government with many cross subsidies for micro-credit, inevitably, BRI is still the cheapest in terms of credit interest rate. This score was followed by BPRS in second place, BPR and BMT third and fourth respectively. However, BPR cemented its position as the fastest in terms of funding process (speed) followed by BPRS, BMT and then BRI. BRI is well-known as a cautious MFI which asks for complete supporting document from a prospective client as a prerequisite to the credit decision process. As a consequence of its cautiousness, BRI has the lowest requirements for collateral compared to other MFIs and was followed by BPRS and BMT respectively. On the other hand, BPR required more collateral due to its condition dealing with high risk customers. BRI is presumed to be the most suitable in terms of payment methods after BPRS, BPR and BMT in a row. BRI's loan officer approach towards clients is more preferred than other those of the other MFIs. Based on their knowledge and perceptions towards the four types of MFI, most clients preferred BRI over other types of MFI. After choosing BRI as the first priority, BPRS is considered to be second priority, BPR as the third and BMT last overall. Overall score for Customer Perspectives is 8.75 out of a maximum of 10 for BRI (the best) followed by BPRS with a score of 7.25, BPR scored 5 and BMT received the lowest score - 4.

7.3.1.4 Financial Perspectives

Various financial performances undeniably give MFI shareholders and stakeholders financial information through the various components of quarterly and annual reports, including cash flow, balance sheet, income statement and financial ratio analysis. Some of the more popular sustainability indicators for microfinance institutions include: financial sustainability (return on assets (ROA), return on equity (ROE), operational self-sufficient (OSS)), outreach (breadth, depth and worth to clients), efficiency and loan repayment (Rosenberg, 2009). Based on the availability of data, in this study, ROA, ROE, OSS were used as financial ratios and the outreach of MFIs, breadth, willingness to pay, depth as the other indicators.

For financial perspectives, the financial reports of each MFI were collected and analyzed. Financial reports of BRI, BPR and BPRS are easily found at the central bank's website because they are under Bank Indonesia's supervision. It was not the case for BMTs which are not under the central bank's supervision. The Ministry of Cooperatives which is supposed to oversee cooperatives including BMTs did not supervise them regularly and appropriately so that it was hard to acquire information concerning financial performance and other management issues. Some BMT associations including PINBUK, BMT centre, INKOPSYAH, BMTkopsyah have regular meetings on the regulatory issues of BMTs. These associations are informal and there is no obligation to report regularly to the head of the association except in the case of INKOPSYAH which deals with loans and repayments to the association. But to make a BMT reliable and credible in front of shareholders, customers and stakeholders, Dinas Koperasi (Cooperative Division) in each province in Indonesia regularly collects and publishes their financial reports as a form of responsibility to the public.

Regarding financial performance of each MFI, there is no particular pattern between the four types of MFIs. Even in one type of MFI which contains six samples of MFI such as BPRS and BMTs, similarities in financial performance are difficult to identify. In other words, we could not say that if we found a good / bad MFI in a specific group, it did not mean that all MFIs in that category are good/bad as well. Table 7.15 shows the result of financial perspectives per type of MFIs.

Table 7.15 Financial Perspectives

Financial Perspectives (FP)	**BPRS**	**BPR**	**BMT**	**BRI**
(FP1)ROA	0.54	0.5	0.42	0.75
(FP2) ROE	0.63	0.3	0.38	1
(FP3) OSS	0.5	0.45	0.42	0.5
Outreach				
(FP-O1) Breadth	0.42	0.4	0.5	0.5
(FP-O3) Depth	0.42	0.45	0.67	0.75
(FP-O2) Worth to clients	0.5	0.84	0.75	0.6
Score	**3.01**	**2.94**	**3.14**	**4.10**

The financial ratios are obtained from MFIs financial reports and outreach indicators were gathered from in-depth interviews with managers.

(FP1) ROA

For measurement and scoring purposes in Table 7.15, the researcher put score 0 for ROA less than 0, score 1 for ROA's range between 0% and 2%, score 2 for ROA's range between 2.01%-4%, score 3 for ROA's range between 4.01%-6% and score 4 for a range of more than 6% (see appendix C1). After scoring, the data were standardized and averaged per type of MFI. The highest ROA went to the BRI unit, the second highest to BPRS, BPR and BMT were the third and fourth highest for ROA, respectively.

(FP2) ROE

For ROE measurement, the researcher put score 0 for ROE less than 0, score 1 for a range between 0% and 10%, score 2 for a range between 10.01%-20%, score 3 for a range between 20.01% and 30% and 4 where ROE was more than 30%. Similar to ROA's scoring method; ROE was also standardized and averaged before being utilized as a BSC score. In general, the highest ROE was the BRI unit, followed by BPRS in second place, BMT in third place and BPR in last place.

(FP3) OSS

Operational self-sufficient (OSS) ratio measures the adequacy of a MFI's revenue to cover its costs. The original ratio of OSS was taken and then standardized and averaged before putting those scores as BSC's score lists. BRI and BPRS have the same highest score, followed by BPR and BMT respectively.

Outreach indicators show MFI impact on society. Most MFI experts put them together with the financial indicators. In this section, there are three indicators of outreach presented; breadth, depth and worth to clients.

(FP-O1) Breadth

Breadth is the number of MFIs clients covered by the MFI. A MFI which has less than 500 clients was scored 0. Score 1 for a MFI with clients between 501 and 1500 clients, score 2 for a MFI with clients between 1501 and 3000, score 3 for a range of 3001 to 5000 and score 4 for an MFI which has more than 5000 clients. The scores were standardized and averaged by MFI type. As a result, BRI and BMT got the highest score and were followed by BPRS and BPR consecutively.

(FP-O2) Depth

The outreach indicator depth is the average loan size per GNI per capita. As the GNI per capita for each respondent is the same, hence, it does not need to be taken into account for the scoring process. Similar to data for willingness to pay above, data on average loan size was collected in the survey of MFI managers' perceptions of clients' perceptions (see Table 7.4). There were five options of answers chosen by MFI managers to state the average loan size that their MFI gave to their clients.[16] Those who answered option a (<2 millions IDR) received score 4, option b (2-5 millions IDR) received score 3, etc. After the scoring process, the data were standardized and averaged by MFI type. The results show that BRI had the highest score, followed by BMT, BPR and BPRS respectively. This fact shows that BPRS managers gave bigger loans/client than other MFI managers did and BRIs managers gave the smaller loan/clients than others did. The smaller loan/clients, the more poor clients are reached and the bigger outreach score.

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[16] See lists of questionnaires in Appendix

(FP-O3) Worth to Clients

Data for worth to clients (defined as willingness to pay) were captured in a survey of managers' perceptions of clients' perceptions (see Table 7.5). There were five answer options chosen by managers to predict the willingness of clients to pay a monthly interest rate.[17] The average of interest rate was put as a score for example: Those who answered option c).1%-2% were scored 1.5 or d). 2%-3% were scored 2.5 and etc. After the scoring process, the data were standardized and averaged per type of MFI. As a result, BPR had the highest score, followed by BMT, BRI and BPRS respectively. This fact shows that BPR managers perceived more than other MFI's managers concerning the clients' capability or willingness to pay high interest rates.

The overall score for financial perspectives was 4.1 out of a maximum of 6 for BRI (the best) is followed by BMT with score 3.14, BPRS was scored 3.01 and BPR was scored lowest with 2.94.

7.3.2 Overall Performance of MFIs based on Balance Scorecard Perspectives

The overall scores of Balanced Scorecard from four perspectives for MFIs can be seen in Table 7.16 below. BRI received the highest score 31.85 out of a maximum of 36, BPRS was second with a score of 26.09, followed by BPR and BMT in the third (22.19) and fourth place (20.16) respectively.

Table 7.16 Balanced Scorecard in MFIs

	BPRS	**BPR**	**BMT**	**BRI**
Internal Process (IP)	10.72	10	9.08	11.33
Learning & Growth (LG)	5.11	4.25	3.94	7.67
Customer/Clients Perspectives (CP)	7.25	5	4	8.75
Financial Perspectives (FP)	3.01	2.94	3.14	4.10
OVERALL SCORE	**26.09**	**22.19**	**20.16**	**31.85**

In all perspectives, BRI's performance is the best. The structure of BRI as the largest MFI in Indonesia has been proven too robust, in addition to, its power from full government support to compete with other small MFIs. As Islamic microfinance, BPRS's performance is the second best. In almost all elements, BPRS is better than BPR and BMT in this research, but BMT performs better in financial perspectives. BMT, over all, received the lowest score

[17] See lists of questionnaires in Appendix

except in financial perspectives. With the lowest score for internal process, learning-and-growth and customer satisfaction, BMT appears not to be managed. If this condition continues, it will jeopardize the institution in the long run.

7.4 THE BSC – PERFORMANCE MODEL

From IP1 to FPO3 indicators are the Key Performance Indicators (KPI) for a MFI from four perspective based on this research. Following the background, literature review and empirical data from the previous chapter, in this section, the relationship or a causal-effect among perspectives, (1) internal process, (2) learning and growth, (3) customer, (4) financial, are examined in order to reveal which perspectives influence others when supporting and sustaining the performance of an MFI.

The BSC model postulates a causal-effect chain that leads from the capability of internal business process through learning and growth to customer perspectives and ultimately affects the financial performance. This structure is consistent with the Balanced Scorecard concept developed by (Kaplan & Norton, 1996a, 1996b, 2001) who emphasize the importance of keeping a balance between the financial and non-financial elements in the business entity. Further information about the causal-effect chain of the BSC can be found in Chapter Three. Therefore, the hypotheses for this model are as follows:

H_1: Internal Process' Perspectives are positively related to Customers' Perspectives

H_2: Internal Process' Perspectives are positively related to Financial Perspectives

H_3: Learning & Growth Perspectives are positively related to Customers' Perspectives

H_4: Learning & Growth Perspectives are positively related to Internal Process Perspectives

H_5: Financial Perspectives are positively related to Customers' perspectives

H_6: Financial Perspectives are positively related to Learning & Growth Perspectives

7.4.1 The Statistical Result of Correlation Between BSC's Elements

This section reports the findings from a study examining the relationships between the BSC elements embedded in the structure of MFIs in Bandung. It further develops the current understanding of the pivotal elements in MFI decisions made by stakeholders (management, customers, shareholders, employees) that in turn affect the sustainability of the MFI itself. The main purpose is to increase our understanding of the factors that influence a MFI's financial performance, specifically, its relationships to internal process, customer, learning and growth and financial perspectives.

Table 7.17 Correlations of Different BSC Perspectives

Correlations Between BSC Perspectives							
			Av_IP	Av_CP	Av_LG	Av_FP	Av_OutR
Spearman's rho	Av_IP	Correlation Coefficient	1.000	.638**	.357	.283	.387
		Sig. (2-tailed)	.	.004	.146	.256	.113
		N	18	18	18	18	18
	Av_CP	Correlation Coefficient	.638**	1.000	.581*	.354	-.042
		Sig. (2-tailed)	.004	.	.011	.150	.870
		N	18	18	18	18	18
	Av_LG	Correlation Coefficient	.357	.581*	1.000	.474*	-.116
		Sig. (2-tailed)	.146	.011	.	.047	.646
		N	18	18	18	18	18
	Av_FP	Correlation Coefficient	.283	.354	.474*	1.000	.321
		Sig. (2-tailed)	.256	.150	.047	.	.194
		N	18	18	18	18	18
	Av_OutR	Correlation Coefficient	.387	-.042	-.116	.321	1.000
		Sig. (2-tailed)	.113	.870	.646	.194	.
		N	18	18	18	18	18

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The correlation between the four perspectives can be seen in Table 7.17. There are strong significant correlations (63.8%) between internal process and customer's perspectives with p-level 0.004. There are also significant correlations (58.1%) between customer's perspectives and learning-and-growth with p-level 0.011. The other significant correlations (47.4%) are between learning-and-growth and financial performance with p-level 0.047 which slightly less than 0.05 as the significance level (see figure 7.1).

From the 6 hypotheses which were statistically tested, the empirical data showed only three hypotheses could be proved to be statistically significant:

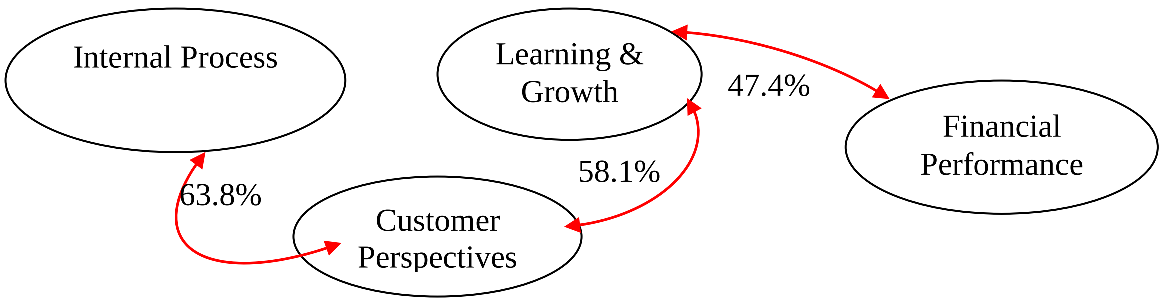
H_1: Internal Process' Perspectives are positively related to Customers' Perspectives

H_3: Learning & Growth Perspectives are positively related to Customers' Perspectives

H_6: Financial Perspectives are positively related to Learning & Growth Perspectives

The other hypotheses; H_2, H_4, H_5 were not proved to be statistically significant in this research. When the financial performance was combined with outreach and the empirical data run together with the other three perspectives, there was no correlation at all for financial performance and outreach with other perspectives. Similar results were found when using the outreach element itself. Therefore, after taking outreach from financial performance perspectives separately, the results turned out to be different. Therefore, it can be concluded that outreach did not have correlation with BSC perspectives.

Figure 7.1 Structure of MFI's Performance based on BSC elements



According to BSC's cause-and effect assumptions, every perspective underpins and delivers the right performance to other perspectives. But in this research, we found that a good internal process in a MFI, such as sufficiency and professionalism of human resources which were supported by the satisfactory salary and compensation, would reduce the employee's turnover ratio. A robust structure with a clear vision of organization can lead to a lucid line of authority and job description so that number of duplicated tasks is decreased and daily operations controlled. Transparency and accountability either in process and evaluation are also very important to achieve the objective of internal process in a MFI. All elements in internal process perspectives affected customers' satisfaction.

Not only does internal process affect customers' satisfactions, learning and growth perspectives also affect it significantly. The availability of an H&R department with clear policies in a MFI built high motivation for employees to learn more and go further in their careers. Equal opportunity and opportunity to attain a position supported by well-educated and proper experienced employees create a healthy and comfortable work environment. To anticipate the growing environment, management, staff and loan officers should be sent to training programs periodically. For these purposes, a MFI has to manage the sufficient budget yearly. Under professional and well-trained officers in a MFI, it was expected that nonperforming loans (NPL) will be reduced significantly and customers would also get more benefit from this cooperation.

Feedback on customers' satisfaction can alert MFI management teams to reevaluate the internal process and learning-and-growth elements. In this research there is no direct relationship between customers' perspectives and financial performance perspectives could be found. But an indirect relationship through learning-and-growth perspectives existed between customers' perspectives and financial performance perspectives. However, it is improper to analyze every perspective partially as they are dependent, cohesive and integrated to each other in the organization. Further analysis related to correlation between each elements of the BSC model is presented in Appendix C3.

7.5 FINDINGS FROM WAQF INSTITUTIONS AND REGULATORS

In addition to the survey which involved demand and supply sides of MFIs presented in the previous two chapters, the researcher also conducted interviews with two managers of *waqf* institutions and a simple FGD (Focus Group Discussion) which involved a regulator from central bank. This section comprises two parts: the first part is related to *waqf* institutions and the second part discusses the result of FGD with a regulator.

7.5.1 Possibility of Indonesian *Waqf* Board (IWB)'s Collaboration with MFIs

When the interviewer asked questions to Indonesian *Waqf* Board (IWB)'s member about the possibility of *waqf* fund investment in Islamic microfinance institutions, he answered that the MFI sector is one of IWB's intended areas of interest and portfolio but at that moment, IWB was focused on building a hospital from the *waqf* funds. To facilitate the collection of *waqf* funds for this purpose, arrangements have been made with eight large Islamic commercial banks to receive *waqf* funds from donors under IWB's supervision. The member also stated that IWB plans in the short term to invest part of the *waqf* fund in Islamic MFI because of its high development potential and also to reduce the unemployment rate. The instrument and the legal environments exist to support these partnerships. IWB favours investment in MFI only in the form of equity/capital (share ownership) with an expected minimum return of 10% per year and soft loans (*qard hassan*). The IWB prefers to share in the ownership when collaborating with MFIs. If a soft loan (*qard hassan*) is given, IWB would provide it for a period of three months only.

7.5.2 Possibility of Tabung Wakaf Indonesia (TWI)'s collaboration with MFIs

When the interviewer asked about the possibility of investing *waqf* funds in Islamic MFIs, the head of Tabung Wakaf Indonesia (TWI) answered that Islamic MFI is one of TWI's existing investment portfolios. He then said that TWI plans in the short term to invest part of the *waqf* fund in BMT Ventura (the name of a MFI). He added that MFI is a tool to reduce unemployment and in the long run can be expected to alleviate absolute poverty. But TWI favours investment in MFI only in the form of equity/capital (share ownership) with the expected minimum return of 11%/annum. However, TWI prefers to invest in MFIs that are a part of their group rather than those which are not.

7.5.3 Opinion of MFI's Managers with regard to the Utilization of *Waqf* funds for Supporting Islamic MFIs.

As part of the survey on MFI managers' opinions illustrated in Chapter Seven, their views on the existence of *waqf* divisions and *waqf* funds in their MFIs were also requested. These questions are mainly addressed to Islamic MFI managers, although it was open to conventional MFIs' managers as there is a possibility that conventional MFIs have a *waqf* division as well. Only 50% of the managers from 12 Islamic MFIs gave their opinions on *waqf* issues. The other 50% said that they did not know whether there would be the possibility of utilizing the *waqf* funds as an additional source of funds for MFIs. The survey found that there were no Islamic MFIs with a *waqf* unit in their operations. Some of them said that they did not have any idea how such a unit would work in a practical way. All Islamic MFIs' managers knew that *waqf* was an Islamic voluntary sector instruments and *waqf* fund can be one of the *waqf* assets. Table 8.1 shows the opinion of some Islamic MFIs' managers about the utilization of *Waqf* funds for supporting needy clients in their institutions.

Table 7.18 Islamic MFI Managers' Opinions on Utilization of *Waqf* Fund in Islamic MFIs

BPRS1	*Waqf* fund will enhance MFI's financial performances and liquidity. *Waqif* will be easy to give a cash *waqf* directly to micro entrepreneur through a particular Islamic MFI. The portion of *qard hassan* will be higher the more cash *waqf* collected. To do this, it will need more human resources and operational cost, administration, notary and survey costs will increase.
BPRS2	*Waqf* fund will create positive image for Islamic MFI and hopefully the intention of *waqifs, nazirs* and the beneficiaries will be *blessed by God*. It will need more human resources and operational cost. *Waqf* fund can be a perennial endowment fund in an Islamic MFI.
BPRS4	*Waqf* fund will bridge the difference between the rich and the needy. Enforcement of *zakah*, *infaq* and *sadaqah* as the *qard hassan* can help micro-entrepreneurs. Soft loans from government or private can be used for *qard hassan* fund.
BPRS5	*Waqf* fund will be useful for the poor who do not have sufficient collateral. Linkage program between Islamic MFIs and other institutions such as *waqf* institutions, commercial Islamic banks and other Islamic financial institutions will reduce the cost of financing and provide *Qard Hassan* for the needy micro clients.
BPRS6	Firm's *qard hassan* is distributed to the needy through special division in firm's group. Those *qard hassan* funds can also be distributed to the needy clients' of Islamic MFIs through MFI's management. This cheaper source of capital can reduce the cost of fund for MFIs clients. It hopefully will increase the proportion of saving account from the needy clients as well.
BMT2	*Waqf* fund will be an added value for BMT. But unfortunately, it can potentially create a new problem for Islamic MFIs. If there are some clients who get *qard hassan* and the others don't, the latter clients will ask for similar services. This discrimination, for some clients, is looked as unfair policy and will make them reluctant to pay the cost of their loan (mark-up margin). It will be quite difficult to hide the information from clients concerning who got *qard hassan*. For Islamic MFI itself, with *waqf* fund as *qard hassan* will decrease the dependency to other money supplier (other big commercial Islamic banks) and at the same time the capital of the MFIs owner will be getting bigger.
BMT5	*Waqf* fund can help the needy who start their micro business.

