Issues and challenges in financing the poor: case of Baitul Maal Wa Tamwil in Indonesia

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Abstract

Purpose – The purpose of this paper is to highlight the issues and challenges in providing financing to the poor people based on the experience of Baitul Maal Wa Tamwil (BMT) in Indonesia.

Design/methodology/approach – A series of structured interviews were conducted with the chairman and staff of the Central BMT (Induk Koperasi Syariah) in Jakarta which is the head-quarter of 382 BMTs throughout Indonesia, with additional chairman and shari’ah supervisory in Central BMT (Pusat Koperasi Syariah) in Makasar. Subsequently, the results from the structured interviews were analyzed using qualitative analysis to arrive at the model of the peculiarities of financing the poor in Indonesia.

Findings – The findings show that the Central BMT has built specific products and empowerment mechanisms for the poor and has an ideal product to be applied in 382 BMT in Indonesia. There are two schemes of financing source in BMT, namely, social ministry (Kelompok Usaha Bersama) and private financing (national and international donor). Specifically, the peculiarities of financing given in BMT are not only in the term of capital but also in the term of providing infrastructure and training for the poor. Moreover, collateral must be provided as a screening process for the poor people to secure any form of financing. If there is no collateral, potential borrowers must opt for joint-liability financing. Furthermore, if the poor could not repay the financing, endowment coming from charity and compulsory Islamic tax (zakat, infaq and sadaqah) would play a vital role to cover for the financing default. Lastly, religious capacity building is also provided as a part of risk management aspect.

Research limitations/implications – This study was only conducted in Indonesia which focussed on the peculiarities of financing for the poor people in Indonesia BMT