In general, managers of Islamic MFIs agreed and fully supported the involvement of *waqf* funds as addition capital for needy clients. The advantages of utilizing *waqf* funds identified by them include the following:

1. *Waqf* funds will enhance MFI's financial performances and liquidity rate
2. *Waqf* funds will create positive image for Islamic MFI
3. *Waqf* funds can be a perennial endowment fund in an Islamic MFI
4. *Waqf* funds will bridge between the rich and the needy
5. *Waqf* funds will be useful for the poor who do not have sufficient collateral

6. This cheaper source of capital can reduce the cost of funds for MFI clients
7. It will increase the proportion of saving account from needy clients
8. *Waqf* funds can help the needy to start their micro business

However, they also point out some important conditions as prerequisites for utilizing the *waqf* funds:

1. Need more human resources for this special division
2. A new special division and product will need more operational cost, administration notary and survey costs to identify the *waqf* beneficiaries
3. It can potentially create a new problem for Islamic MFIs as *waqf* may create unequal opportunities to get cheaper or zero financial charges on financing between clients in the same MFI
4. This discrimination, for some clients, will be perceived as an unfair policy and will make them reluctant to pay the cost of their loan (mark-up margin)

The ways in which additional funds can be gathered include:

1. Enforce z*akah*, *infaq* and *sadaqah* as *qard hassan* for helping micro entrepreneurs
2. Soft loans from government or private can be *qard hassan* funds
3. Linkage programmes between Islamic MFIs and other institutions such as *waqf* institutions, commercial Islamic banks and other Islamic financial institutions

7.5.4 Regulatory Perspectives

In order to gain comprehensive perspectives about the problems facing microfinance, a simple FGD (Focus Group Discussion) on Islamic microfinance was organized on 19th of October 2010 at the University Padjadjaran, Bandung Indonesia. The event was attended by 150 students, 18 MFI directors (our respondents), 15 academicians and a senior staff from the central bank as a regulator. There were 4 main speakers: the director of BRI *Shari'ah* (BRIS), the director of BPN *Shari'ah* (BPNS), a senior head of division of central bank and one lecturer. After four speakers shared their papers for 15 minutes each, there were Q&A and discussion sessions for 30 minutes. The main purpose of this discussion was to understand new information from microfinance practitioners and regulators in order to engage them with dialogue and discussion about the problems of microfinance in general and Islamic MFIs in particular. The questions-and-answers (Q&A) and discussions were written in a minute-book.

The first speaker from BRI *Shari'ah* (BRIS) presented the BRIS program, the development of micro banking products, and future targets. Almost similar to BRIS, the second speaker from BPN *Shari'ah* (BPNS) presented the product of his bank and the future plan. The third speaker, a senior head division of central bank, Bank Indonesia, presented the regulator's perspective about microfinance and voluntary sectors in Indonesia. The last speaker, a lecturer, gave a presentation on the role of *waqf* in supporting and sustaining the operations of Islamic MFIs.

In the next part, the regulator's perspective on MFI issues based on questions from the audience and MFI representatives in particular are presented. The results from the Q&A and discussions are summarized as the following:

7.5.4.1 Unfair Competition among MFIs

Unfair competition perceived by some MFI actors raises a question regarding the privileged treatment for BRI. One manager asked the regulator's point of view towards unfair competition perceived by BPR, BPRS, and BMT with regards to the government's policy which gives privileged treatment to BRI in terms of massive facilities and subsidized loans. The official from the central bank said that many financial institutions such as large commercial banks, rural banks, cooperatives both conventional and Islamic, offer micro loans to active small and micro borrowers in Indonesia. The competition between the providers is tough and inevitable. Regulators try to accommodate all of these financial institutions' interests with the proper regulations. But satisfying all of the parties involved is impossible. Some banks are owned by Indonesian citizens (state owned banks), other banks by foreign companies and the rest are owned by privately owned by individuals. However, micro borrowers always get considerable benefit from the fierce competition between MFIs as they get competitive interest rates and excellent services as a consequence. Based on this argument, the regulator tends to stand on micro-borrower's side. As a result, MFIs provide excellent services and cheaper, competitive financial charges to attract potential clients.

BRI, as a large state commercial bank with a micro banking division, is in an advantageous position. The government has a special program for active micro entrepreneurs through BRI's subsidy rate which is good news for most clients who benefit from the program. However, this appears unfair for other MFIs especially BPR, BPRS or BMTs which charge the high financial cost of micro loans to their clients. Therefore, these microfinance institutions have to find specific target markets that will stay loyal to them irrespective of the lower rates of BRI's. However, Indonesia has a large population and BRI cannot satisfy the needs of all with their subsidized rates. Furthermore, the subsidy rate is given rarely, infrequently and is unpredictable. Indeed, to attract the masses' attentions and create a particular image especially before general elections, the incumbent president usually announces the special subsidy rate for loans through BRI as a state bank.

Other facts revealed in focus group discussion were the existence of a linkage program between MFIs with the big commercial banks. It is no longer a secret that small MFIs borrow money with a lower interest rate, still higher than Bank Indonesia's rate, from large commercial banks, even from BRI, and then lend that money to their clients. Therefore, from the regulator's point of view, instead of considering the profit of the owners of BPR/BPRS, it is better to provide needy clients access to cheaper sources of funds from BRI. As BRI's stakeholders, Indonesian citizens deserve to access the cheaper sources of funds and other direct and indirect benefits from the government as long as they are eligible.

7.5.4.2 Prudent Regulation

A MFI manager raised a question concerning the regulator's point of view towards prudent regulation and standardization of supervision that are perceived to be either too difficult to comply with or not suitable with the nature of MFIs. In response, the regulator said that Bank Indonesia has many new regulations to satisfy MFI needs. Bank Indonesia responds to the needs of MFIs with flexibility but still wants to keep the basic principle of financial prudence.[18]

7.5.4.3 Waqf based Islamic MFIs

A participant asked the official from central bank for his views on the concept of *waqf* based Islamic MFIs. He replied that MFIs under Bank Indonesia's supervision are commercial rural banks with profit-oriented motives. As a business entity, a MFI has a responsibility towards its

[18] Every single regulation can be downloaded from Bank Indonesia's website. Unfortunately, most of regulations published in that website in Indonesian language.

stakeholders and shareholders. Profit maximization is still an ultimate goal in the banking system and Islamic MFIs are no exception. Therefore, if we hope MFIs have double roles, both as commercial and charity institutions, it is too difficult and not compatible with the bank's nature.

The central bank as regulator and supervisor does not have regulation to regulate these kinds of double functions. There is no single regulatory standard or rule to regulate *waqf* in banking or microfinance which are under central bank supervision. He then stated that *waqf* is one of the voluntary or third sectors which is more suitably regulated by the Ministry of Religion or the Ministry of Social Welfare.

7.6 CONCLUSIONS

Based on the findings obtained from the fieldwork in Chapters Six and Seven, a number of research questions and hypotheses developed that were tested in this study. More broadly, the objectives for this section were to determine: the relationships between the various elements of the BSC in the MFI context and whether these factors were related each others. Further, a review of the literature found no specific framework or construct for microfinance to use as guidance for the present study. Consequently, qualitative exploratory work was necessary to develop an understanding of MFI elements and their variables.

This empirical chapter presented the research findings from the MFI side. In response to the findings of the demand side in Chapter Six, in the beginning of this chapter, we presented what MFI managers perceived about their clients' perceptions. Although MFI managers or chief executive officers were given the same questions and criteria as MFI clients, the results were still slightly different. MFI managers' point of view concerning the necessity to provide clients with some types of training is suitable with the fact that the majority of clients never received prior training.

It is significant that MFI managers' perception of their clients' preferences towards Islamic MFI's were different from the reality. This perception was true even for conventional MFI managers. These facts show that there are positive signals for developing Islamic MFI in the future.

Overall scores of the Balanced Scorecard from the four perspectives for MFIs cemented BRI as the best performer, BPRS in the second place, followed by BPR and BMT in the third and fourth place respectively. The structure of BRI as a biggest MFI in Indonesia is proven too robust, in addition to, so powerful with full government support to compete with other small MFIs. In contrast, BMT showed a weak institutional structure in terms of internal processes, learning-and-growth and customer satisfaction. It seems that BMT is not managed well according to BSC's key performance indicators. Among four perspectives, there are also strong significant correlations between internal processes and customer's perspectives, between customer's perspectives and learning-and-growth and between learning-and-growth and financial performance. Therefore, the balance of these four perspectives can sustain the development of microfinance institutions comprehensively.

The last part in this chapter explored empirical finding from *waqf* institutions and regulator perspectives. This part also presented a possible interface between *waqf* funds and MFIs by examining the opinions of MFI managers and regulators on the topic.

CHAPTER 8

DISCUSSIONS AND CONTEXTUALISING THE FINDINGS

8.1 INTRODUCTION

The fact that the growth of Islamic MFIs lags far behind conventional MFIs in the country with the largest Muslim population in the world as presented in Figure 1.1, has been explained through the findings in empirical Chapters Six and Seven. This chapter aims to contextualize the empirical findings in light of the theoretical discussions and information presented in the literature review chapters. The aim of this chapter is to use the information and then arrive at conclusions that can be applied in the real world in general and in Indonesia in particular. Recalling from the first chapter, one of the objectives of this research was to investigate scope of integrating *waqf* and microfinance and to propose policies that can be implemented in Indonesia.

The final part of the previous chapter as presented in Section 7.5 expounds the findings related to the possible interface between *waqf* funds and MFIs by examining the opinions of both *waqf*'s and MFIs' managers and also regulators. This chapter contextualizes the findings. To do so, issues identified in the last two chapters are presented in consideration of the potential role of *waqf* in this context. In this chapter, the findings are integrated, linked and discussed with the demand and supply side issues and literature review. The chapter takes the following structure: Section 8.2 presents the discussion of empirical findings from demand and supply sides of MFIs. Section 8.3 presents a discussion of the empirical findings from *Waqf* institutions' managers, regulators and Islamic MFIs' managers.

8.2 DISCUSSIONS OF EMPIRICAL FINDINGS FROM DEMAND AND SUPPLY SIDES OF MFIs

This section contextualizes the findings from the three parts of the previous chapters namely the literature review, the demand side and the supply sides analysis. The literature reviews discussed in Chapters Two and Three were comprised mainly relevant studies of microfinance and the voluntary sectors especially *waqf*. Chapter Four discussed past studies relating to Indonesia's experiences of the two issues above from the statistical data and the literatures pertaining to the growth and performance of the microfinance and *waqf* sectors in Indonesia. Chapter Five discussed the methodology used to achieve the aim, objectives and answer the research questions. In general, the literature review provides the theoretical basis and the necessary input from previous studies. The last two chapters, Chapter Six and Seven reveal the reasons behind sluggish growth by Islamic MFIs from clients' and institutions' perspectives. Among others the profile, perceptions, understanding, preferences, reasons for MFIs clients choosing a particular MFI, MFI's managers, *nazir's waqf* and regulator views on clients' perceptions were examined. Furthermore, the Balanced Scorecard of MFIs using both quantitative and qualitative analysis was carried out.

Before going further to explore the possibility of integrating Islamic microfinance and *waqf* institutions, the concepts/findings affecting this relationship are presented and linked to past studies discussed in the literature review. This discussion focuses on the characteristics of players, clients and management teams in these institutions and the structure of each institution as a whole. The next subsection, discusses the perspective from both demand and supply sides of MFIs comprehensively.

8.2.1 Demand Side

8.2.1.1 Characteristics of MFIs Clients

Contrary to other MFIs outside Indonesia which focus on female clients, in this sample as presented in Table 6.1, most MFIs clients are male. Consistent with Robinson (2009), most MFIs in Indonesia use an individual lending approach instead of a group lending approach and very few of them target females as the main client group. Based on our survey in Table 6.2, the range of ages of the majority of MFI clients' was between 30–41 years which is considered to be a productive age. There is presumably a good reason to give loan to the younger age clients more than other group ages. The younger the clients, the longer they are expected to work and the more productive they are. However, the microfinance sector is predicted to have more risks when compared to the banking sector in terms of collateral which is mostly low in value but costly and also due to the dynamic nature of micro-business. Younger people who have prospective businesses are potentially good clients for a MFI.

With regards to professions and jobs of clients as presented in Table 6.3, most BRI clients are permanent employees. This finding is different to those of Don Johnston's reported in

Morduch (2009) as dicussed in Chapter 2. This difference is likely due to the use of a different sample and geographical area of research. As a state bank, BRI gets the first priority in attracting government employees as its clients and to channel the subsidies programme to them. This finding supports Morduch's (2009) argument that the government has played crucial role in achieving the success of microfinance in BRI's case. A government employee working from 8 am to 5 pm during weekdays is more likely to use the financing for consumption purposes instead of funding small businesses. Similar to the results in Table 6.7, the use of micro enterprise finance for consumption purposes was also highlighted in other empirical research on several countries by Arum and Hulme (2009), Rahman (1999) and Bukley (1996). In reality, it is an open secret that almost all government employees take financing from financial institutions by putting down their employee certificates as collateral. House, car and motorcycle certificates are also used as other forms of collateral. Financing might be used to buy a new mobile phone, pay children's tuition fees, hospital bills, household-wares and other unproductive items. If this is not controlled many clients can get into debt-traps and over-indebtedness as outlined by Hospes and Lont (2004), Hulme and Mosley (2006), Kiiru (2007), Kayed (2007) and Khan (2008).

It is clear from Table 6.3 that BMT, BPR and BPRS do not choose government employees as their target market. BMT, BPR and BPRS deal with the high risk clients from the private sectors, both formal and informal. As a result, these MFIs have to cope with the clients from the business sector which creates uncertainty for profits and returns. This in turn affects the uncertainty of financing repayment. It should be noted that the business sector is dynamic and unpredictable by nature. However, the business sector also offers potentially higher returns. Therefore, BMT, BPR and BPRS clients presumably use the financing for productive businesses, although there is a possibility to use it for consumption purposes also. Based on facts presented in Chapter Six, one of the target markets of BMT, BPR and BPRS is entrepreneur clients with real business. It can be concluded that in fact BRI does not serve the same market segment as BMT, BPR and BPRS.

There was an interesting finding regarding the loan duration as presented in Table 6.4. The majority of loans' tenure for every type of MFI was less than one year which cannot be sufficient for establishing or maintaining a real business. The in-depth interviews reveal that short-term financing implies that the clients used the funds for emergency or consumption needs. This finding supports the arguments of Morduch (2009) that the household uses the money to meet short-term consumption needs and not to make long term productive investments. If the majority of financing modes are only for one year or less, it cannot be expected to create a sustainable business which will reduce the unemployment rate and ultimately alleviate the poverty rate. Therefore, although most BMT, BPR and BPRS are micro entrepreneurs, with financing of one year or less duration they could most likely use the funds for short-term consumption and emergency needs. The fact supports the arguments by Hulme (2000) that outside Bangladesh, MFIs have not even scratched the surface of poverty. These results challenge the role of microfinance in alleviating poverty as the practice of microfinance appears to contradict this notion.

Along with the short tenure of financing, the majority of clients from all MFIs only get financing once. Very few clients (16.2%) who got financing were able to get funds more than twice from the same institution as presented in Table 6.6. This finding has many implications. Firstly, it was quite easy for a client to convince loan officers to give them a loan for the first time. One reason for this may be that the loan officers tried to fulfill their target client numbers by getting new customers to increase their bonuses. Secondly, after evaluating the first financing, only a small number of clients qualified to get the next loan because only those clients who repaid financing and its cost on time and still had the valuable collateral were eligible. The clients who had problems in the repayment of the principal and its cost jeopardized the level of microfinance’s NPL. In some cases, it was not easy to sell the collateral to cover the unpaid financing. Thirdly, when the reason of this was asked by researcher to the loan officers, most of them said that it was very difficult to get a good client who had a sustainable business especially small or micro business and loan officers then seek new clients as replacements. Fourthly, for the clients who failed to continue the second loan, they tried to apply the next loan to a new MFI.

BPRs deal with the highest risk clients and as a consequence they charged the borrowers a higher interest rate, as presented in Table 6.8. The interviews with clients revealed that most borrowed money only for consumption purposes or emergency needs although the interviews revealed that when applying for funds the clients claimed to use the money for working capital or buying fixed assets to support their business. These were some tricky ways to get loans intentionally by the applicants and ignored by the loan officers as long as the value of collateral was larger than the size of loan. Notwithstanding the provisions of the application process that clearly states that the loan purposes are for fixed assets or working capital, the applicants just choose one of them without paying much attention. In reality, the clients used the loan for covering hospital costs for family member, admission school payments for kids, and other debt payments and consumption (as a down payment for a motorcycle, a new TV, hand phone, and other household-wares). If they wrote the ‘working capital or fixed assets’ in the application, it was just a formality only.

Collateral in some form is still an essential requirement for receiving financing. Car or motor ownership certificates are the most common collateral to get a quick loan, which in some cases could be processed in only 60 minutes. As most of the funds are used for consumption or emergency purposes, it becomes difficult to repay the loan plus the high interest/mark-up/cost plus *murabahah* rate for some clients who do not have continuous income from a real business. Therefore, the above observations are consistent with the explanation of Khan (2008) regarding the less popularity of partnership-based financing based on *mudarabah* and *musharakah.* The data provides some indication as to why the loan duration is only one year or less. This may be due to the unsustainable business for which the financing is requested which creates high risks and sometimes results in the selling of collateral in the auction market.

8.2.1.2 Perception of MFI’s Clients towards the Interest /Mark-up/Cost-plus Murabahah Rate

In a fierce competitive environment, MFIs try to attract new clients and maintain existing ones. The research results show that client perceptions of interest rate/cost plus in a given *murabahah* transaction on average was lower than or equal to the actual rate as presented in Table 6.9. In other words, the interest/mark-up rate paid by the majority of the clients was much higher than their perceptions. Surprisingly, most BMT clients perceived that BMT’s rate was lower than other MFIs whereas in the reality, BMT’s rate was high compared to BRI. The majority of BRI clients said that BRI’s rate was reasonable and relatively lower than others. Factors such as gender, age, and jobs influence perceptions slightly differently. However, it appears that the clients did not too concerned about the level of interest/mark-up rate as they wanted to get the money first due to emergency needs without worrying about the future consequences.

In order to respond to the hypotheses about MFI’s Clients’ perception, statistical test were used and the result of analysis are presented from Table 6.9 to Table 6.12

Hypothesis 1 : MFI's Clients' perception to their MFI's interest/return paid compared to other MFI's are equal for different type of groups of respondents
Overall, there was a statistically significant different between each type of gender, age, jobs, MFIs and clients' perception of the relative interest/profit rate.

The following sub-hypotheses are presented in order to examine whether, statistically, there is any significant differences in perceptions across different groups of respondents:

H_{1-1} : There is no statistically significant difference between different genders of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.
The significance level of this perception was less than the required alpha level of 0.05 where 0.011 for chi-square. This means that there was a statistically significant difference between the different gender groups of respondents and their perception of the relative interest/profit rate.

H_{1-2} : There is no statistically significant difference between different group of age of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.
According to statistical test, there was significant difference between different range of ages and clients perceptions with a significance level less than the required alpha level of 0.05 whereas 0.00 for chi-square.

H_{1-3} : There is no statistically significant difference between type of jobs of MFI's clients and the MFI's clients' perceptions of relative interest/profit rate.
Statistically, there was significant difference between different type of jobs and clients perceptions with a significance level less than the required alpha level of 0.05 whereas 0.010 for chi-square.

H_{1-4} : There is no statistically significant difference between different type of MFI's clients and their perception about the relative interest/return paid.
Statistically, the significance level of this perception was 0.00 for chi-square which is less than the required alpha level of 0.05. This means that there was a statistically significant difference between different types of MFIs and the MFI's client perception of the relative interest/profit rate.

However, the easiness and promptness in screening process of different MFIs are more important factors than the higher rate of return/interest rate for some clients. This finding supports the arguments of Obaidullah and Khan (2008) that easy access, timeliness and flexibility are more important factors for micro-entrepreneurs than funding costs. This result is also coherent with the statement of Robinson (2009) that borrowers need the financing process to have features such as secure, simple, quick disbursement, confidential, liquidity, good services and convenience.

It should be noted that *murabahah* dominated about 80% of financing modes in Islamic MFIs. During the fieldwork, it was observed that the practice of *murabahah* was not what it is supposed to be from a *Sharia'h* perspective. Whereas the bank should sell the real product to the clients, in reality many Islamic MFIs did not do it properly. They just gave the money to the clients, signed the contract, but for all practical purposes, they let the clients buy the object of *murabahah* afterwards. This creates a moral hazard problem for clients as they can misuse the loan. As discussed above, funds taken for productive purposes have been used for consumption and meeting emergency needs. This practice makes no different in term of substance between Islamic and conventional financing at all.

8.2.1.3 Level of MFI's Clients' Understanding towards Islamic MFI's Products

In general, the majority of MFIs clients did not understand the financing modes and the concept of Islamic banking or microfinance products, *murabahah, mudarabah, musharakah*, and *ijarah* as presented in Table 6.13. Female clients showed better understanding of *murabahah* and *mudarabah* concepts than their male counterparts (see Table 6.13.1). *Musharakah* and *ijarah* are not significantly understood by MFI's clients. In reality, *murabahah* and *mudarabah* products have a larger portion in the Islamic microfinance institution's portfolio compared to *musharakah* and *ijarah*. Therefore, it makes sense that MFI clients were more familiar with the first two products than the latter. Men tended to pay less attention to the concepts of products.

The respondents who are 30 years old or less as presented in Table 6.13.2 and not government employees as presented in Table 6.13.3 have better understanding about the concept of four Islamic microfinance products than others subgroups. The older clients and those who were government employees seemed not to care about the underlying Islamic contracts of products. For them, the financing or credit is same in substance irrespective of what it is called. This view may be due to their ignorance or just for practicality or what they observe in practice. However, the evidence indicates that there may be a need to approach Islamic MFI's clients to make them understand the *Shari'ah* concepts and their willingness to join with Islamic MFIs. These extra efforts to educate new clients, market the products and maintain the existing clients should be done continuously and vigorously. If this is not done, there is a danger of the market for Islamic MFIs' will become stagnant or even decline gradually.

In order to analyze whether there is any differences between the level of understanding about the concept of Islamic MFI's products and different groups of respondents, the hypothesis 2 and its sub-hypothesis were formulated as follows:

Hypothesis 2: The level of understanding towards the concept of Islamic Microfinance Products (*murabahah, mudarabah, musharakah and ijarah*) based on the different group of MFI's clients

H_{2-1}: There are no significant differences between different genders of MFI's clients regarding their lack of understanding about the concepts of Islamic Microfinance Products.

The results of Mann-Whitney U-Tests are presented in Table 6.13.1. The result of U-Test indicates that there is a statistically significant difference between females and males in terms of their lack of understanding with regard to the *murabahah* concept whereas the significant value of 0.002 is less than the confidence level of 0.05. The same thing occurred for understanding the *mudarabah* concept. There is also a statistically significant difference between females and males in terms of their lack of understanding of the *mudarabah* concept whereas the significant value of 0.019 is less than the confidence level of 0.05.

It is not the case for the *musharakah* and *ijarah* concepts. There is no statistically significant difference between females and males in terms of their lack of understanding level regarding these two concepts. The significance value of 0.140 and 0.178 respectively are significantly higher than the confidence level of 0.05.

H_{2-2} : There are no significant differences among age subgroups of MFI's clients regarding their lack of understanding of the concepts of Islamic Microfinance Products.

The Kruskal-Wallis test results show that there is a significant difference in terms of lack of understanding of the four Islamic MFI product concepts across four different age subgroups. This can be proved as all the p-values in each product are lower than critical p-value of 0.05. Concerning the understanding level of the *murabahah* concept, respondents aged between 42 and 52 and between 30 and 41 showed more lack of understanding than other age subgroups. The understanding level of the *mudarabah* concept, respondents aged 53 years old or more and between 42 and 52 showed more lack of understanding than other age subgroups.The table shows similar patterns for *musharakah* products. The understanding level of *musharakah* concept, respondents aged 53 years old or more and between 42 and 52 showed more lack of understanding than other age subgroups. The understanding level of the *ijarah* concept, respondents aged 42 and 52 and between 30 and 41 showed more lack of understanding than other age subgroups.

$H_{2\text{-}3}$: There are no significant differences among the different types of MFI's clients' job regarding their lack of understanding of the concepts of Islamic Microfinance products.

The Kruskal-Wallis test results show that there is a significant difference in terms of lack of understanding levels of the four Islamic MFI product concepts across three different types of respondent job subgroups. This can be proved as all the p-values in each product are lower than critical p-value of 0.05. Respondents with a job as a government employee showed a greater lack of understanding of *murabahah* than other respondents with either informal jobs or private employees. Respondents who have a job as a government employee showed more lack of understanding of *mudarabah* than other respondents with either informal jobs or private employees.

The same results occurred towards the *musharakah* and *ijarah* products. Government employees showed greater lack of understanding of *musharakah* than other respondents with either informal jobs or private employees. Government employees showed a greater lack of *ijarah* understanding than other respondents with either informal jobs or private employees.

$H_{2\text{-}4}$: There are no significant differences among the different types of MFI's clients' subgroup regarding their lack of understanding of the concepts of Islamic Microfinance Products.

The Kruskal-Wallis test results show that there is a significant difference concerning lack of understanding levels of four Islamic MFI's product concepts across four different types of MFI respondent. This is the case because all p-values for each product are lower than the critical p-value of 0.05. Respondents who were clients of BPR showed a greater lack of understanding of *murabahah* than other respondents who were clients of BRI, BMT and BPRS respectively. Respondents who were the clients of BPR showed a greater lack of understanding *mudarabah* than other respondents who were clients of BRI, BPRS and BMT respectively. The same results were observed for both the *musharakah* and *ijarah* products. Respondents who were clients of BPR showed a greater lack of understanding of *musharakah* than other respondents who were clients of BRI, BPRS and BMT respectively. Respondents who were clients of BPR showed a greater lack of understanding of *ijarah* than other respondents who were clients of BRI, BPRS and BMT respectively.

It should be noted that there is still a gap between needs and knowledge of *Shari'ah* financial products and services. As Seibel and Agung (2005) points out the gap could delay the success in mobilizing potential public funds for investment due to low switching rate from potential demand to real demand. Furthermore, the gap in knowledge will also make marketing and selling effort for Islamic banking products and services more difficult.

The lack of understanding and knowledge of MFI's clients concerning Islamic financial products is partly due to the bare minimum training they received. This argument is in line with the suggestions of Masyita *et.al* (2011) that micro entrepreneurs should get training in managerial, technological and spiritual aspects to boost their business performance. The majority of clients in the sample never received training during loan periods with only a third of MFI's clients receiving some training sessions. Among the different organizations, while a very small number of BRI, BPR and BPRS's clients received training sessions, the majority of BMT's clients had received some training.

There was contradictory result in the understanding of the *Shari'ah* concepts among different gender groups. The results from the demand side survey presented in Chapter Six reveals that women have better understanding of the concepts than men. The survey reveals that a larger percentage of female clients never received training sessions compared to their male counterparts. Although fewer women received training compared to men, the understanding of the former group was still better than the latter in terms of Islamic microfinance products.

Public education about the concepts of Islamic microfinance and banking products are pivotal to enhance awareness among clients. It takes considerable effort, time and patience to educate the public or clients about new concepts and products in their daily busy lives. If there is no social goal in an Islamic MFI, the cost of these educations will be perceived as a burden. Therefore, to support Islamic MFIs in achieving their social goal, Islamic voluntary funds such as *sadaqah*, *infaq* and *waqf* can be used. Understanding the products of Islamic microfinance is very important due to the particular contracts used. Therefore, in some Islamic MFIs offices, just before signing the contract the loan officers explain the characteristics of the products briefly to the clients with expectation that the clients would understand the documents/contracts they sign.

8.2.1.4 The Implication of Lack of Understanding towards Practice of Islamic modes of Financing

It should be noted that *murabahah* dominated the majority of financing modes in Islamic MFIs both BPRS and BMT. During the fieldwork, it was observed that the practice of *murabahah* (where the MFI is expected to sell goods/assets not give cash) was not what it is supposed to be. Most Islamic MFIs gave cash for *murabahah* modes financing due to the practicality. These practices have been heavily criticized by academicians and other observers. In subsection 8.2.2, the practice of *murabahah* in the majority of Islamic MFIs was discussed. Not only has this practice created a moral hazard but it is also not *Shari'ah* compliant. There is no difference in substance between conventional and Islamic MFIs in this regard. Therefore, this practice should be forbidden by the *Shari'ah* supervisory boards. *Shari'ah* supervisory boards who supervise BPRS and BMT should take seriously this issue. Ways to implement viable *murabahah* transaction which delivering good/assets not money/cash with the appropriate costs of transactions should be found.

8.2.1.5 Preferences of MFI's Clients and Reasons to Choose a MFI

In relation to MFI's client preferences in choosing either a conventional or Islamic MFI, the survey reveals interesting findings. Survey showed that 54.4% of respondent preferred an Islamic MFIs to conventional counterpart. Although the majority of respondents preferred Islamic MFI to a conventional MFI, the majority of respondents were clients of the latter. This finding is supported by Kayed (2007) and indicates that in religious matters people tend to form attitudes that correlate to their religious convictions without possessing the theoretical and/or practical knowledge to justify their attitude. The satisfaction, confidence and religious observances were the main reasons for most clients' preferences of using Islamic MFI's products. But in the end, the practicality and economic reasons became dominant factors in their choice of conventional MFI as highlighted by Khan (2008) and Robinson (2009).

The hypothesis below tries to find whether there is any significant difference between Client's preferences and different types group of respondents

Hypothesis 3: MFI's Clients have their preferences towards Conventional or Islamic MFI based on the different group of MFI's clients

H_{3-1} : There are no significant differences between different genders of MFI's clients and MFI's clients' preferences on Conventional/Islamic MFI

The Mann-Whitney U Test showed that variable of gender has significant relationships to Islamic or conventional preferences with p-values 0.000 which less than the significance level 0.05 as presented in Table 6.17.

H_{3-2} : There are no significant differences among age subgroups of MFI's clients and MFI's clients' preferences on Conventional/Islamic MFI

On the contrary, The Kruskal-Wallis test proved that variable of 'age' was a statistically insignificant variable to determine this preference as its p-value 0.375 was higher than the significance level 0.05.

H_{3-3} : There are no significant differences among the different types of MFI's clients' job and MFI's clients' preferences on Conventional/Islamic MFI

The Kruskal-Wallis Test examined that there is significant difference between type of jobs with the preferences on Islamic/Conventional MFIs as its p-value 0.004 which less than the significance level 0.05.

H_{3-4} : There are no significant differences among the different types of MFI's clients' subgroup and MFI's clients' preferences on Conventional/Islamic MFI

The Kruskal-Wallis Test examined that there is significant difference between type of MFIs with the preferences on Islamic/Conventional MFIs as its p-value 0.000 which less than the significance level 0.05.

It was expected for BMT (Islamic MFI) clients to prefer and choose Islamic MFI and also sensible for BPR's (conventional MFI) clients to prefer conventional MFI. However, it was surprising to see that more than a quarter of BPRS respondents and 1% of BMT clients (both of them are Islamic MFIs) preferred the conventional MFI. Similarly, almost half of BRI's and a fifth of BPR's clients preferred Islamic MFIs rather than conventional MFIs although they were completely aware that BRI and BPR are conventional financial organizations. Moreover, the proportion of BRI's (conventional MFI) clients who prefer Islamic and conventional MFIs was almost equal. The findings that conventional MFI's clients preferred an Islamic MFI and Islamic MFI's clients preferred a conventional MFI raise some questions. The disparity in preferences and choices appears to be inconsistent behavior, and in some cases, appears opportunistic.

The results on preferences provide some important information related to market opportunity of Islamic MFIs. Given that a fifth of BPR clients and a half of BRI clients indicate preferences towards Islamic financing, they could be potential clients for Islamic MFIs. On the contrary, there were 1% of BMT's clients and less than a third of BPRS' clients who were not loyal and can potentially shift to conventional MFIs.

This finding provides some insight on the understanding of behavior of Indonesian Muslims towards economic transactions (*muamalah*) and spiritual aspects. Even though Indonesia is not an Islamic republic, it has the largest Muslim population in the world. Indonesian Muslims live in an increasingly secular society in which religion has less and less influence on their daily lives. In their economic lives, choice appears to be based on pragmatic economic/financial factors. However, when respondents were asked about their preferences towards their choice for Islamic products or conventional, the majority preferred Islamic MFIs. While Islamic faith takes priority in the normative sense, economic motive becomes an important factor when actual choices are made.

MFI's client ranked easiness and speed/promptness are two highest ranking for services factors, followed by low interest, nearness, low collateral, loan size, payment methods and loan officer factors consecutively as presented in Table 6.18. Excellent services factors are more prioritized than financial factors.

According to most MFI clients as presented in Table 6.19, BMTs were *Shari'ah* compliant institutions. BPRS was well known for speed/promptness in approvals process and also desired loan officer's-clients relationship category. For rest of operational categories, BRI was ranked highest in other features related to providing services. Specifically, BRI was well recognized as a MFI with easiness, good process of application, low interest rates, low collateral, appropriate payment methods, and most preferable MFI. Research of Morduch (1999, 2009) and Robinson (1992, 1994, 2004, and 2009) support these features of successful operations of BRI in providing microfinance.

8.2.2 Supply Side

Similar to other commercial institutions, MFIs have to compete with other competitors either directly or indirectly to attract potential customers. By understanding the customers' preferences, perceptions and meet these by enhancing the institutions' performance and improving the quality of products and services, MFI managers can expect to increase the profit for the institution.

Like other modern corporations/organizations, the performance of a MFI needs to be measured. Nonetheless, appropriate tools of assessment which are supplemented by guidelines and benchmarks are needed. However, same key elements of assessment cannot be used for all type of MFIs as there is no one size fits all answer due to the uniqueness of different MFIs. In the next subsection, the perspectives from supply side of MFIs are contextualized with the literature and findings from the demand side.

8.2.2.1 MFI's Management Perceived Clients' Perceptions

More than half of MFI managers perceived that MFI's clients can afford to pay monthly interest rate/cost plus between 1% and 2% in *murabahah* contracts as presented in Table 7.4. Regarding financial charges, MFI's manager's perception were slightly different from clients'perception as presented in Table 7.5.Both MFI management and clients agreed that BRI was the cheapest and followed by BPRS. They had a different perception in valuing BPR and BMT. BMT was perceived by MFI's clients to be cheaper than BPR whereas MFI management perceived the opposite as presented in Table 7.6.

The findings show that MFI managers' level of understanding about the client's needs and wants was quite good. But, MFI managers overestimated clients' understanding of Islamic MFI's products, *mudarabah* and *murabahah* as clearly stated in Table 7.9. In reality, these products are mostly unknown by clients and this fact was contrary to the managers' expectations. Therefore, MFI managers' view on the necessity to provide clients with some types of training is suitable to fulfill the gap as presented in Table 7.7.

The MFIs managers' perception of clients' preferences towards Islamic MFIs (72.22%) were surprisingly higher than the reality (54.4)%. This perception even came from conventional MFIs' management. Similarly, the managements' perception of MFI clients' preferences towards conventional (11.11%) was lower than the clients' preferences (45.6%). MFI's managers of both Islamic and conventional MFIs perceived that as Muslims, clients would prefer Islamic than conventional MFIs. MFI managers perceived clients' perceptions were still slightly different than the reality in terms of priority of clients in choosing a MFI. For example, low interest/mark-up/cost plus *murabahah* rate is more important than low collateral but the managers perceived otherwise.

The facts on perceptions show that there are opportunities for developing Islamic MFIs. With a potential high demand for Islamic MFIs in Indonesia, in addition to the MFIs managements' perceptions, there is a possibility for conventional MFIs to convert to Islamic ones in the future. This trend can be observed during the last ten years in Indonesia, whereby conventional banks have started to convert to Islamic banks or have opened Islamic windows as starting point to move further to be Islamic bank. For example, in 2005, BRI established BRI *Sharia'h* (BRIS) to accommodate demand of Muslim clients for Islamic microfinance products and services.

8.2.2.2 Other Consequences of MFI Managements' Perceptions towards MFI's Policy

High volatility/variety of interest rate among BPRs can be explained by the short term orientation of loan officers and a strategy to meet their own annual targets as long as the clients have something valuable to be guaranteed as collateral. Loan officers' or marketers' target in terms of number of clients or amount of money the clients borrowed determine their commissions and other performance indicators which in turn are important incentives for loan officer to maintain or move forward in his/her career. Some loan officers resort to unethical practices in some cases in order to attract the prospective clients to fulfill their annual target as a marketer.

The high interest rate was applied by BPR due to the high risks involved with their clients. Unlike BPR, BRI charges moderate or even lowest interest rate as they deal with the low risk clients (for example BRI has MoU with particular institutions for special rate of interest) and also because of cross subsidy programs from the Indonesian government. BPR and BRI are conventional MFIs but they represent opposite poles in terms of policy, strategy, segmentation and positioning. According to a BRI staff member in an interview, BRI can borrow unlimited funds as long as the clients fulfill all the prerequisites and pass the screening application process. A BRI unit officer can ask for an unlimited amount of money from BRI’s headquarters if there are potential customers in his/her unit. Unlimited money from BRI’s headquarters is the other advantage of BRI compared to other MFIs.

As the primary representatives of Islamic MFIs, BPRS and BMT’s positions lie in the middle between two larger-conventional players, BPR and BRI. BPRS and BMT have Muslims as a target market by offering Islamic finance products such as *murabahah, musharakah, ijarah, rahn* and other Islamic finance services to the market. If the cost-plus rate (*murabahah*) is compared to the interest rate (for benchmark purpose only), it seems that BPRS and BMT were moderate in terms of risk and return. However, Bank Indonesia as the central bank that regulates and supervises MFIs requires them to maintain non-performing loans (NPL) at a maximum of 5% overall. This policy is useful and serves as an early warning system for MFIs to avoid situations that can jeopardize their operations in the future. Akin to other commercial banks, Bank Indonesia applies prudent regulation for MFIs (BRI, BPR and BPRS only), whereas BMT, as a cooperative, is supervised by the Ministry of Cooperatives.

As is apparent from the research, some MFIs’ managers/chief executive officers' perceptions are slightly different from the clients’ expectations in a few matters. This leads to the conclusion that there could be somewhat misleading, inefficient and ineffective policies provided by MFI when translating the clients’ expectations, perceptions and preferences. In the future, it is recommended that the managers/chief executive officers conduct surveys regularly to understand their customers’ opinions regarding products and services and then fulfill their needs. However, there are many opportunities for growth in microfinance, but they must provide the products, services and convenience that the clients desire.

8.2.2.3 Different Formats of MFIs based on the BSC

In order to understand the structure of each type of MFI, their performance was assessed by using the balanced score card (BSC). CGAP as a think tank of MFI has also used the BSC in some of their research tools. This study examined four perspectives for each type of MFIs: Internal Process, Learning and Growth, Customers, and Financial Performances as suggested by Kaplan and Norton (1992, 1996). The research revealed that the structure of BRI as the largest MFI in Indonesia and partly due to government support is robust and makes it difficult for other smaller MFIs to compete as discussed in Chapter 7. For all perspectives used in BSC, BRI got the highest scores, followed by BPRS, BPR, and BMT.

The next sub-sections discusses the results based on 'The BSC based MFIs' Model'.

8.2.2.3.1 Internal Process of 'The BSC based MFIs' Model'

Overall score for Internal Process Perspectives as presented in Table 7.12, BRI is the highest, followed by BPRS, BPR, and BMT respectively. As suggested by Norton and Kaplan (1992), internal business processes are something that the institution/company must excel at and BRI has excelled itself to the desire level. Almost in all elements of "internal process perspectives" BRI got the maximum score except on the subject of human resources factors. BRI has a robust structure of organization as highlighted by Robinson (2009), strongly committed to its vision and daily operation. BRI has excellent packages of remuneration for staffs and LO's which are better than the same level of industry remuneration in general and other MFIs in particular. With low level of staff's turn over, clarity in the line of authority and very low duplication of works among the staffs, BRI can be an example for other MFIs for internal process perspectives. BRI's achievements have been written in many publications by Robinson (2009), Morduch (2009), Arun *et al* (2009), and other authors.

BPRS was scored the second highest with moderate number of human resources, clear structure organization, vision and daily operation. BPRS was slightly below BRI, meanwhile BPR almost has the same scores as BPRS except comparison of salary. The lowest score was BMT. BMT has the same pattern with BPRS and BPR but smaller score for each element. Because of the small scale of their business, BMTs need more clients and more human resources to scale up their business. As Aghion and Morduch (2005) stated that various factors can influence the performance. Therefore, BPRS, BPR and BMT must excel the internal process elements which influence their performance.

8.2.2.3.2 Learning and Growth Perspectives of 'The BSC based MFIs' Model'

As Tapanya (2004) emphasized that BSC measures both inside and outside the institutions which are contributed to MFI's mission, learning and growth perspectives are one way to achieve the objectives and mission of a MFI. As presented in Table 7.13, the overall score for Learning and Growth Perspectives was highest for BRI, followed by BPRS, BPR and BMT. BRI meets almost all elements of learning growth perspectives such as availability of human resources of department, the clarity of policies, the professional systems in recruitment process, minimum criteria and experience of staffs, training for staffs, sufficient budgets for training but the average of non performance loan (NPL). With routine and regular training for its staff, BRI created many innovative ways to achieve a desirable performance as highlighted by Kaplan and Norton (1992). This innovation derived from learning-and-growth create the institution continue to improve and create value and ultimately, financial aspects are important issues for shareholders.

8.2.2.3.3 Customer Perspectives of 'The BSC based MFIs' Model'

As asserted by Kaplan and Norton (1992), identifying customer perspectives is important for setting any organization's policies. Overall score for customer perspectives as presented in Table 7.14, BRI was the highest, followed by BPRS, BPR and BMT. In terms of easiness, application process, low interest, low collateral, payment methods, LO's profile, client's preferences and overall performance, BRI showed the maximum score. The research conducted by Robinson (2009), Morduch (2009), Arun (2009), Aghion and Morduch (2005) supported the findings above. Kaplan and Norton (1996) also underlined the importance of customer satisfaction to boost the performance. Only for *Shari'ah* compliance and speed/promptness criteria, BRI got the lowest scores.

BMT was scored the best MFI for *Shari'ah* compliance. As a state commercial bank fully supported by Indonesian government with many cross subsidies for micro-credit, inevitably, BRI is still the cheapest in terms of credit interest rates. Schreiner (2002) also said that cost of financing (transaction costs, interest rates and other charges) is still an important factor for MFI clients. Hence, it makes sense that BRI became the most preferable MFI because of its interest rates.

8.2.2.3.4 Financial Perspectives of 'The BSC based MFIs' Model'

Kaplan & Norton (1996) explain that financial perspectives measure whether a firm/organization's strategy, implementation and execution are contributing to firm's improvement in general. However, many people believe that financial performance is everything and the ultimate goal of a profit organization/firm. Based on financial performance, BRI got the highest score for ROA, ROE and OSS. As such BRI is good at utilizing its total assets to generate returns (ROA) and produce returns for the owner (ROE). OSS ratio as highlighted by Ahlin *et al* (2011) and Engels (2010) measures how well BRI is able to cover its total costs of operating.

In relation to breadth of outreach as presented in Table 7.15, BRI and BMT have the same score which covers a large number of clients (breadth) but in term of average loan size (depth), BRI's score is slightly higher than BMT. As Rosenberg (2009) stated in his research about five indicators in measuring a MFI for CGAP, with this breadth score means BRI had served more clients and also more poor clients compared than BMT. BPR and BPRS followed them. BRI's managers gave smaller loan/clients than others did. As Engels (2010) argued, the smaller loan/clients, the more poor clients are reached and the greater depth of outreach. Hatch & Frederick (1998) and Dunford (2002) found the opposite facts to Engels' argument; loan size is ineffective in selecting poor.

For *'worth to clients'* indicator, BPR and BMT were better than BRI. Similar to BRI, BPRS got the second highest score for financial ratios (ROA, ROE and OSS) but for outreach indicators, BPRS got the lowest MFIs. Overall, BMT was the lowest for financial ratio but the highest for outreach. In general, BPRS' and BPR's positions for financial ratio and outreach were in between of BRI and BMT.

8.2.2.3.5 Overall Performance of 'The BSC based MFIs' Model'

A balanced non-financial and financial performance is extremely important to create sustainability for microfinance institutions (Kaplan and Norton, 1992). In all perspectives as presented in Table 7.16, BRI got the highest scores. BRI has proved that with four balanced perspectives created more positive results to overall performance. As Islamic microfinance, BPRS's performance is the second best. BPRS has the more capability and capacity than BPR and BMT with more balanced perspectives as a starting point. Almost all elements, BPRS is better than BPR and BMT but financial perspectives (including outreach) whereas BMT is slightly better. BPR is slightly less than BPRS almost for four perspectives. BMT, over all, got the lowest score except the outreach. BMT needs to push almost every element simultaneously to create MFI sustainability in the future as suggested by Schreiner (2002), Vinelly (2002), Rosenberg (2009), Engels (2010) for a healthy MFI. With the lowest score for internal process, learning-and-growth, customer satisfaction and financial ratios, BMT seemed that it is not well managed. If this condition continues, it will jeopardize institutions in the long run.

Figure 1.1 in Chapter One shows that Islamic MFIs grew slower than their conventional counterparts in terms of assets. It should be noted that the MFIs in this study pertain to the eighteen MFIs in the Bandung area whereas MFI's in Figure 1.1 are for Indonesia-wide where the number of conventional MFIs is far larger than Islamic MFIs. The cumulative assets in Figure 1.1 represent assets of all conventional and Islamic MFIs in Indonesia. However, the number of Islamic MFIs is far smaller than conventional MFIs. Therefore, Figure 1.1 is not comparable with the sample used in this research. Yet the graph was used as a starting point for raising research questions.

This research considered only MFIs in Bandung area for sampling tried to find out all four perspectives comprehensively. Although it is realized that financial performance should reflect the other three perspectives simultaneously. The contribution of this study is to show how the four perspectives work together simultaneously leading to the balanced and sustainable performance of MFIs in the future.

8.2.2.3.6 Causal-Effect Relationship Among Perspectives of 'The BSC based MFIs' Model'

Keeping a balance between the financial and non-financial elements in the business entity is very important. Therefore, the hypotheses for the BSC's model are as follows:

H_1: Internal Process' Perspectives are positively related to Customers' Perspectives

H_2: Internal Process' Perspectives are positively related to Financial Perspectives

H_3: Learning & Growth Perspectives are positively related to Customers' Perspectives

H_4: Learning & Growth Perspectives are positively related to Internal Process Perspectives

H_5: Financial Perspectives are positively related to Customers' perspectives

H_6: Financial Perspectives are positively related to Learning & Growth Perspectives

Based on the results of correlation test between BSC perspectives, statistically, only three hypotheses were proved statistically significant in this research;

H_1: Internal Process' Perspectives are positively related to Customers' Perspectives

H_3: Learning & Growth Perspectives are positively related to Customers' Perspectives

H_6: Financial Perspectives are positively related to Learning & Growth Perspectives

The relationships between the different components of BSC indicate strong significant correlations between the internal process and customer's perspectives (63.8%). There are also significant correlations between customer's perspectives and learning-and-growth (58.1%) and slightly significant correlations between learning-and-growth and financial performance (47.4%). This causal effect is relevant with the concept of BSC developed by Kaplan and Norton (1996, 2001).

Identifying the internal process of a MFI as core business processes is crucial for effective delivery of MFI's value to the particular clients as the target markets. Clearness of mission and vision, appropriate compensation and job description, strengthen risk management and corporate governance are some objectives of internal process perspectives. Different types of MFI's customers/clients should be taken into account the fact that they have their own value and perception. Therefore, it is better to balance the focus on those particular target markets. Increase the target market penetration, re-lending to old customers with the competitive interest rate, number of products and services, high satisfaction and then total customers served at the end are some of customer perspectives objectives. A well managed of internal business process could satisfy more customers.

In addition to improving MFI's culture in the key areas, balancing a MFI's focus on competency development is also the part of learning and growth perspective for a MFI. Improving access to information, the fairness of recruitment, training investment, employee productivity and motivation of management team and employees are objectives of learning and growth perspectives. Increase in learning, education investment, employee's productivity and minimizing employee turnover can be achieved through the creation of more opportunities and job satisfaction. The availability of H&R department with well planned for employees' carrier opportunities can improve high motivation among employees for going further in their careers. Equal opportunity and chance to get position supported by well educated and proper experienced employees is expected to create a healthy and comfortable work environment.

The employee's satisfaction tends to share the superior value while dealing with customers (Clemmer, 2003). Jim Clemmer (2003) found that there was a cause-and-effect relationship between loyal employees and loyal customer. He said that the best employees deliver the superior value that builds customer loyalty. Therefore, it is reasonable that learning-and-growth has strong correlation to customer's perspectives. However, feedback on customers' satisfaction can alert MFI's management teams to reevaluate MFI's internal process and learning-and-growth elements.

For financial perspectives, the effect of using the finance system approach improves the sustainability of a MFI without injection of funds from outside. Profit motive with compulsory collateral is part of finance system approach which helps a MFI to be financially independent. However, the consequences of this approach are that the outreach indicators such as the breadth, depth, and worth of clients are not satisfactory. In some cases, the depth and breadth of operations in terms of average loan size per client and number of clients served by institutions respectively has been low. Smaller loan sizes per client (depth), more clients are served (breadth) add to more transaction costs and more risks that may require sufficient collateral. A well-managed budget either for daily operations or staff's empowerment can improve efficiency and effectiveness which can lead to good financial performance of a MFI.

This structure is consistent with the Balanced Scorecard's concept suggested by Kaplan and Norton (1992) which emphasizes that it is very important to keep the balance between financial and non-financial elements in a business entity.

8.3 DISCUSSIONS OF EMPIRICAL FINDINGS FROM *WAQF* INSTITUTIONS' MANAGERS, REGULATORS AND ISLAMIC MFIs

This section elaborates on the integration of *waqf* institutions with Islamic MFIs and regulators policy regarding these two institutions. The empirical study found that there are some linkages among three entities to collaborate to help needy micro entrepreneurs to improve the quality of their life. In general, *waqf* institutions would appreciate collaboration with Islamic MFIs to help the needy micro-entrepreneurs. The corpus of cash *waqf* fund can be invested in profit oriented business, financed as *qard hassan* and used as capital to create MFI as suggested by Ahmed (2012). The profit of corpus of *waqf* can be used for social purposes. This research focused only on using *qard hassan* as an instrument of *waqf* fund to support Islamic MFIs as suggested by Khan (1997), Ahmed (2003, 2007, 2012), Cizakca (2004), El-Gari (2004), Kahf (2004), Zarka (2007), Wilson (2007), Linari-Pierron and Flatter (2009) and Asutay (2010).

The discussions in the last chapter revealed that two *waqf* institutions agree with the idea of collaboration with Islamic MFIs in the form of *qard hassan*. The role of *waqf* funds in the form of *qard hassan* in contributing to sustainable Islamic MFIs is discussed next.

8.3.1 Necessity of *Qard Hassan* from the Clients' (demand side) Point of View

Government and private employees who have permanent jobs cannot be the target of *qard hassan* funds as they have jobs which are not related to micro-business at all. BMT, BPR and BPRS clients should be considered the target market of *qard hassan* financing instead of BRI clients. The first reason for this is that most of their clients were not government and private employees but the informally employed and micro-entrepreneurs. Secondly, based on the current amounts of *waqf* funds, it was still far less than the requirements. Therefore, *qard hassan* will be distributed to a selected number of MFIs and their clients. *Qard hassan* can be suitably distributed to BMT and BPRS which are *Sharia'h* compliant and also because more of their clients prefer Islamic to conventional MFIs. In terms of gender, there is no difference between females and males as the target of *qard hassan*.

The other result from the findings indicates that the high interest rate or mark-up/cost plus *murabahah* were big issues for the clients compared to the easiness and promptness to get financing approval. A high interest/mark-up/cost plus rate means higher cost of financing which should be a critical issue for real micro entrepreneurs struggling to start and build their new micro-business. Consequently, this may not be the case in general for all MFI clients. The data reveals that MFI clients are not always the poor but active entrepreneurs or employees of a particular company as reported by Akula (2004). In many cases the needy clients do not get the chance to access micro-finance at all. Moreover, the evidence shows that most MFIs asked for proper collateral as reported by Khan (2008), Ahmed (2010) and Morduch (2009) whereas the poor could not afford to fulfill this requirement. Therefore, the poor deserve to get a *qard hassan* loan.

Surprisingly, the majority of respondents who use conventional MFIs indicate a preference for Islamic MFIs. This is probably because most of the clients were Muslims. Clients who use Islamic MFIs indicate tranquility, peace, confidence and religious observances as main reasons for their preferences of Islamic MFI's products. However, the pragmatic and economic reasons are dominant factors in choosing conventional MFIs. The enthusiasm towards Islamic finance can be an opportunity for developing Islamic MFI forward in the near future as long as the Islamic MFIs offer the professional services at least at the same standard as the conventional MFIs.

8.3.2 Necessity of *Qard Hassan* from the MFI's institutions (supply side) Point of View

In general, MFI's managers understand their clients' perceptions of products and services. As mentioned earlier, Islamic MFIs, BPRS and BMT's positions lie in the middle between two giant-conventional players, BPR and BRI in terms of mark-up/cost-plus *murabahah* (cost of loan) and they were quite moderate in term of risk and return. Meanwhile, BPRS and BMT are expected by Muslims to perform more social function than others i.e., give more credit to the needy and unemployed to start their own business without worry with the interest/cost-plus/mark-up and so on. More credit means more opportunities for the poor and jobless. An alternative solution to help Islamic MFIs perform their double functions, profit and social oriented motives, as outlined by Asutay (2010) with the concept of Islamic Moral Economics (IME) is the *qard hassan* from *waqf* fund.

To use the *waqf* fund in an Islamic MFI as part of the investment portfolio is not an easy decision for *waqf* institutions. As a professional *waqf* manager, the nazir is expected to invest the *waqf* fund and manage the *waqf* assets productively in order to share more benefits for the beneficiaries either directly or indirectly as reported by Masyita *et.al* (2005). Therefore, the *nazir* who manages the *waqf* fund should choose carefully their investment portfolios. As discussed Chapter Three, there are two ways to use *waqf* funds. (1) To provide *qard hassan* and (2) Invest it and use the returns for social activities. If the *nazir* chooses to invest the *waqf* fund in Islamic MFIs either in the form of *mudarabah*, *musharakah* or *qard hassan*, he/she should make the acquaintance of the characteristics and performance of a MFI. Without investing cautiously, the principles of the *waqf* fund may decline which may imply that the *nazir* fails to fulfill his/her duties.

There are some the advantages and disadvantages to the practice of *qard hassan* loans for Islamic MFI clients. But with a well-prepared and anticipated plan, the disadvantageous effects can be minimized.

To help *nazir* choose the appropriate MFI, therefore, the Balanced Scorecard of four types of MFIs conducted in this research can be used as a management decision tool. The BSC based MFI's model resulted in this research could help the *nazir* to consider which type of MFIs will utilize *waqf* funds. However, it should be remembered that *waqf* is one of Islamic voluntary sectors. Therefore, it would be better to invest *waqf* funds in Islamic MFIs than their conventional counterparts. BPRS and BMT are appropriate choices especially for the preferences of clients towards Islamic MFIs. Although BRI is the best for most categories of *'The BSC based MFIs Model'* and BPR is the third best, BRI & BPR are not recommended for using the *waqf* funds because they both are conventional.

Based on the result of empirical findings in Chapter Seven, the *nazir* can consider BPRS and BMT based on the followings reasons:

1. Overall, clients preferred BPRS than BMT in terms of easiness, application process, low cost of loan, promptness in process, payment methods, loan officer's relationship and the institutions performance. But BMT is the clients' favorite regarding the low collateral. Even some of BMTs do not ask for collateral as a prerequisite to provide financing.
2. Based on internal process perspectives, BPRS is slightly better than BMT especially for human resources, salary/compensation and work duplication. The rest of elements are the same.
3. From learning growth perspectives, BPRS shows much better than BMT in terms of the clearness of policy, staff's experience and annual training budgets. The other elements almost the same.
4. Based on customer's perspectives, BPRS got more clients' appreciation than BMT in almost of all elements.
5. Based on financial perspectives, BPRS leads throughout the financial ratio. But concerning to outreach, BMT leads in all of the outreach indicators. Outreach indicators of BMT show that BMT covered more clients (breadth), more reach the poor (depth) and BMT's clients more willing to pay the high cost of loan (worth to clients).

Based on the findings, it is proposed to add one more perspectives for '*The BSC based MFIs' Model*' is Social Perspective. Social perspective comprises the social mission of Islamic MFIs to dedicate the *qard hassan* to giving more opportunities to the needy, jobless and the poor to start their own micro business. Indicators of the social perspectives can be the amount of funds contributed for *qard hassan*, how many needy clients are being served, and how many months a MFI permitted clients to use the *qard hassan* loan and so on. Therefore, *The BSC based Islamic MFIs' Model*' should have five perspectives. Using the elements in *The BSC based Islamic MFIs' Model*, the *nazir* can do an MFI appraisal in a more balanced and comprehensive way.

8.4 CONCLUSIONS

This chapter provided a comprehensive discussion of the results presented in empirical Chapters Six and Seven. The contents of discussion of the demand side of MFI are the characteristics of MFI's clients, perception of MFI's clients towards the interest /mark-up/cost-plus *murabahah* rate, level of MFI's clients' understanding of Islamic MFI products, the implication of this lack of understanding towards the practice of Islamic modes of financing. The contents of the discussion of supply side of MFI are MFI's management perceived clients' perceptions, other consequences of the MFI managements' perceptions towards MFI's policy, different formats of MFIs based on the BSC. The results of discussions of empirical findings as regards demand and supply of MFIs are presented and analyzed based on theory and past studies from the literature review.

There are several conclusions that can be drawn from the fieldwork: (1) MFI's managers' thoughts about clients' preferences for an Islamic MFI might be mainly caused by the clients' faith as Muslims. (2) The understanding and knowledge about Islamic banking and finance products related to daily transactions among Muslim clients are not enough to induce them to shift their deposit/account to Islamic banking and finance. (3) The characteristics of Indonesian Muslims are quite unique. They put economic/financial factors above religious ones when they deal with the economic/financial transactions. Moderate Muslims who come from the middle class income or above have unique characters of becoming potential clients and a new market for Islamic banking. Meanwhile, Muslims with lower income who rely on religious reasons when choosing an MFI, not a potential market for Islamic banking, can be a target market for Islamic MFI. But this separation is not always the case, there are some situations in between, hence, tailor-made schemes are needed as outlined by Obaidullah and Khan (2008). Microfinance customization to serve the poor may be exemplified by being flexible and comprehensive.

This research also proposed *The BSC based Islamic MFIs' Model*' which has five perspectives. It discussed the empirical findings on the opinion of *waqf* institution managers, regulators and Islamic MFI's managers about the implementation of *waqf* funds in the form of *qard hassan* into Islamic MFI. MFI's managers opinions' were explored to get proper and balanced perspectives as regards the integration of *waqf* funds into their MFIs. A regulator from central bank also was asked his perspectives on unfair competition among MFIs, prudent regulation and the possibility of *waqf* based Islamic MFIs to be implemented. The necessity of *qard hassan* from the clients' (demand side) point of view and from the MFI's institutions (supply side) point of view was also presented in this chapter.

CHAPTER 9

CONCLUSIONS AND RECOMMENDATIONS

9.1 INTRODUCTION

This thesis started by indicating that developing micro businesses can be one of the most effective ways for creating jobs and reducing unemployment rate in Indonesia. As the most populous Muslim country in the world, Indonesia's microfinance market needs a special *Shari'ah* compliant approach to fit in with the country's culture and norms. Both Islamic and conventional microfinance institutions must deal with issues of efficiency and effectiveness in managing the sources of funds, daily operations and distribution of funds. However, different MFIs have diverse missions and visions which can influence the style of management and performances. In the first chapter, the background of this research pointed out that Indonesia's MFIs mostly use the financial system approach with a profit motive and serves the economically active micro entrepreneurs. Meanwhile, 15.12 million people remain unemployed[19] and excluded from financial services. As these people are considered high risk borrowers with no proper collateral, many MFIs are reluctant to finance them. With this attitude and approach it will not be possible to reduce the unemployment rate in Indonesia by providing microfinance.

9.2 RESEARCH OVERVIEW

The high unemployment rate in Indonesia calls for searching for ways in which financing can be provided to the jobless and poor. One way is to provide MFIs with low cost funds that can be used to serve the needs of the poor and unemployed and used in viable micro-businesses. Being the most Muslim populous country, the demand for Islamic financial products and voluntary sectors is expected to be high. This study explores issues related to integration of Islamic MFIs and *waqf* to meet the financial needs of the poor and unemployed to enable them start their own micro businesses at the lowest or even zero cost. This study also examines MFI operational issues including style of management, availability of resources. As mentioned in

[19] Indonesia Unemployment Rate based on the IMF September 2011 report was 6.8%. Sources: www.world-economic-outlook.findthebest.com/d/d/Indonesia/Unemployment-rate Accessed on 2nd of May, 2012.

the first chapter, the Islamic MFIs grew sluggishly and are lagging behind conventional MFIs in terms of assets in Indonesia. This fact raised the curiosity whether Islamic MFIs' lower growth than conventional MFIs can be generalized to represent all Islamic MFIs' performance in Indonesia. Covering the whole of Indonesia with its large population and a wide-ranging area with three time zones would not be possible for this thesis due to time and cost constraints, so this research chose to focus on MFIs in the Bandung area.

In a review of the literature we explored the concept of microfinance and Islamic voluntary sectors, *waqf*, in particular. The practices and theory of microfinance and Islamic microfinance and the measurement tools to evaluate a MFI were presented in the Chapter Two. In a country with high levels of poverty, microfinance, however, is still a hot matter to be discussed. As the development of microfinance institution, the debate about the differences between 'the financial system' and 'the poverty lending' approach still continues. The need to customize the strategy for each type of MFI remains important. The distinctiveness of microfinance institutions either conventional or Islamic were also presented in this chapter. The dynamics interaction of the players in the MFIs from demand side, micro entrepreneurs, and supply side, loan officers and manager were also presented.

It is interesting to learn from the previous research with regards as many misleading assumptions and unanticipated consequences which came up as the results of various experiences from several MFIs from different countries. In relation to Islamic microfinance institutions, there were some issues which need to be addressed such as the unique characteristics of products, contracts, and risk management. These are specific challenges for policies and decision makers in this field. The combination between Islamic microfinance and *waqf* was introduced and discussed with the intention of knowing how this concept can fit into current practice of Islamic MFIs. With different nature, the collaboration between the Islamic voluntary sectors (non profit oriented) and microfinance (profit oriented) is not an easy task especially from the demand side perspectives. There was some hesitancy concerning the implementation of *qard hassan* loans in Islamic MFIs. Some MFIs' managers presumed that most regular micro borrowers would be reluctant to pay the loan and its cost (i.e. cost-plus *murabahah*) when they knew there were other micro-borrowers who received *qard hassan*, a free interest/cost-plus loan. This will be a problem if there is no particular strategy to anticipate it. Therefore, it is necessary to know the structure and the performance of each type of microfinance institution. The measurement of performance is very important for both stakeholders' and stockholders' interest. Therefore, a specific approach which applies a mixture of non-financial and financial measurement, the Balanced Scorecard, was chosen to explore and evaluate MFIs.

The chapter on voluntary sectors explored the role of identity and motivations behind people give and be altruistic. However, altruism is not new in Islamic culture. Islam persuades people to make charitable contributions for others. Z*akah*, *infaq*, *shadaqah* and *waqf* are the forms of Islamic philanthropy. Philanthropy has very close link to trust. Therefore, transparency, reputation, accountability, credibility, good collaboration, productivity, risk management and *Shari'ah*-compliant are the key words for keeping a trust especially for a *waqf* fund management. This research also proposed the concept of a good *waqf* government whereas there is a clear relation among *waqif*, *mutawalli*, *waqf* board and *maukuf'alaih* and their elements to support it.

In general, four type of microfinance institutions and two *waqf* institutions in Indonesia were introduced in the chapter four. BRI is the largest and fully supported by the Indonesian government, BPR is the conventional rural bank and other two Islamic Microfinance institutions, BPRS (Islamic rural bank) and BMT (*Baitul Maal wa Tamwil*) are also the samples of this research. In most cases, conventional and Islamic MFIs have mostly used the financial approach in daily operation, meanwhile the group-lending scheme has proven less successful in Indonesia. The data shows that BRI and BPR which are conventional MFIs show better growth than Islamic MFIs, BPRS and BMT in Indonesia.

It is not easy for Islamic microfinance products and voluntary sectors to develop well in Indonesia. These facts led to the questions that were investigated in this research. Other facts from PIRAC's research centre stated that individual giving in financing NPO in Indonesia is less than 15% without including other religious groups and z*akah infaq* and *sadaqah* (ZIS) are the most common form of individual giving rate based on religious grouping. According to the study, religious command, social solidarity, feelings of compassion and trust are the main reasons why people donate their money. The profile of two noted *waqf* institutions and a possible interface between *waqf* fund and MFIs by examining the opinions of MFIs' managers and regulators on the topic were presented in a chapter concerning the Indonesian case.

As mentioned in previous chapters, the character of *waqf* institutions is quite unique and varies from one to the other. The idea of collaboration between Islamic microfinance and *waqf* institutions was presented in the previous chapter. There are a far smaller numbers of *waqf* institutions than Islamic MFIs in general. A particular *waqf* institution can collaborate with particular Islamic MFIs within the same region. Therefore, examining too many MFIs as the sample of this research is not only ineffective and inefficient but also irrelevant. Every microfinance program needs to be tailored specifically to meet complex local realities, the needs of specific micro entrepreneurs, the complexity and nature of ventures to be financed (Khan, 2008) .Based on that reasons, the aim and the objectives of this research were determined by these reasons and raised seventeen research questions.

9.3 RESEARCH FINDINGS: OVERVIEW AND CONCLUSIONS

The study examined the demand and supply side issues related to Islamic MFIs and then investigated the scope for integrating microfinance and *waqf* institutions in *orde*r to give more opportunity to the needy and poor to access financial services. Nine objectives of this research have been determined to achieve the research's aim. By answering seventeen research questions set forth in the first chapter, nine objectives have been fulfilled and the aim had been achieved.

The details of how the research questions were addressed in the dissertation are given below:

Research Question 1: What are the important factors in managing Islamic MFIs and waqf institutions?

The first question concerned the important factors in managing Islamic MFIs and *waqf*. This question was answered in the literature review chapters where microfinance and *waqf* concepts and both practices were presented. From past and contemporary studies in the field of microfinance and *waqf* sectors, the important factors in managing these two institutions were formulated.

Choosing between 'the financial system' or 'the poverty lending' approaches as the most suitable model for the characteristics of MFIs in Indonesia is still an unresolved issue. However, to generalize a particular approach to fit various circumstances is impossible but the former is perceived to be more suitable than the latter. Seven key characteristics of a strong microfinance institution according to Fruman and Isern (1996) are: vision, financial services and delivery methods, organizational structure and human resources, administration and finance, management information system, institutional viability and outreach and financial sustainability. Some characteristics of micro entrepreneurs are lack of collateral, illiteracy, the higher administering cost of loans (assessment, processing and monitoring) which make it impossible for traditional financial institutions to offer credit to micro enterprises (Ahmed, 2002; Khan, 2008).

Lessons should be learned from many misleading assumptions and barriers, both internal and external, to hinder the growth of microfinance both finance and non finance-related factors which lead unanticipated consequences. There are some finance-related problems of MFIs such as asymmetric information, economic viability, low rate of ROI, debt trap, high drop-out rate and non graduation from poverty (Ahmed, 2002). "The access and cost of financial services" is very important for micro-entrepreneurs (Robinson, 2009 : 45). There are some non-finance factors which have significant impact for developing MFIs such as insufficient supervisory teams, low paid salary for officers, moral hazard, culture and specific behavior. Sufficient supervisory and monitoring teams compared with the number of clients, called ratio matters, are important to increase the repayment rate.

To encourage Muslims to donate their money, it is better to recognize the factors that drive them to giving. The role of identity and motivations are the reasons why people give and do altruism. Islam persuades people to make sacrifices for others through *zakah, infaq, sadaqah* and *waqf.* Trust is very important in the philanthropy sector and easier depleted than grown. Therefore, transparency, reputation, accountability, credibility, good collaboration, productivity, risk management and *Shari'ah*-compliant are the key words for sustainability of *waqf* management.

Research Question 2: What are the facts which showed that Islamic MFIs grow slowly in Indonesia compared to conventional MFIs?

The second research question relates to the fact that Islamic MFIs grew slower in Indonesia compared to conventional MFIs was answered in Chapter Four. The statistical data as shown in Figure 4.4 until 4.9 about four types of MFI in Indonesia shows the slow growth of Islamic MFIs. In the area of microfinance, BRI is still the largest and most powerful institution because it is fully supported by the Indonesian government. BPR and other two Islamic microfinance institutions, BPRS and BMT, struggle on in fierce competition. Statistically, BRI and BPR, conventional MFIs, have showed better growth than Islamic MFIs, BPRS and BMT in Indonesia generally.

Research Question 3: *What are the characteristics of MFI clients profile compared to other types of MFIs?*

The third research question relates to the characteristics of MFIs clients profile contrasted with different types of MFIs was dealt with in the empirical chapter on the demand side of microfinance in which results from the answers of questionnaires conducted with MFI clients were reported. The information and data derived from the answers of questionnaires of MFI's clients investigated the profile of clients and their responses revealed the unique characteristics of MFI's clients profile from conventional and Islamic MFIs.

Regarding the profile of MFI's clients, in general, male respondents are bigger than females with the age range was between 30 and 41 years old. These findings are in line with the characteristics of MFI clients in Indonesia which are not female oriented. Females and males have the same opportunity as long as they qualify to get a micro loan through a similar screening process. Data shows that MFIs tend to give a loan to younger aged clients especially by BMT, BPR and BPRS. BRI clients are slightly less risky than other types of MFIs' clients.

Most BRI clients are permanent employees in the government or private sectors. Otherwise, BPR and BPRS do not choose the government employees as their target market but they chose private and informal sectors. Government employees, who are BRI's target market, have particular characteristics: fixed income, the lowest risk (almost zero because the monthly salary goes directly to BRI account as a loan payment), low cost (because BRI had a MoU with the government/company).

For the short duration of loan, the purposes of loan mainly for consumption. Compared to other types of MFIs, BPR deals with the highest risk clients and then as a consequence of that, BPR charged the borrowers higher interest rate for return. Short loan is the majority type for BMT and BPR. The short duration of the loan implies that the clients use the loan for emergency or consumption needs. The duration of loan also affects the cost of loan as a consequence. Only a small number of clients took repeated loans from MFIs. During an in-depth interview, some MFI's managers said that the clients who got loan only once commonly do not usually qualify for a second because of their bad reputation with the first loan payment history.

Research Question 4: What are the differences in perceptions between conventional and Islamic MFI clients towards the products?

To identify the different perceptions between conventional and Islamic MFIs clients towards the products particularly interest rate/cost-plus *murabahah* was the fourth research question. Similar to the previous question, the answers to this question came through empirical data derived from interviews with MFI's clients.

BRI on average was the lowest interest rate of MFI, respectively followed by BPRS, BMT and BPR. Surprisingly, when clients were asked their perceptions about the rate of their interest rate/cost plus *murabahah* compared to other MFIs, 94.7% clients felt his/her MFI's rate was equal and even lower than other MFIs but actually, the majority of their interest rate was much higher than their perception. It seems like they tried to convince themselves that they had selected the cheaper and right MFI.

Furthermore, although in reality BPR had the highest interest rate, its clients perceived that the interest rate was equal to other MFIs. Akin to BPR, BPRS clients demonstrated the same perception but actually the fact was quite higher than BRI. Astonishingly, most BMT clients perceived that BMT rate was lower than other MFIs whereas in reality, BMT's rates were high compared to BRI and BPRS. The majority of BRI clients said that BRI's rate was reasonable and relatively lower than other which was in line with the data. In brief, the client's perception of interest rate/cost plus in *murabahah* transaction in average was lower than or equal to actual rate.

Research Question 5: *What are the differences in understanding between conventional and Islamic MFIs clients towards concept of Islamic microfinance products?*

The fifth research question was to examine the different understanding of conventional and Islamic MFIs clients towards the concepts of Islamic microfinance products. The empirical results provided an answer to this question in Chapter Six. The majority of MFI's clients did not understand the concept of Islamic microfinance products, *murabahah*, *mudarabah*, *musharakah*, and *ijarah* except for BMT and BPRS' clients who understood only the *murabahah* concept. More than 50% of BMT and BPRS's clients understood the *murabahah* concept. Lack of training and education are the main reasons for the facts above.

Research Question 6: How do MFI's managers' perceptions of the lack of these understandings?

The sixth research question attempted to know how MFI managers perceived the lack of understanding of these concepts by clients. MFI's managers perceptions of the lack of the clients' understanding regarding concepts of Islamic microfinance products were presented in the Chapter Seven. Table 7.9 shows that 55.5% of MFI managers' perceived clients who understood the *murabahah* concept but in reality only 26.85% of respondents understood. The survey then revealed that 19.28% of respondents understood the *mudarabah* concept but from 38.9% of MFI's managers believed the clients familiar with it. With a huge gap between the clients understanding and what the MFI's managers perceive about their knowledge regarding the microfinance products, the popularity of these products were terribly underestimated by MFI's managers. MFI managers thought that two products were familiar to MFI's clients but in reality these product were unknown at all and this fact was beyond their expectations.

Because the majority of clients did not receive training during the loan period, MFI managers' showed their perceptions of the necessity of training for MFI's clients such as management, technical and spiritual trainings for supporting clients' business. For another two instruments, *musharakah* and *ijarah*, 16.7% and 11.1% of the manager stated that the clients understood *musharakah* and *ijarah* respectively, and the survey result of clients showed that only 14.12% and 14% of respondents understood *musharakah* and *ijarah* concepts consecutively which were quite closer to manager's perception.

Research Question 7: What are MFI clients' perceptions of their own MFI compared to other MFIs?

The seventh research question concerned MFIs clients' perceptions of their own MFI's rates compared to other MFIs. Information was gathered through questionnaires conducted with clients in order to know their relative perceptions whether their own MFI's interest rate/cost-plus *murabahah* was lower, similar or higher than other MFIs. The comparative results are reported in the Chapter Six. Although, in reality, the majority of their interest/mark-up/cost plus *murabahah* rate was much higher than client perception, most stated that their rate was either equal to or even lower than other MFIs. This perception almost was perceived by all types of MFI clients. This fact reveals that most clients thought that they had chosen the best MFI with a reasonable cost of loan.

Research Question 8: What does MFI management perceive about clients' perceptions?

In order to see whether managers have recognized and understood their clients' wants, the eighth research question attempted to discover managements' views on clients' perceptions. The results of this attempt can be found in the empirical chapter, Chapter Seven.

According to BMT and BRI managers, the average willingness to pay interest rate/mark-up margin was higher than the answers of their clients' in our survey. This fact told us that BMT and BRI charged less than the managers perceived clients' willingness or ability to pay for the cost of a loan. This was not the case for BPR and BPRS. BPR and BPRS managers perceived that their clients' willingness to pay was lower than BPR clients who paid the average monthly interest rate. BPR and BPRS charged their clients a higher cost of loan than their managers perceived of the clients' willingness to pay monthly.

MFI managers' have the same perception with the clients in valuing BRI the cheapest and BPRS the second cheapest MFI. But, there was a different perception in valuing BPR and BMT between MFI managers and clients. BMT was perceived by MFI clients to be cheaper than BPR whereas managers perceived the opposite.

Research Question 9: What are the preferences and reasons for clients to select a specific MFI?

The ninth research question sought to find out clients' preferences and reasons for choosing an MFI. Eight variables were ranked by clients to show their preferences and rankings when choosing an MFI.

Table 6.16 shows that the majority of respondents preferred Islamic MFI rather than conventional MFI despite the fact that the majority of respondents were conventional clients. Most clients perceived that by using Islamic products, a Muslim feels tranquility and peace of mind but ultimately practicality and economical reasons became dominant factors in making a decision. To prefer one thing and choose another thing appears to be an inconsistent behavior.

Some non-economic/finance factors, mostly services, such as easiness, promptness in the process and nearness to the market were prioritized higher by clients compared to economy/finance factors such as low interest, low collateral and loan size. Excellent management services and economic/financial reasons were the main factors in choosing a MFI and religious reasons were given lower priority.

These findings have many implications related to the understanding of Indonesian Muslims'civil society behavior towards economic transactions and spiritual aspects. It should be noted that although Indonesia is the largest Muslim population in the world, it is not an Islamic country. Currently, Indonesian Muslims live in an increasingly secular environment in which religion has less and less influence on their daily lives. In economic activities, pragmatic choice based on the economic behavior perspective is dominant in decision making process both consciously or subconsciously.

Research Question 10: What are MFI manager's perceptions of MFI's client's preferences and reasons for choosing a MFI?

While the ninth research question dealt with the preferences and reasons for choosing a MFI presented from the clients' point of view, the tenth research question looks at MFI management's views of clients' preferences and reasons. A comparison of the demand and supply sides was presented in Chapter Seven. MFI managers' perceptions of their clients' preferences towards Islamic MFI were relatively more positive than the reality. Most MFI managers from both conventional and Islamic MFIs perceived an Islamic MFI to be more preferable to clients a conventional one. These facts show that there are positive signals for developing Islamic MFI in the future.

Although managers were given the same questions as clients, the results turned out to be slightly different. Some non-economic/finance factors, mostly services, such as easiness and speed/promptness of the process were the first two priorities for both managers and clients. According to clients, economy/financial factors such as a low of interest rate were more important than low collateral but managers perceived otherwise. The nearness of MFI's location was fourth and more important than low collateral ranked fifth by clients whereas it was perceived less important by managers (see the seventh priority of managers' perceptions). Clients and managers agreed that loan officer's characteristics were not a priority; hence, they put this category in last priorities/ranking. For loan size and method of payment, both managers and clients' opinions are slightly different but do not have much effect on making a decision.

Even though more clients prefer Islamic to conventional MFI, religious reasons are not the main reasons when choosing an MFI. The services and economic/finance factors stated above are highly prioritized instead.

Research Question 11: What are the differences between the management styles of conventional and Islamic MFIs?

The eleventh research question attempted to identify the differences between the management style of conventional and Islamic MFIs. In depth-interviews with managers were conducted to gather empirical data about management styles. The data was processed using nonparametric statistics and based on BSC approach, revealed different styles and patterns from four perspectives, internal process, learning-and-growth, financial performances and customer satisfaction. The answers to this question can be found in detail in Chapter Seven.

To investigate the structure of MFI on the supply side, the BSC approach which applies the combination of financial and non-financial perspectives was applied in this research.

Based on internal process perspectives, all MFIs showed the same style and pattern about the clearness of organization's structure, a stated vision, daily operation controller, staff/officers turnover, clear line of authority, the evaluation of performance and the issue of transparency and accountability. But, the different types of MFIs have different styles and patterns, i.e. the scale of human resources, work duplication, compensation and salary. BPR has the most human resources, followed by BPRS and BRI consecutively. BMT's human resources were far from the other MFIs and need more clients to scale up their businesses. There are many overlapping works in BMT compared to other MFIs. Regarding the compensation, BRIs was still the highest and strictly followed by BPRS and BPR. BMT's compensation was the lowest.

Based on learning growth perspectives, the variables of this perspective in a MFI are availability of human resources of department, the clarity of policies, the professional systems in recruitment process, minimum criteria of staff, sufficient budgets for training, staff development and the awareness of staff performance towards non-performance loan (NPL). BRI showed the best performance for all elements and was strictly followed by BPRS. BPR had the lowest minimum staff criteria, training for staff and NPL but for the clearness of policies, minimum staff experience criteria and annual training budgets, BPR was slightly better than BMT. For the rest of the elements, BMT still had the lowest scores. Particularly for annual training budgets, BMT allocates minimum budgets as it is not necessary for BMTs which are under ministry of cooperative's supervision.

In this research, the elements of customer perspectives are *Sharia'h* compliance, easiness, process, low interest/mark-up, speed/promptness, low collateral, payment methods, LO's profile, MFI's most preferable and overall performances. BRI got the highest score for all elements except *Sharia'h* compliance and speed/promptness of process. BMT is the best MFI according for *Sharia'h* compliance and BPR is the best for speed/promptness of the application process. BRI is well-known as a cautious MFI which asks for complete supporting document from a prospective client as a prerequisite in the credit decision process. As a consequence of its cautiousness, BRI can make the lowest requirement for collateral compared to other MFIs. Otherwise, BPR required more collateral due to its condition dealing with the high risk customers. Based on their knowledge and perception towards the four types of MFI, most clients preferred BRI rather than other types of MFI. After choosing BRI as the first priority, BPRS was considered to be the second priority, BPR as the third and BMT the last priority.

From the financial perspectives point of view, BRI showed the best financial ratios performance such as ROA, ROE and OSS, and followed by BPRS, BPR and BMT consecutively in general. For outreach, BRI was still the best for breadth and depth but BPR the best worth to clients. Surprisingly, BMT showed higher scores of breadth and depth than BPRS and BPR. Hence, for financial perspectives, BRI was the best, followed by BMT, BPRS and BPR consecutively.

Overall scores of Balanced Scorecard from the four perspectives of MFIs cemented BRI (conventional) as the winner, BPRS (Islamic) in the second place, followed by BPR (conventional) and BMT (Islamic) in the third and fourth place respectively. The structure of BRI as the largest conventional MFI in Indonesia fully supported by government has been proven too robust to compete with other small MFIs. The position of BPR (conventional) was under BPRS (Islamic) MFI for the four perspectives. On the contrary, BMT showed weak structure in terms of internal process, learning-and-growth and customer satisfaction. It seemed that BMT is not managed well according to BSC perspectives. This finding shows that not all conventional MFI's performances are better than Islamic MFIs, in particular for management of the institution.

Elements in every perspective reveal the specific differences of MFI management (see the sub section 7.3). Learning these elements can be a guide for managers and policy makers to understand the differences between each type of MFI. Between the four perspectives, there are also significant correlations between internal process and customer's perspectives, between customer's perspectives and learning-and-growth and between learning-and-growth and financial performance.

Research Question 12: How do Islamic MFIs compete with their conventional counterparts?

The twelfth research question tried to know how Islamic MFIs compete with their conventional counterparts. This question had been addressed comprehensively based on data from Chapter Six, Seven and contextualized findings in Chapter Eight. Learning from the empirical data from the demand and supply sides of MFI is one way to understand the problems on the ground.

Based on the profile of MFIs clients on the demand side, we can discern the target markets for conventional and Islamic MFIs. Unfortunately, there is no significant difference between Islamic and conventional MFI clients to be considered by Islamic MFIs' managers as an important factor to compete with conventional MFI. If any, the difference was found on BRI which attracts government employees as low risk clients. The easiness and promptness of screening process are more important than higher interest rate/mark-ups for some clients. This finding supports the arguments of Obaidullah and Khan (2008) who said that easy access, timeliness and flexibility are more important factors for micro-entrepreneurs than cost of funding. The result is also coherent with the statement of Robinson (2009) that borrowers need the financing process to have features such as secure, simple, quick disbursement, confidential, liquidity, good services and convenience.

There is a need for a specific approach for Islamic MFI clients to make them understand *Shari'ah* concepts and be willing to join with Islamic MFIs. These extra efforts to educate new clients, market the products and maintain existing clients should be done continuously and vigorously.

Avoiding *'form over substance'* in Islamic MFIs in order to get the trust from clients by implementing the proper Islamic finance products is the most important thing to do. Although the majority of respondents preferred Islamic MFI to conventional MFI on the grounds of satisfaction, confidence and religious observances, ultimately practicality and economic reasons became dominant factors in their choice of conventional MFI as highlighted by Khan (2008) and Robinson (2009).

Optimizing every element in '*The BSC based Islamic MFIs' Model'* is an alternative way to enhance Islamic MFI management to compete with its conventional counterparts. However, a balanced combination of financial, non-financial and social perspectives can excel Islamic MFIs performances and capture the majority of Muslims as clients.

Research Question 13: Why do the Islamic MFIs grow slowly in Indonesia compared to conventional MFIs?

The thirteenth research question identifies the reasons why the Islamic MFIs grew slower compared to conventional MFIs in Indonesia. As mentioned in the previous chapter, in general the scale of economy and the number of conventional MFIs are far bigger than Islamic MFIs. In order to know why the clients prefer conventional over Islamic MFI, this research is comprehensively conducted. To know the reasons why Islamic MFIs grew slower compared to their conventional counterpart, the researcher examined the demand and supply sides of MFIs.

From the demand side, Islamic MFI managers should fully recognize clients' wants, preferences and needs from products and services. Based on the empirical data, there was some misinterpretation by managers of clients' preferences in relation to policies. Although they prefer Islamic MFIs, in the end, clients chose a MFI based for practical and economic/financial reasons. From the supply side, the data revealed that on one hand BRI as conventional MFI showed a powerful and robust structure. On the other hand, BPRS and BMT's management performances, in many elements both financial and non-financial, were below the conventional ones. No wonder then, that clients finally chose the best MFI in services and that was also affordable instead of choosing a religious/*Shari'ah* compliant one.

Research Question 14: What are the linkages between waqf institutions and Islamic microfinance institutions?

The fourteenth research question looks at the linkage between Islamic microfinance and *waqf* institutions in Indonesia. The answer to this question is presented in Chapter Eight and is based on the data from the empirical chapter and literature review.

Two important matters for microfinance clients are the access and cost of financial services (Robinson, 2001). The statements of Robinson (2001) resonate with the findings of this research as easiness and promptness to get access and cost of finance charges are the top priorities of the respondents. In many cases of microfinance worldwide, the usage of the poverty lending approach provides loan to poor borrowers at low cost. But the consequences of the poverty lending approach is that MFIs are not sustainable, mainly because 'their interest rates on loans are too low for full cost recovery' (Robinson, 2001: 8).

As mentioned before, MFIs in Indonesia including BMT mostly use the financial system approach instead of the poverty lending approach with the implication that only the economically active micro-entrepreneurs could be served. The consequence is that the poor and jobless do not have access to financial services. However, as there are no subsidies available, the cost of microfinance loan is not cheap. Even if available, MFIs relying on subsidies are not expected to be sustainable in the long run. This is a dilemma for MFI. If using the financial system approach, the poor and jobless cannot access the financial services. If using the poverty lending approach, the poor and jobless can chance micro-financing but it will unsustainable in the long run. Therefore, in order to make MFIs that can be accessed by the poor and jobless but still be sustainable in the long run, MFIs can collaborate with other voluntary sectors which provide charitable funds for social services only for special clients who are poor and jobless. Particularly for Islamic MFIs, z*akah, sadaqah, infaq* and *waqf* are some Islamic voluntary instruments that can be used in giving the opportunities to work for the needy dan poor.

Research Question 15: How can waqf institutions support the growth of Islamic MFIs?

The fifteenth research question focuses on how waqf institutions can support the growth of Islamic MFIs. The answer to this question can be found in Chapters Seven and Eight. Integration between Islamic MFIs and *waqf* institutions through *qard hassan* loans would help needy micro-entrepreneurs start their micro-business. As suggested by Ahmed (2012), the corpus of cash *waqf* fund can be invested in profit-oriented business such as Islamic MFI and the profit of these investments can support needy MFI clients through *qard hassan* loan and social purposes. The corpus of cash *waqf* can be directly lent as *qard hassan* loan to needy MFI clients. The corpus of cash *waqf* can be used as capital to establish an Islamic MFI.

Qard hassan should not be given to government and private employees who have a permanent job but to the needy micro-entrepreneurs and jobless people to start their own business. The groups who live at the poverty line and under can hardly get a chance to access microfinance loans. BMT and BPRS' officers can identify and find these groups who live in MFI's office surroundings to become qard *hassan* borrowers. In terms of gender, there should be no difference between females and males as the targets of *qard hassan*. The findings of this study indicate that clients of BMT and BPRS who prefer Islamic than conventional MFIs should be prioritized as the target market of *qard hassan.* Existing Islamic MFIs dealing with these groups of clients are not costly compared to *waqf* based institutions providing financing. However, these groups living at the bottom of pyramid are often physically and economically isolated (Prahalad & Hart, 2004). As such, a special strategy is needed to approach them and provide them with microfinance.

However, the 'mercy of the rich' is still a big issue in collecting *waqf* fund. Relying on deeply to the rich as the source of *waqf* fund is not sufficient. The nazirs should actively find the other type of *waqifs* such as the middle class of Muslims with promoting *cash* waqf certificate and also through various marketing strategies to promote *waqf* fund management programmes. Another issue which should be seriously taken into account the investment decision of nazirs. The decision to invest *waqf* fund as part of their investment portfolio into an Islamic MFI is not an easy. The corpus of *waqf* fund can be directly invested to establish and fund an Islamic

MFI. If the *nazir* chooses to invest the *waqf* fund in Islamic MFIs either in the form of *mudarabah*, *musharakah* or *qard hassan*, he/she should make the acquaintance of the characteristics and performance of an MFI. Without being cautious, the principal or corpus of *waqf* fund can decline implying that the *nazir* is not fulfilling his/her duties.

Research Question 16: What are the constraints inhibiting the integration and collaboration of these institutions?

Identifying the constraints in daily operations of the linkage and collaboration between two institutions is the sixteenth question of this research and was addressed in Chapter Eight by contextualizing the findings from the empirical chapters. There were some constraints that inhibit the integration of two institutions. First, the collected *waqf* fund was too small due to the number of *waqifs* and *waqf* fund compared to its potency. A small amount of *waqf* fund does not fulfill the scale of economy for specific investment portfolio. Second, Islamic MFI managers will have problems convincing regular MFI borrowers to keep repaying their loans and cost of loans if at the same time there are *qard hassan* fund programs for the needy and poor to start their own business. It can create moral hazards for unethical micro borrowers to be reluctant to repay the loan and its costs and put themselves eligible to get the free mark-up loan. Third, *the qard hassan* fund which came from *waqf* fund, to some extent, is not an interesting investment choice for the *Nazir* when managing the *waqf* fund productively. Fourth, the issues in choosing a prospective MFI for placing the *qard hassan* fund can be a big challenge for the *Nazir*. The elements in *The BSC based Islamic MFIs' Model*' can help *Nazir* to make a decision. However, the collaboration between two institutions should be enhanced with well planned strategies.

Research Question 17: *How can waqf be integrated with Islamic MFI to boost the growth of Islamic MFIs?*

The last research question addressed how *waqf* could be integrated with Islamic MFI to boost their growth. The answers to this question have been presented in Chapter Eight and summarized in Chapter Nine. Based on the findings, it is proposed that one more perspectives for '*The BSC based MFIs' Model*'be added: the social perspective. Social perspective comprises the social mission of Islamic MFIs to dedicate qard *hassan* to giving more opportunities for the needy, jobless and the poor to start their own micro-business. Social perspectives will have elements that include how much money to contribute for *qard hassan*, how many needy clients can be served and how many months a MFI can let clients use the *qard hassan* loan and so on. Therefore, the *BSC based Islamic MFIs' Model*' should have five perspectives. Using the elements in the *BSC based Islamic MFIs' Model*; the *nazir* can do the appraisal towards an Islamic MFI in a proper way, which is more balanced and comprehensive.

By fulfilling all the research questions, nine objectives of this research have been satisfied. As a result, the research's aim which was to examine demand and supply issues related to Islamic MFI and investigate the scope of integrating microfinance and *waqf* institutions in order to provide more opportunity to the needy and poor to access financial services as a social mission has been fulfilled.

9.4 IMPLICATIONS OF THE STUDY AND RECOMMENDATIONS

9.4.1 Implications of the Study

The results of this research show that there are positive signals for helping needy micro-entrepreneurs with the *qard hassan* loan, developing Islamic MFI in the near future and making Islamic MFI and *waqf* institutions fulfill their social mission to help the poor. With there is potentially a large demand for Islamic MFIs in a Muslim majority country like Indonesia there are incentives for conventional MFIs to convert to Islamic MFIs in the future. This is similar to the development of Islamic banking industry in Indonesia during the last ten years which started to provide Islamic banking services by opening dual windows, Islamic and conventional. In many cases, the dual-window bank is a starting point to move further towards full Islamic bank status.

The findings of this thesis should be of interest to policy makers, professionals, the boards of directors, the public, clients and academics, especially on issues relating to philanthropy, Islamic microfinance and good '*waqf*' governance practice. Policy makers such as Bank Indonesia, the Ministry of Cooperatives and SMEs and the Indonesian *Waqf* Board (IWB) may use the findings regarding the formulation of new regulations to support waqf-based Islamic MFIs, capacity building, public education/training and giving other incentives to establish Islamic MFIs. In relation to governance practice, policy makers should continuously recognize the important roles played by *waqf* and Islamic MFIs institutions in order to create more benefits for the poor, the needy and jobless people.

The professionals such as MFI managers/Board of Directors and *nazir/mutawalli*/trustee managers may use the findings to integrate two diverse institutions, one profit-oriented and the other non-profit oriented motive, to provide more benefits to the poor and the needy to accomplish their social mission. The findings in this study may be used by MFI managers as a parameter to further recognize not only their client's profile, perception, preferences and opinions but also to do self-introspection into their own institutions and comparing/benchmarking with other institutions. The findings may help the *nazir/mutawalli* to recognize the urgency of the need for *qard hassan* to help the poor and reduce the unemployment rate.

The public, the MFIs' clients in particular, may use the findings to compare and choose a certain type of MFI which suits their needs. The people who are rich, pious and have the potential to be *waqif* may use this finding to motivate themselves to share their wealth with *waqf* institutions which give *qard hassan* loans. The clients may use this study to help them choose suitable MFIs based on their preferences and conditions. Finally, the academician may get benefit from the findings to conduct further research related to these issues.

The founding fathers of Islamic economics suggested comprehensive alternative ways and means of uplifting society's socio-economic conditions based on moral and welfare principles. Giving the opportunity to work to the poor to sustain themselves through *qard hassan* loan is one of them. The role of *waqf* in supporting sustainable Islamic MFIs is potentially exponential but will require efforts to become a reality.

The recommendations arising from this research are discussed next.

9.4.2 Recommendations

9.4.2.1 Recommendations to Strengthen Demand Side Aspects

Economically active clients (men and women) need easy and quick access to get a loan with the reasonable and competitive interest/mark-up/cost-plus rate. Therefore, every MFI's management team should do their best to give excellent services. Especially for Islamic MFIs' clients, they need more information and education programs to enhance their knowledge of the concept of Islamic MFI's products. For the needy, poor micro-entrepreneurs, and jobless in particular, MFIs should have a special division to manage them with *qard hassan* loans. From this special division, *qard hassan* borrowers will get special training on managerial, technical and spiritual matters to build the special character needed to be tough micro-entrepreneurs. Meanwhile, *zakah*, *sadaqah* and *infaq* funds from Islamic voluntary sectors can support their life and family during the programs until they become self-sufficient.

9.4.2.2 Recommendations to Strengthen Supply Sides Aspects

Especially for Islamic MFIs, '*The BSC based Islamic MFIs' Model*' can be a reference benchmark in measuring the performance. To fulfill the high expectations society holds for what an Islamic MFI should be (a social and moral mission to help the needy and poor), an Islamic MFI should have a special division for identifying needy borrowers, distributing *qard hassan* loans and managing the needy and poor borrowers to repay on time. Islamic MFIs can create a special product such as '*qard Hassan* loan certificate'. This product can be introduced by *Nazir* to prospect *waqifs* through *waqf* institutions. The *waqif* who is interested in donating their money can buy a '*qard hassan* loan certificate' with some donations denominations. For example the value of *qard hassan* loan is £100/certificate or £500/certificate and so on. With this product, it will be easy for an Islamic MFI to attract *waqf* institutions and *waqifs* as well.

9.4.2.3 Recommendations for Collaboration Between Waqf and MFI's Institutions

Based on data from some *waqf* institutions, the collected *waqf* fund value is very tiny and far smaller than their potency. *Waqf* institutions need more marketing efforts to promote their programs and products to society in general and rich people in particular. Past studies show that charity, giving, philanthropy is a human need for sharing with others or at least feeling good for themselves. With special themes and programs for *qard hassan* loan, the marketing mix program can be done intensively.

The enthusiasm towards Islamic microfinance as shown by the majority of respondents in this research can be a big opportunity for developing Islamic MFI forward in the near future as long as Islamic MFIs offer professional services to at least the same standard as the conventional MFIs.

9.5 LIMITATIONS OF THE STUDY

Although the thesis examines various issues on the demand and supply sides of Islamic MFIs, it has several limitations. Firstly, the nature of the topic in this research is complex. The issues of microfinance, Islamic microfinance in particular and *waqf* are broad, multi-dimensional, complex and related to other variables. Therefore, in this study, the researcher tried her best to organize and identify the problems related to the aim and objectives of this research. Many problems and issues which are highly related to *waqf* and microfinance were not investigated due to the limitations of time and budget. Some of these issues include the impact of MFIs on the clients, the impact of *waqf* in the economy, etc.

Secondly, there are several real life situations and conditions which the researcher could not include in the research sampling. There are thousands of microfinance institutions with different types of ethnic characteristics spread in the three zone times in Indonesia. Thus, it is difficult, if not impossible to take a random sample of the population which represents Indonesia as a whole. Furthermore, there is insufficient information from secondary sources about MFIs and *waqf* institution suitable for fulfilling the research questions. Therefore, collecting the primary data concerning the MFI's performance and structure from a particular city, Bandung, was the only reasonable way to address the research questions. As the result, the results of this research cannot be generalized to represent MFIs in Indonesia overall but only a particular area *i.e.*, Bandung.

Thirdly, it must be noted that the number of MFIs (18 MFIs) and *waqf* institutions (2 institutions) in the sample is relatively small and does not fulfill the assumption of normal distribution. Therefore, to analyze the data with non-normal distribution, non probability samples and small numbers nonparametric statistics were used. As a consequence of this, many statistical measurements such as econometric or multivariate data analysis and models which have normality assumption as a prerequisite cannot be properly applied. However, statistics and other research methods are merely tools or instruments that help the researcher to achieve the aims and objectives of this study. They are not the central to the research but they ought to bow to necessity in the fieldwork.

Fourthly, one major obstacle in the field of Islamic finance is the inability to quantify religious or *Shari'ah*-related variables. For example, the motivation and the economic/financial factors affecting donations to *waqf* funds were not investigated. The risks and returns are not able to be measured and quantified accurately due to many uncountable factors derived them such as religiousness and piousness.

9.6 FURTHER RESEARCH RECOMMENDATIONS

Despite the limitations of this research as discussed above, this study can provide guidance for futher comprehensive research on microfinance and voluntary sector to support MFIs. Having identified the limitations of the study, the following are the recommendations for future research in the realm of Islamic MFIs and *waqf* sectors in Indonesia:

1. This study was conducted under the assumptions of the present condition of MFIs, conventional and Islamic, in Bandung area only. As there are thousands of microfinance institutions with different types of ethnic characteristics spread in the three time zones in Indonesia, future research will be more statistically informed if the researcher can take a random sample of the population which represents Indonesia as a whole.
2. Future research on Islamic MFIs' demand sides may be extended into study of customer behavior of Islamic MFI's clients in choosing a MFI and using the loan from a MFI. Investigating more variables on clients' sides such as their incomes, savings, level of educations, their spending habits and other behaviors will create a comprehensive understanding about the characteristics of customers.
3. Research on Islamic MFI's supply side may be extended into study of organization behavior of Islamic MFIs managers in managing an Islamic MFI. Different styles of management and structure of institutions generate different performance of institutions. Therefore, if more MFIs are involved in the future research, more information on dynamics and operations can be obtained to explain the behavior of Islamic MFIs.
4. Further investigation about demand and supply of BRI Syariah can complement this research. However, the combination of the reputation of BRI with Islamic microfinance concept will produce knowledge and information for both academic research and the industry.
5. Future directions of research should also focus on, but not be limited to, more fully investigating the poor and the needy who deserve to get *qard hassan* loan and other trainings to enhance their capacity building to be an active microentrepreneur. Needs assessment are also needed for the poor or the target clients of *qard hassan* loan.

6. *Waqf* institutions as one of important institutions providing *qard hassan* fund should be explored in more details with regards to their investment portfolio, mission, vision, and their commitment to invest their *waqf* fund to sustain Islamic MFIs.

In order to conduct a proper research based on the recommendations above, it will be required the collaboration of multidiscipline experts with different perspectives to enrich and enhance the future research.

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APPENDICES

APPENDIX 1

QUESTIONNAIRES FOR MFI'S CLIENTS

Dian Masyita
E2 no. 12 Taman Melati
Pasir Impun
Bandung Indonesia
Telp: (022) 7217817

20th September 2010

Title:
Survey Questionnaire for Customers' of Conventional and Islamic Microfinance Institutions (MFIs) in Indonesia

Dear Sir/Madam,

Micro and small scale businesses are one of the most effective ways for creating jobs and reducing unemployment rate. Therefore, micro, small sized enterprises are one of Indonesian economy's pillars nowadays. A better understanding about the mechanism and real problems of MFIs can be a valuable contribution to create the healthy of MFI in the future.

The purpose of this survey is to obtain information of MFI's customer opinion about your MFI compared to other MFI's surroundings

This is to kindly request you to respond to the questions and return the questionnaire to the person who issued it to you or to the above address.

Thank you for your cooperation.

Yours sincerely,

Dian Masyita
Researcher

Durham University

QUESTIONNAIRES for MFI's CLIENTS

Respondent Background/Basic Information

1.	Number	
2.	Name / Code Resp	
3.	Location/Address	
4.	Occupation	
5.	Age	
6.	Sex	Male / Female
7.	Are you registered as a MFI's customer? If Yes, What is the MFI's name? What are your reasons to choose this MFI? How many years are you dealing with the MFI?	Yes / No …………………………………………………….. …………………………………………………….. ……………………………………………. ……………………………………………..
9.	Where did you get the information about this MFI?	Internet/ Newspaper/ Advertising/ Brochures/ Friend/Relatives/MFI's Clients

Please tick the appropriate box to indicate your preference and fill the open question below

1. What are your reasons to choose this MFI? (you can select more than 1 answer)
   Identify your priority: 1 = most important 8 = not important
   a. Near your house/office priority /rank..........
   b. Relatively easy in terms of administration process priority /rank..........
   c. Low interest rate/ mark-up priority /rank.........
   d. Quickly processing priority /rank..........
   e. No/low collateral priority /rank.........
   f. Loan Size priority /rank..........
   g. Payment Methods priority /rank..........
   h. Loan Officer's Profile priority /rank..........

2. How much is the value of your loan? ________________

3. What is the tenure of the loan ______(in months)

4. How frequently do you pay your installments?
   a. daily b. weekly c. monthly d. quarterly e. annually

5. How much do you have to pay in each installment? _____________

6. In the past 3 years, what other types of credit you have used?

Other Lending Institutions	Amounts
___________________.	Rp__________
___________________.	Rp__________
Local Traders/Money Lenders/ Landlords	____________
Family/friends	____________

7. Are any of your previous loans outstanding? □Yes □No

8. How many times you have taken funds from the current MFI?
   □ Once □Twice □Thrice □Four times □Others
   ____
   ____

9. What was the intended purpose of your current loan?
   □ Working capital □ Fixed capital □ Both fixed and working capital □ Consumption

10. Compared to other MFIs, how much your interest rate/rate of return on your MFI?
    a. lower b. similar c. higher
    Please rank these MFIs below from 1 (the cheapest) – 4 (the most expensive)
    . ... BPR ……..BPRS ……… BMT ……..BRI

11. Have you acquired any training? (there can be more than one answers)
    □ Managerial trainings □ Technical trainings □ Spiritual /motivation trainings

12. Which one of the following do you prefer?
    □ Islamic MFIs,
    why?..
    ……………………………………………………………………………………
    □Conventional MFIs,
    why?..
    ……………………………………………………………………………………

13. Are you familiar with any of the following?:

Murabahah,	□Yes	□No
Mudharabah,	□Yes	□No
Musharakah	□Yes	□No
Ijarah	□Yes	□No

14. Which one of the following do you think is the most Shari’ah compliant?
    .... BPR ……..BPRS ……… BMT ……..BRI

15. Which one do you think is the most accessible and relatively easy to find?
    .... BPR ……..BPRS ……… BMT ……..BRI

16. Which one do you think has the best in term of credit application process?
    .... BPR ……..BPRS ……… BMT ……..BRI

17. Which one do you think is the cheapest in terms of interest rate/ mark-up rate?
.... BPR ……..BPRS ……… BMT ……..BRI

18. Which one do you think is the fastest in terms of funding process?
.... BPR ……..BPRS ……… BMT ……..BRI

19. Which one do you think requires the lowest of collateral?
.... BPR ……..BPRS ……… BMT ……..BRI

20. Which one of the following do you think provides the the largest loan?
.... BPR ……..BPRS ……… BMT ……..BRI

21. Which one do you think is the most suitable in terms of the payment methods?
.... BPR ……..BPRS ……… BMT ……..BRI

22. Which one do you think has the most suitable loan officer?
.... BPR ……..BPRS ……… BMT ……..BRI

23. If you are allowed to choose, which one of the following would you prefer to take a loan from?
.... BPR ……..BPRS ……… BMT ……..BRI

24. According your opinion, out of four MFIs (– BPR – BPRS – BMT - BRI), which one is the best?
Please rank the MFIs below from 1 (the best) – 4 (the worst)
.... BPR ……..BPRS ……… BMT ……..BRI
Describe your reasons?
……………………………………………………………………………………….
……………………………………………………………………………………….
……………………………………………………………………………………….
……………………………………………………………………………………….

APPENDIX 2

QUESTIONNAIRES FOR MFI's MANAGERS

Dian Masyita
E2 no. 12 Taman Melati
Pasir Impun
Bandung Indonesia
Telp: (022) 7217817

20th September 2010

Title: Questionnaires for Conventional and Islamic Microfinance Institutions (MFIs) in Indonesia

Dear Sir/Madam,

Micro and small scale businesses are one of the most effective ways for creating jobs and reducing unemployment rate. Therefore, micro, small sized enterprises are one of Indonesian economy's pillars nowadays. A better understanding about the mechanism and real problems of MFIs can be a valuable contribution to create the healthy of MFI in the future.

The purpose of this survey is to obtain information of MFI's management from MFI's management team about four perspectives; internal process, learning and growth, financial and their perceived about customer satisfaction. These perspectives derived form the balanced scorecard concept.

This is to kindly request you to respond to the questions and return the questionnaire to the person who issued it to you or to the above address.

Thank you for your cooperation.

Yours sincerely,

Dian Masyita
Researcher

In Depth Interview with MFI's Management

Profile

Name of Microfinance Institution:
Affiliation/Type :□ Government □ Private □ Bank □ NGO □others______
Location :___________________________
Year of establishment :__________________________
Number of beneficiaries :__________________________
Total disbursement :___________________________
Annual disbursement (latest) : ___________________________
Fixed Capital (value) :____________________________
Number of employees : □ Total =
□ Admin Staff ________
□ Loan Officers ________

Source of Capital (shareholders)	Year	Amount (Rp)

Internal Process Perspectives (IP)

1. **(IP1)** Number of Clients : ....
2. **(IP2)** Do you have an organizational chart for your organization?
   □ Yes □ No
   If yes, can you provide the chart, please?

3. **(IP3)** Who determines the MFI's vision?
   □ Board of Director □ CEO/Manager □ Others______

4. **(IP4)** Who controls the daily operations of the MFI ?
   □ Board of director □ CEO/Manager □ Others______

5. **(IP5)** How is staff compensation divided among basic salary, benefits, and incentives?
   Basic salary: ……………………………………………………………………
   Benefits: ……………………………………………………………………
   Incentives: ………………………………………………………….…………………

6. **(IP6)** How is LO compensation divided among basic salary, benefits, and incentives?
   Basic salary: ……………………………………………………………………
   Benefits: ……………………………………………………………………
   Incentives: ………………………………………………………….…………………

7. **(IP7)** How does the average salary for loan officers compared to salaries at other MFIs or for account officers in the banking sector, and for similar positions in the general economy?
□ lower ………………..□ the same ………………..□ higher/better ……………

How does the average salary for administrative staff compared to salaries for similar positions in the economy?
□ lower ………………..□ the same ………………..□ higher/better ……………

8. **(IP8)** Is staff turnover a problem? □ Yes □ No.
If Yes, why? ………………………………………………………………………
……………………………………………………………………………………….
……………………………………………………………………………………….

(Open Questions-IPa) What seems to motivate staff?
□ sense of mission, □ professional pride, □ other ________
□ loyalty to the institution, □ wages

9. **(IP9)** Are the lines of authority of administration in the organization clear?
□ Yes □ No

10. **(IP10)** Is there any duplication of work among the employees? □ Yes □ No
If Yes, explain …………………………………………………………………………

11. **(IP11)** Is performance of employee assessed on a regular basis?
□ Yes □ No

(Open Question-IPb) If Yes, What are the key indicators on which the performance of a manager is assessed?
□ _________________ □ _________________ □________________ □___________

(Open Question-IPc) What are the key indicators on which the performance of an admin staff is assessed?
□ _________________ □ _________________ □________________ □___________

(Open Question-IPd) What are the key indicators on which the performance of a loan officer is assessed?
□ _________________ □ _________________ □________________ □___________

(Open Questions-IPe) Who has the authority to approve a loan?
□ Board of director □ CEO □ Credit Analyst/loan officers □ other ________

12. **(IP12)** Does the MFI have an internal audit function and the external auditors?
□ Yes, How? ……………………………………………………………………..
□ No.

Learning & Growth Perspectives (LG)

1. **(LG1)** Does the MFI have HR/personnel department? □Yes □ No

2. **(LG2)** Are there clear policies set out in a written personnel manual? □Yes □ No

3. **(LG3)** Is the job vacancy for staff/loan officers advertised in the mass media? □Yes □ No

4. **(LG4)** Do you have any specific criteria to select the staff/officers
   □Yes □ No
   If Yes, what kind of criteria
   □ Education: ________________________
   □ Experiences: ________________________
   □ Others _____________________________________

5. **(LG5)** Do you have any minimum experience to select the staff/officers
   □Yes □ No

6. **(LG6)** Is there any training course for loan officers? □Yes □ No
   If Yes, how many training courses per year? ___________
   Do they attend on the average? _____________

(Open Questions-LGa) Is training/course institutionalized within the organization?
□ Yes, please explain……… □ No, please explain ….

7. **(LG7)** What is its estimated cost/year for training?
   ____

(Open Questions- LGb) How were the managers trained last year?
□ In-house □ Training institutions □ Others ____________________

8. **(LG8)** What are the targets for a loan officer/year?
   □ Number of clients: _____ / year
   □ (NPL) Number of default payments (in percentage) ____/year
   □ Others………………………………………………………………………………

(Open Questions-LGc) How long does it take for loan officers to reach full potential or capacity on average? ____ months

Question for Islamic MFIs

1. **(Waqf1)** Do you have a waqf division in your institution? □ Yes □ No

If the answer of question no. 36 is YES,

2. **(Waqf2a)** Can you explain how a *waqf* division works in your MFI?
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………….

If the answer of question no. 36 is NO,
(Waqf2b) what is your opinion about an Islamic MFI creating a waqf division to provide qard hasan loans for micro entrepreneurs?
…………………………………………………………………………………………
…………………………………………………………………………………………
Advantages:………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
Disadvantages: …………………………………………………………………………..
…………………………………………………………………………………………
…………………………………………………………………………………………

3. **(Waqf3)** According to your opinion, how can the cost of funds be reduced for micro entrepreneurs?
…………………………………………………………………………………………
…………………………………………………………………………………………

FINANCIAL PERSPECTIVES	**Bank Rakyat Indonesia (Conventional MFI)**	**Bank Perkreditan Rakyat (Conventional MFI)**	**Bank Pembiayaan Rakyat Syariah (Islamic MFI)**	**Baitul Maal Wa Tamwil (Islamic MFI)**
INSTITUTIONAL CHARACTERISTICS				
Number of MFIs				
Personnel				
FINANCING STRUCTURE				
Capital/Asset Ratio				
Commercial Funding Liabilities Ratio				
Debt to Equity				
OUTREACH INDICATORS				
Number of Active Borrowers				
OVERALL FINANCIAL PERFORMANCE				
Return on Assets				
Return on Equity				
Operational Self-Sufficiency				
Financial Self-Sufficiency				
REVENUES				
Financial Revenue/Assets				
EXPENSES				
Total Expense/Assets Adjusted				
Financial Expense/Assets				
Operating Expense/Assets				
Personnel Expense/Assets				
Administrative Expense/Assets				
Adjustment Expense/Assets				

MFI's team Perceived about Customer Perspectives

Please tick the appropriate box to indicate your preference and fill the open questions below.

1. What do you think the customer's reasons to choose this MFI? (you can select more than 1 answer)

   Identify your priority: 1 = most important 8 = not important

   a. Near your house/office priority ....
   b. Relatively easy in terms of administration process priority ....
   c. Low interest rate/ mark-up priority ....
   d. Quickly processing priority ....
   e. No/low collateral priority ....
   f. Size of loan priority ....
   g. Payment Methods priority ....
   h. Loan Officer's Profile priority ....

2. How much the average value of their loan? ____________________

   a. < 2 juta (US 200) b. 2 – 5 juta c. 5,1 – 10 juta d. 10,1 - 30 juta e. > 30 juta

3. How much their willingness to pay for monthly interest rate/mark-up rate?

   a.<0.5% b. 0.5-1% c. 1-2% d. 2-3% e. 3-4%

4. Compared to other MFIs, how much your MFI's interest rate?

   a. lower b. similar c. higher

   Please rank these MFIs below from 1 (the cheapest) to 4 (the most expensive)

   .... BPR ……..BPRS ……… BMT ……..BRI

5. How is your payment method?

   a. daily b. weekly c. monthly d. quarterly e. annually

6. What do you think the need of training for customers? The answers more than 1

   □ managerial training □ technical trainings □ spiritual/ motivation trainings

7. Which do you prefer?

   □ Islamic MFIs,

   why?..
   ………………………………………………………………………………………
   ………………………………………………………………………………………
   ………………………………………………………………………………………

   □Conventional's MFI,

   why?..
   ………………………………………………………………………………………
   ………………………………………………………………………………………

8. Do you think your MFI's customer familiar with :

Murabahah,	□Yes	□No
Mudharabah,	□Yes	□No
Musharakah	□Yes	□No
Ijarah	□Yes	□No

9. Which one is the most syari'ah compliant?
.... BPR ……..BPRS ……… BMT ……..BRI

10. Which one is the most available and relatively easy to find?
.... BPR ……..BPRS ……… BMT ……..BRI

11. Which one is the best in term of credit application process?
.... BPR ……..BPRS ……… BMT ……..BRI

12. Which one is the cheapest in terms of credit interest rate/ mark-up rate?
.... BPR ……..BPRS ……… BMT ……..BRI

13. Which one is the fastest in terms of funding process?
.... BPR ……..BPRS ……… BMT ……..BRI

14. Which one is the lowest for collateral?
.... BPR ……..BPRS ……… BMT ……..BRI

15. Which one is the biggest for its loan size?
.... BPR ……..BPRS ……… BMT ……..BRI

16. Which one is the most suitable in terms of the payment methods?
.... BPR ……..BPRS ……… BMT ……..BRI

17. Which one is the most appropriate loan officer?
.... BPR ……..BPRS ……… BMT ……..BRI

18. If you are allowed to choose, which one do you prefer to choose to give you a loan?
.... BPR ……..BPRS ……… BMT ……..BRI

19. According your opinion, out of four types of MFIs (– BPR – BPRS – BMT - BRI), which one is the best?
Please rank these MFIs below from 1 (the best) – 4 (the worst)
.... BPR ……..BPRS ……… BMT ……..BRI

Describe your reasons?

………………………………………………………………………………………
………………………………………………………………………………………
………………………………………………………………………………………
………………………………………………………………………………………
………………………………………………………………………………………
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APPENDIX 3

QUESTIONNAIRES FOR *WAQF* FUND MANAGERS/*NAZIRS*

Dian Masyita
E2 no.12 Taman Melati
Pasir Impun
Bandung - Indonesia
Telp: (022) 7217817

20th September 2010

Title: Survey for Waqf Institution in Indonesia

Dear Sir/Madam,

One of potential solutions to the necessity of sufficient fund for public needs is *waqf* fund, which results from people's donation. In the history, *waqf* had effectively reduced poverty and enhanced people's welfare. Recently, the *waqf* fund management helps reduce poverty rate by inducing microfinance development in some countries.

The purpose of this survey is to obtain information of waqf management from waqf institution management team about the potency of waqf fund in the future and their opinions about waqf based microfinance concept.

This is to kindly request you to respond to the questions and return the questionnaire to the person who issued it to you or to the above address.

Thank you for your cooperation.

Yours sincerely,

Dian Masyita
Researcher

Durham University

Questionnaire for *Waqf* Fund Management

Name of *Waqf* Institution : ………………………………….
Affiliation ◻ Government ◻ Private ◻ Religious organization
Location : …………………………………..
Year of establishment : …………………………………..
Number of Waqifs : ◻ individual
◻ institution/group
Number of employees : ………………………………….
Management structure : ◻ Simple *Mutawalli* ◻ Board of *Mutawallis*/Trustees
No. of *Mutawallis*/Trustees: _____________

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1. What is the total value of waqf assets until now?
   ◻ Waqf Assets (building, estates, lands, etc) = _____________
   ◻ Waqf Funds (Cash, cash certificates) = _________________

2. What is your expection of the value of waqf assets in 5 years time?
   ◻ Waqf Assets (building, estates, lands, etc) = ________________
   ◻ Waqf Funds (Cash, cash certificates) = _____________________

3. How much was contributed to the waqf fund annually in the last four years?
   ◻ 2010 ………………………………..
   ◻ 2009 ………………………………..
   ◻ 2008 ………………………………..
   ◻ 2007 ………………………………..

4. What is the form used to raises funds for *waqf* in your institution?
   ◻ Cash ◻ Cash *waqf* certificate ◻
   Others…………………………

5. How has the the *Waqf* fund invested in different asset types:

Asset Type	**Percentage**

6. Will you consider using a part of your *waqf* fund for Islamic Microfinance institutions (MFIs)?
   ◻ Yes, Why? ……………………………………………………………………..
   ……………………………………………………………………………………
   ……………………………………………………………………………………
   ◻ No, Why? ……………………………………………………………………..
   …………………………………………………………………………………
   ……………………………………………………………………………………

7. If answer to Question No. 6 is Yes:
What kind of form is your institution willing to participate in MFIs?
□ Equity /capital □ Debt (loan)

If the answer is equity/capital, answer questions 8-10:
8. Do you expect any return on the investments?
□ Yes, what is the expected return (in percentage annually)?
....
....□ No,
why?..
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………

9. How would you ensure that the capital is intact?
....……………………………………………
……………………………………………………………………………………
....……………………………………………
……………………………………………………………………………………

10. What kind of share would your institution want to invest in?
□ Shares ownership ………………………………………………………………
□ Other
....

11. In the answer is debt/loan, do you expect return for that loan?
□ Yes, what percent annually? ………………………………
(For Islamic MFI) How do you ensure the money is provided in a Shariah complaint manner?
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………

□ No
…………………………………………………………………………………..

If the answer is no, would your institution prefer to allocate *waqf* fund as a *qard hasan*? □ No
□ Yes, for how long? □ 3 months □ 6 months □ 12 months □ 24 months

APPENDIX A
MFI'S CLIENTS PERCEPTIONS

Rank	Shari'ah	Easy	Application	low interest	speed/ fast	Collateral	Payment methods	Loan Officers	Preference	Overall	RANK
1	BMT	BRI	BRI	BRI	BPRS	BRI	BRI	BPRS	BRI	BRI	**BRI**
2	BPRS	BPR	BPRS	BPRS	BPR	BMT	BPRS	BRI	BPRS	BPRS	**BPRS**
3	BRI	BPRS	BPR	BMT	BRI	BPRS	BPR	BPR	BPR	BPR	**BPR**
4	BPR	BMT	BMT	BPR	BMT	BPR	BMT	BMT	BMT	BMT	**BMT**
Note:	**BPR**	**BRI**	**BPRS**	**BMT**							

Average Weighted Index and Ranking of MFIs

Shariah Compliant				Easiness				Application				Ranking
BPR	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	
84	676	1424	240	508	232	288	1356	692	472	332	996	1
147	645	414	543	612	651	270	246	432	708	252	342	2
490	244	70	316	288	416	330	96	250	320	406	124	3
260	70	46	176	101	92	248	107	131	58	202	148	4
981	1635	1954	1275	1509	1391	1136	1805	1505	1558	1192	1610	total
1.71	2.84	3.40	2.22	2.62	2.42	1.98	3.13	2.62	2.72	2.08	2.81	Average
4	2	1	3	2	3	4	1	3	2	4	1	**MFI's Rank**
Low Interest rate				**Speed/Promptness**				**Low Collateral**				**Ranking**
BPR	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	
352	248	332	1440	772	444	368	836	420	296	612	1124	1
372	729	456	252	468	822	237	255	321	723	447	291	2
332	376	302	110	204	286	484	138	334	364	270	136	3
198	82	189	77	125	47	162	213	197	78	138	130	4
1254	1435	1279	1879	1569	1599	1251	1442	1272	1461	1467	1681	total
2.18	2.49	2.22	3.26	2.72	2.78	2.18	2.5	2.21	2.54	2.55	2.92	Average
4	2	3	1	2	1	4	3	4	3	2	1	**MFI's Rank**
Payment Methods				**Loan Officers**				**Preference**				**Ranking**
BPR	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	**BPR**	**BPRS**	**BMT**	**BRI**	
728	484	472	1064	660	656	472	936	560	464	436	968	1
384	696	303	324	483	606	273	333	339	702	273	429	2
236	338	340	134	204	336	328	180	296	318	316	200	3
148	53	186	135	145	38	199	138	175	66	217	91	4
1496	1571	1301	1657	1492	1636	1272	1587	1370	1550	1242	1688	total
2.60	2.73	2.26	2.88	2.60	2.86	2.22	2.77	2.38	2.70	2.16	2.93	Average
3	2	4	1	3	1	4	2	3	2	4	1	**MFI's Rank**
								Overall Performance				**Ranking**
								BPR	**BPRS**	**BMT**	**BRI**	
								556	464	372	968	1
								315	735	282	447	2
								320	328	308	166	3
								172	50	234	102	4
								1363	1577	1196	1683	total
								2.37	2.74	2.08	2.92	Average
								3	2	4	1	**MFI's Rank**

The Original Vote of Clients

Shariah Compliant				Easiness				Application				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
21	169	356	60	127	58	72	339	173	118	83	249	1
49	215	138	181	204	217	90	82	144	236	84	114	2
245	122	35	158	144	208	165	48	125	160	203	62	3
260	70	46	176	101	92	248	107	131	58	202	148	4
575	576	575	575	576	575	575	576	573	572	572	573	Total
4	2	1	3	2	3	4	1	4	2	3	1	MFI's Rank

Low Interest rate				Speed/Fast				Low Collateral				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
88	62	83	360	193	111	92	209	105	74	153	281	1
124	243	152	84	156	274	79	85	107	241	149	97	2
166	188	151	55	102	143	242	69	167	182	135	68	3
198	82	189	77	125	47	162	213	197	78	138	130	4
576	575	575	576	576	575	575	576	576	575	575	576	Total
3	2	4	1	1	2	3	4	4	2	3	1	MFI's Rank

Payment Methods				Loan Officers				Preference				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
182	121	118	266	165	164	118	234	140	116	109	242	1
128	232	101	108	161	202	91	111	113	234	91	143	2
118	169	170	67	102	168	164	90	148	159	158	100	3
148	53	186	135	145	38	199	138	175	66	217	91	4
576	575	575	576	573	572	572	573	576	575	575	576	Total
3	2	4	1	3	2	4	1	3	2	4	1	MFI's Rank

Overall Performance				Ranking
BPR	BPRS	BMT	BRI	
139	116	93	242	1
105	245	94	149	2
160	164	154	83	3
172	50	234	102	4
576	575	575	576	Total
3	2	4	1	MFI's Rank

APPENDIX B
MFI's MANAGERS PERCEPTIONS

Rank	Shari'ah	Easy	Application	Low interest	speed/ fast	Collateral	Payment methods	Loan Officers	Preference	Overall	RANK
1	BMT/BPRS	BRI	BRI	BRI	BMT	BMT	BRI	BMT	BMT	BRI	**BRI**
2	BPRS/BMT	BPR	BPRS	BPRS	BPRS	BPRS	BPR	BPRS	BPRS	BPRS	**BPRS**
3	BRI	BPRS	BPR	BPR	BPR	BPR	BPRS	BRI	BPR	BMT	**BPR**
4	BPR	BMT	BMT	BMT	BRI	BRI	BMT	BPR	BRI	BPR	**BMT**
Note: **BPR** **BRI** **BPRS** **BMT**											

Average Weighted Index & Ranking of MFIs based on MFIs Managers Valuation

Shariah Compliant				Easiness				Application				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
0	36	36	0	8	0	4	60	8	8	20	36	1
0	24	24	6	30	6	12	6	18	24	9	3	2
14	2	2	18	8	22	6	0	12	16	2	6	3
11	0	0	7	2	5	10	1	4	0	9	5	4
25	62	62	31	48	33	32	67	42	48	40	50	total
1.39	3.4	3.4	1.72	2.67	1.83	1.78	3.72	2.33	2.667	2.2	2.78	average
4	1	1	3	2	3	4	1	3	2	4	1	MFI's Rank
Low Interest rate				**Speed/Fast**				**Low Collateral**				**Ranking**
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
4	0	4	64	28	4	28	12	12	0	52	8	1
18	27	3	6	6	33	6	12	12	27	6	9	2
12	18	6	0	14	12	8	2	14	18	6	0	3
5	0	13	0	2	0	5	10	4	0	0	13	4
39	45	26	70	50	49	47	36	42	45	64	30	total
2.17	2.5	1.44	3.89	2.78	2.72	2.61	2	2.3	2.5	3.56	1.67	average
3	2	4	1	1	2	3	4	3	2	1	4	MFI's Rank
Payment Methods				**Loan Officers**				**Preference**				**Ranking**
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
24	0	12	36	16	20	24	12	16	8	44	4	1
15	24	6	9	3	21	15	15	6	33	9	9	2
8	20	2	6	10	10	10	8	12	10	6	8	3
3	0	12	3	8	1	2	6	6	0	1	10	4
50	44	32	54	37	52	51	41	40	51	60	31	Total
2.78	2.4	1.78	3	2.06	2.89	2.83	2.28	2.2	2.83	3.33	1.72	Average
2	3	4	1	4	1	2	3	3	2	1	4	MFI's Rank
								Overall Performance				**Ranking**
								BPR	BPRS	BMT	BRI	
								8	20	20	28	1
								12	15	3	21	2
								4	14	10	8	3
								10	1	7	0	4
								34	50	40	57	total
								1.89	2.78	2.2	3.17	Average
								4	2	3	1	MFI's Rank

The Original Vote of MFI’s Managers

Shariah Compliant				Easiness				Application				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
0	9	9	0	2	0	1	15	2	2	5	9	1
0	8	8	2	10	2	4	2	6	8	3	1	2
7	1	1	9	4	11	3	0	6	8	1	3	3
11	0	0	7	2	5	10	1	4	0	9	5	4
18	18	18	18	18	18	18	18	18	18	18	18	total
4	2	1	3	2	3	4	1	3	2	4	1	MFI’s Rank

Low Interest rate				Speed/Fast				Low Collateral				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
1	0	1	16	7	1	7	3	3	0	13	2	1
6	9	1	2	2	11	2	4	4	9	2	3	2
6	9	3	0	7	6	4	1	7	9	3	0	3
5	0	13	0	2	0	5	10	4	0	0	13	4
18	18	18	18	18	18	18	18	18	18	18	18	total
3	2	4	1	3	2	1	4	3	2	1	4	MFI’s Rank

Payment Methods				Loan Officers				Preference				Ranking
BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	BPR	BPRS	BMT	BRI	
6	0	3	9	4	5	6	3	4	2	11	1	1
5	8	2	3	1	7	5	5	2	11	3	3	2
4	10	1	3	5	5	5	4	6	5	3	4	3
3	0	12	3	8	1	2	6	6	0	1	10	4
18	18	18	18	18	18	18	18	18	18	18	18	Total
2	3	4	1	4	2	1	3	3	2	1	4	MFI’s Rank

Overall Performance				Ranking
BPR	BPRS	BMT	BRI	
2	5	5	7	1
4	5	1	7	2
2	7	5	4	3
10	1	7	0	4
18	18	18	18	total
4	2	3	1	MFI’s Rank

APPENDIX C1 – THE BALANCED SCORECARD

Internal Process (IP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(IP1)Total Human Resources	0	1	3	0	0	3	1	2	1	0	2	2	0	1	0	0	0	1
(IP2) Structure Organization	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP3) MFI's Vision Determiner	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP4) Daily operat controller	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP5) Staff's Compensation	2	2	2	1	2	1	1	2	2	2	1	1	1	2	1	1	2	2
(IP6)LO's Compensation	2	2	2	1	2	1	1	2	2	2	1	1	1	2	1	1	2	2
(IP7)Comparison of salary	2	2	2	2	2	2	1	2	2	1	2	2	1	1	1	1	1	2
(IP8)Staff's Turn Over	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP9) Line of Authority	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP10)Work's Duplication	1	0	0	1	0	1	0	0	1	0	0	0	0	0	0	0	0	1
(IP11) Perform Evaluations	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(1P12) Transprcy-Accntability	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
	14	**13**	**13**	**12**	**15**	**12**	**10**	**13**	**14**	**12**	**11**	**11**	**10**	**12**	**10**	**10**	**12**	**16**
Learning & Growth (LG)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(LG1) H&R Departement	1	1	1	0	1	0	1	0	1	1	1	1	0	1	0	0	1	1
(LG2)Clear policies	1	1	1	1	1	1	1	1	1	1	1	1	1	1	0	1	1	1
(LG3) Advertised Job opportu	0	1	1	0	1	0	0	1	0.5	1	0	0	0	1	1	1	0	1
(LG4) Minimum Staff Criteria	1	1	1	1	1	1	1	0	0.5	1	0	0	1	1	2	0	1	2
(LG5) Min Staff's experiences	2	0	1	1	2	0	2	0	0	0	1	1	0	0	0	0	2	2
(LG6)Training for Staffs	3	2	2	1	1	1	2	1	2	0	1	1	1	1	3	2	2	2
(LG7) Ann Training Budgets	2	2	2	2	2	3	1	2	2	2	0	0	0	1	1	1	1	2
(LG8)Average Target NPL	2	2	3	3	0	2	0	2	2	2	2	2	1	2	2	3	2	2
	12	**10**	**12**	**9**	**9**	**8**	**8**	**7**	**8.5**	**8**	**6**	**6**	**4**	**8**	**9**	**8**	**10**	**13**
Customer/Clients Perspectives (CP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(CP1) Shari'ah Compliant	1.5	1.5	1.5	1.5	1.5	1.5	0.5	0.5	0.5	0.5	0.5	2	2	2	2	2	2	1
(CP2) Easiness	1	1	1	1	1	1	1.5	1.5	1.5	1.5	1.5	0.5	0.5	0.5	0.5	0.5	0.5	2
(CP3) Application Process	1.5	1.5	1.5	1.5	1.5	1.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1	1	1	2

(CP4) Low Interest/CoC	1.5	1.5	1.5	1.5	1.5	1.5	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	2
(CP5) Speed/fastness	1.5	1.5	1.5	1.5	1.5	1.5	2	2	2	2	2	1	1	1	1	1	1	0.5
(CP6) Low Collateral	1.5	1.5	1.5	1.5	1.5	1.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1	1	1	2
(CP7) Payment Methods	1.5	1.5	1.5	1.5	1.5	1.5	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	2
(CP8) Loan Officers Profile	1.5	1.5	1.5	1.5	1.5	1.5	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	2
(CP9) Preference	1.5	1.5	1.5	1.5	1.5	1.5	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	2
(CP10) Overall Performance	1.5	1.5	1.5	1.5	1.5	1.5	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	2
	14.5	**14.5**	**14.5**	**14.5**	**14.5**	**14.5**	**10**	**10**	**10**	**10**	**10**	**8**	**8**	**8**	**8**	**8**	**8**	**17.5**
Financial Perspectives (FP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(FP1)ROA (%)	1.62	2.17	4.79	- 1.35	0.8	6.26	4.05	-2.02	1.58	1.77	3.02	0.28	1.1	-1.13	1.7	1.5	6.09	4.19
(FP2) ROE (%)	12.68	35	33.75	- 3	2.8	48.48	14.86	- 8	2.57	2.4	29.46	4.27	2.88	- 2.5	14.2	25	10.92	39.53
(FP3) OSS	1.42	1.13	1.24	0.92	1.21	1.63	1.20	0.93	1.09	1.07	1.13	0.89	0.92	0.87	1.32	0.83	2.32	1.17
Outreach (O)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
Breadth	1	1	4	0	0	4	1	2	1	0	4	4	2	2	1	0	3	2
Worth to clients (%)	1.5	1.5	0.75	1.5	1.5	0.75	2.5	1.5	1.5	2.5	2.5	2.5	0.75	2.5	2.5	1.5	1.5	1.5
Depth (in million IDR)	1	2	2	1	2	2	2	1	2	2	2	2	4	3	3	3	1	3

Original Data of Financial Perspectives & Outreach

Financial Perspectives (FP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(FP1) ROA (%)	1.62	2.17	4.79	- 1.35	0.8	6.26	4.05	-2.02	1.58	1.77	3.02	0.28	1.1	-1.13	1.7	1.5	6.09	4.19
(FP2) ROE (%)	12.68	35	33.75	- 3	2.8	48.48	14.86	- 8	2.57	2.4	29.46	4.27	2.88	- 2.5	14.2	25	10.92	39.53
(FP3) OSS	1.42	1.13	1.24	0.92	1.21	1.63	1.20	0.93	1.09	1.07	1.13	0.89	0.92	0.87	1.32	0.83	2.32	1.17
Outreach (O)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
Breadth	1357	800	10616	191	327	10433	600	1688	800	360	18276	9162	1555	2400	1100	350	3700	1530
Worth to clients (%)	1.5	1.5	0.75	1.5	1.5	0.75	2.5	1.5	1.5	2.5	2.5	2.5	0.75	2.5	2.5	1.5	1.5	1.5
Depth (in million IDR)	20	7.5	7.5	20	7.5	7.5	7.5	20	7.5	7.5	7.5	3	1	3	3	3	20	3

A1-With Score only ROE, Breadth, and Depth file BSC before standardized…

Financial Perspectives (FP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(FP1)ROA (%)	1.62	2.17	4.79	- 1.35	0.8	6.26	4.05	-2.02	1.58	1.77	3.02	0.28	1.1	-1.13	1.7	1.5	6.09	4.19
(FP2) ROE (%)	12.68	35	33.75	- 3	2.8	48.48	14.86	- 8	2.57	2.4	29.46	4.27	2.88	- 2.5	14.2	25	10.92	39.53
(FP3) OSS	1.42	1.13	1.24	0.92	1.21	1.63	1.20	0.93	1.09	1.07	1.13	0.89	0.92	0.87	1.32	0.83	2.32	1.17
Outreach (O)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
Breadth	1	1	4	0	0	4	1	2	1	0	4	4	2	2	1	0	3	2
Worth to clients (%)	1.5	1.5	0.75	1.5	1.5	0.75	2.5	1.5	1.5	2.5	2.5	2.5	0.75	2.5	2.5	1.5	1.5	1.5
Depth (in million IDR)	1	2	2	1	2	2	2	1	2	2	2	2	4	3	3	3	1	3

A2 (With Score for FP after A1) with File BSC Correlation with full score

Financial Perspectives (FP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(FP1)ROA (%)	2	2	4	0	1	4	3	0	2	2	3	1	1	0	2	1	4	3
(FP2) ROE (%)	2	4	4	0	1	4	2	0	1	1	3	1	1	0	2	3	2	4
(FP3) OSS	2	2	2	1	2	3	2	1	2	2	2	1	1	1	2	1	4	2
Outreach (O)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(O1)Breadth	1	1	4	0	0	4	1	2	1	0	4	4	2	2	1	0	3	2
(O2) Worth to clients (%)	1.5	1.5	0.75	1.5	1.5	0.75	2.5	1.5	1.5	2.5	2.5	2.5	0.75	2.5	2.5	1.5	1.5	1.5
(O3)Depth (in million IDR)	1	2	2	1	2	2	2	1	2	2	2	2	4	3	3	3	1	3

A3 Standardized (With Score for FP after A1) with File BSC Correlation with full score

Financial Perspectives (FP)	**BPRS1**	**BPRS2**	**BPRS3**	**BPRS4**	**BPRS5**	**BPRS6**	**BPR1**	**BPR2**	**BPR3**	**BPR4**	**BPR5**	**BMT1**	**BMT2**	**BMT3**	**BMT4**	**BMT5**	**BMT6**	**BRI**
(FP1)ROA (%)	0.5	0.5	1	0	0.25	1	0.75	0	0.5	0.5	0.75	0.25	0.25	0	0.5	0.25	1	0.75
(FP2) ROE (%)	0.5	1	1	0	0.25	1	0.25	0	0.25	0.25	0.75	0.25	0.25	0	0.5	0.75	0.5	1
(FP3) OSS	0.5	0.5	0.5	0.25	0.5	0.75	0.5	0.25	0.5	0.5	0.5	0.25	0.25	0.25	0.5	0.25	1	0.5

Outreach (O)	BPRS1	BPRS2	BPRS3	BPRS4	BPRS5	BPRS6	BPR1	BPR2	BPR3	BPR4	BPR5	BMT1	BMT2	BMT3	BMT4	BMT5	BMT6	BRI
(O1)Breadth	0.25	0.25	1	0	0	1	0.25	0.5	0.25	0	1	1	0.5	0.5	0.25	0	0.75	0.5
(O2) Worth to clients (%)	0.6	0.6	0.3	0.6	0.6	0.3	1	0.6	0.6	1	1	1	0.3	1	1	0.6	0.6	0.6
(O3) Depth (in million IDR)	0.25	0.5	0.5	0.25	0.5	0.5	0.5	0.25	0.5	0.5	0.5	0.5	1	0.75	0.75	0.75	0.25	0.75

APPENDIX C2 : STANDARDIZED SCORE

Internal Process	BPRS1	BPRS2	BPRS3	BPRS4	BPRS5	BPRS6	BPR1	BPR2	BPR3	BPR4	BPR5	BMT1	BMT2	BMT3	BMT4	BMT5	BMT6	BRI
(IP1)Total Human Resources	0	0.33	1	0	0	1	0.33	0.67	0.33	0	0.67	0.67	0	0.33	0	0	0	0.33
(IP2) Structure Organization	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP3) MFI's Vision Determiner	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP4) Daily operat controller	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP5) Staff's Compensation	1	1	1	0.5	1	0.5	0.5	1	1	1	0.5	0.5	0.5	1	0.5	0.5	1	1
(IP6)LO's Compensation	1	1	1	0.5	1	0.5	0.5	1	1	1	0.5	0.5	0.5	1	0.5	0.5	1	1
(IP7)Comparison of salary	1	1	1	1	1	1	0.5	1	1	0.5	1	1	0.5	0.5	0.5	0.5	0.5	1
(IP8)Staff's Turn Over	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP9) Line of Authority	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(IP10)Work's Duplication	1	1	0	1	0	1	0	0	1	0	0	0	0	0	0	0	0	1
(IP11) Perform Evaluations	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(1P12) Transprcy-Accntability	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
	11	**11.33**	**11**	**10**	**10**	**11**	**8.83**	**10.67**	**11.33**	**9.5**	**9.67**	**9.67**	**8.5**	**9.83**	**8.5**	**8.5**	**9.5**	**11.33**

Learning & Growth	BPRS1	BPRS2	BPRS3	BPRS4	BPRS5	BPRS6	BPR1	BPR2	BPR3	BPR4	BPR5	BMT1	BMT2	BMT3	BMT4	BMT5	BMT6	BRI
(LG1) H&R Departement	1	1	1	0	1	0	1	0	1	1	1	1	0	1	0	0	1	1
(LG2)Clear policies	1	1	1	1	1	1	1	1	1	1	1	1	1	1	0	1	1	1
(LG3) Advertised Job opportu	0	1	1	0	1	0	0	1	0.5	1	0	0	0	1	1	1	0	1
(LG4)Minimum Staff Criteria	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0	0.25	0.5	0	0	0.5	0.5	1	0	0.5	1
(LG5)Min Staff's experiences	1	0	0.5	0.5	1	0	1	0	0	0	0.5	0.5	0	0	0	0	1	1
(LG6)Training for Staffs	1	0.67	0.67	0.33	0.33	0.33	0.67	0.33	0.67	0	0.33	0.33	0.333	0.33	1	0.67	0.667	0.67
(LG7) Ann Training Budgets	0.67	0.67	0.67	0.67	0.67	1	0.33	0.67	0.67	0.67	0	0	0	0.33	0.33	0.33	0.33	0.67
(LG8)Average NPL	0.67	0.67	1	1	0	0.67	0	0.67	0.67	0.67	0.67	0.67	0.33	0.67	0.67	1	0.67	0.67
	5.83	**5.5**	**6.33**	**4**	**5.5**	**3.5**	**4.5**	**3.67**	**4.75**	**4.83**	**3.5**	**3.5**	**2.17**	**4.83**	**4**	**4**	**5.17**	**7**

Customer/Cients Perspectives	BPRS1	BPRS2	BPRS3	BPRS4	BPRS5	BPRS6	BPR1	BPR2	BPR3	BPR4	BPR5	BMT1	BMT2	BMT3	BMT4	BMT5	BMT6	BRI
(CP1) Shari'ah Compliant	0.75	0.75	0.75	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.25	1	1	1	1	1	1	0.5
(CP2) Easiness	0.5	0.5	0.5	0.5	0.5	0.5	0.75	0.75	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.25	0.25	1
(CP3) Application Process	0.75	0.75	0.75	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.5	0.5	0.5	1
(CP4) Low Interest/CoC	0.75	0.75	0.75	0.75	0.75	0.75	0.5	0.5	0.5	0.5	0.5	0.25	0.25	0.25	0.25	0.25	0.25	1
(CP5) Speed/fastness	0.75	0.75	0.75	0.75	0.75	0.75	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.25
(CP6) Low Collateral	0.75	0.75	0.75	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.5	0.5	0.5	1
(CP7) Payment Methods	0.75	0.75	0.75	0.75	0.75	0.75	0.5	0.5	0.5	0.5	0.5	0.25	0.25	0.25	0.25	0.25	0.25	1
(CP8) Loan Officers Profile	0.75	0.75	0.75	0.75	0.75	0.75	0.5	0.5	0.5	0.5	0.5	0.25	0.25	0.25	0.25	0.25	0.25	1
(CP9) Preference	0.75	0.75	0.75	0.75	0.75	0.75	0.5	0.5	0.5	0.5	0.5	0.25	0.25	0.25	0.25	0.25	0.25	1
(CP10) Overall Performance	0.75	0.75	0.75	0.75	0.75	0.75	0.5	0.5	0.5	0.5	0.5	0.25	0.25	0.25	0.25	0.25	0.25	1
	7.25	**7.25**	**7.25**	**7.25**	**7.25**	**7.25**	**5**	**5**	**5**	**5**	**5**	**4**	**4**	**4**	**4**	**4**	**4**	**8.75**

Financial Perspectives (FP)	BPRS1	BPRS2	BPRS3	BPRS4	BPRS5	BPRS6	BPR1	BPR2	BPR3	BPR4	BPR5	BMT1	BMT2	BMT3	BMT4	BMT5	BMT6	BRI
(FP1)ROA (%)	0.5	0.5	1	0	0.25	1	0.75	0	0.5	0.5	0.75	0.25	0.25	0	0.5	0.25	1	0.75
(FP2) ROE (%)	0.5	1	1	0	0.25	1	0.25	0	0.25	0.25	0.75	0.25	0.25	0	0.5	0.75	0.5	1
(FP3) OSS	0.5	0.5	0.5	0.25	0.5	0.75	0.5	0.25	0.5	0.5	0.5	0.25	0.25	0.25	0.5	0.25	1	0.5
(O1)Breadth	0.25	0.25	1	0	0	1	0.25	0.5	0.25	0	1	1	0.5	0.5	0.25	0	0.75	0.5
(O2) Worth to clients (%)	0.6	0.6	0.3	0.6	0.6	0.3	1	0.6	0.6	1	1	1	0.3	1	1	0.6	0.6	0.6
(O3) Depth (in million IDR)	0.25	0.5	0.5	0.25	0.5	0.5	0.5	0.25	0.5	0.5	0.5	0.5	1	0.75	0.75	0.75	0.25	0.75
	2.6	**3.35**	**4.3**	**1.1**	**2.1**	**4.55**	**3.25**	**1.6**	**2.6**	**2.75**	**4.5**	**3.50**	**2.55**	**2.50**	**3.50**	**2.60**	**4.10**	**4.1**

APPENDIX D
OPEN QUESTIONS

MFIs	OQ-IPa What seems to motivate staff?	OQ-IPb What are the key indicators on which the performance of a manager is assessed?			OQ-IPc What are the key indicators on which the performance of an admin staff is assessed?		
BPRS1	Mission	Target	Responsibility	Team Work	Target	Honesty	Discipline
BPRS2	Loyality and Professional pride	Target	NPL	Administration	Accuracy	Absentee	Discipline
BPRS3	Professional pride	Target	Reports	Profitability	Motivation	Agility	Performance
BPRS4	Mission and Professional Pride	Managerial skill	Responsibility	Target	Quality	Honesty	Responsibility
BPRS5	Mission	Target	NPL	Profitability	Accuracy	Administration	NPL
BPRS6	Salary	Target	Profitability	Administration	Satisfaction	Services	Low Complaints
BPR1	Interpersonal & welfare (family insurance and holiday fund)	Financial Performance	Target	NPL	Errors	Speed	Human Errors
BPR2	Professional Pride	Target	Administration	Proper Report	Tidily/Neatly Administration	On time	Meticulously in Money
BPR3	loyality and carriers	Target	On time	Managerial	Neat	Target	Neat administration
BPR4	Comfort place to work	Target	On time	NPL	Target	Finished job on time	
BPR5	Loyality	Target	Services	NPL	Services	Low complaint	neatly
BMT1	Mission and Loyality	Target	Administration	NPL	Orderly		Quality of works
BMT2	Loyality and professional pride	Target	NPL	Managerial	Orderly	Minimal errors	quality
BMT3	Mission, Loyality and Ideology	Target	Managerial	NPL	Funding	Lending	Collection
BMT4	Mission	NPL rate	Margin/profit	the loyal of member	Absence	Loyal	Performance
BMT 5	There is a hope in the future	Target	Monthly Report	NPL	Accuracy	Speed	Errors
BMT6	Professional Pride and Salary	Target	Religious level	NPL	Discipline	Religious level	Target
BRI	Professional Pride and Salary	Target	Administration	NPL	Accuracy	Speed	discipline

MFIs	OQ-IPd What are the key indicators on which the performance of a Loan Officer is assessed?			OQ-IPe Who has the authority to approve a loan?
BPRS1	Target	Assistance for Client	NPL	Board of Directors
BPRS2	Target	NPL	Loyal	The Funding Committee
BPRS3	Target	Relationship	Responsibility	The Funding Committee
BPRS4	Target	NPL	Responsibility	Board of Directors
BPRS5	Growth of clients number	Growth of outstanding	NPL	The Funding Committee
BPRS6	Target	NPL	Relationship	The Funding Committee
BPR1	Target	Number of customers	Growth	<20 million IDR(US$ 2000) = directors, >20 million Rp (US$ 2000) = commissionaires
BPR2	Target	NPL	Responsibility	The Funding Committee , < 25 million IDR (US$ 2500) = Directors and > 25 million IDR (US$ 2500) - commissioners
BPR3	Target	NPL	Relationship	<50 million IDR (US$ 5000) = Directors , > 50 million IDR (US$ 5000 = commissioners
BPR4	Target	Honesty	NPL	The Funding Committee
BPR5	Profit/PLS	NPF rate	Target	Board of Directors
BMT1	Target	NPL	Honesty	The Funding Committee
BMT2	Target	Collection	Responsibility	The Funding Committee
BMT3	NPL	Target	Loyality	The Funding Committee
BMT4	Target	NPL	Responsibility	The Funding Committee
BMT 5	Discipline	Religious level	Target	The Funding Committee
BMT6	Target	NPL	Responsibility	CEO
BRI	Target	NPL	Relationship	The Funding Committee

MFIs	OQ-LGa Is training/course institutionalized within the organization?	OQ-LGb How was the manager trained last year?			OQ-LGc How long does it take for loan officers to reach full potential or capacity on average?
BPRS1	Yes	-	Training institutions		6 months
BPRS2	Yes	In-house training	Training institutions		6 months
BPRS3	Yes	In-house training	Training institutions	Tailor made	3 months
BPRS4	No	In-house training			10 months
BPRS5	Yes	-	Training institutions		3 months
BPRS6	Yes	-	Training institutions		6 months
BPR1	No	In-house training	Training institutions		depend on NPL
BPR2	Yes	In-house training	Training institutions		one month
BPR3	No	In-house training	Training institutions		8 months
BPR4	Yes	In-house training	Training institutions		12 months
BPR5	Yes			Tailor made	3 months
BMT1	No	-	Training institutions		12 months
BMT2	No	In-house training			12 months
BMT3	No	In-house training			3 months
BMT4	No	In-house training			6 months
BMT 5	Yes	In-house training	Training institutions		3 months
BMT6	Yes		Training institutions		7 months
BRI	Yes		Training institutions		6 months

APPENDIX E General Information of MFIs in the sample

Name of MFI	Nu. Of Clients Borrowers	Total of Funding (in Million IDR)	Total Staff	Adm Staff	Loan Officers
BPRS1	1357	10,080.00	14	11	3
BPRS2	800	14,000.00	30	12	10
BPRS3	10616	161,064.00	80	30	50
BPRS4	750	3,243.00	14	11	3
BPRS5	327	4,071.00	14	6	8
BPRS6	10433	47,000.00	56	40	16
BPR1	600	4,300.00	16	7	5
BPR2	1688	10,400.00	31	18	13
BPR3	800	9,000.00	22	17	5
BPR4	360	5,178.00	12	7	5
BPR5	18276	63,062.00	40	15	25
BMT1	9162	3,472.00	36	17	19
BMT2	1555	1,870.00	9	2	2
BMT3	2400	2,700.00	23	8	15
BMT4	350	745.00	7	2	5
BMT5	1100	2110.00	5	2	3
BMT6	3700	9,000.00	13	7	6
BRI Unit	2530	31,000.00	9	3	6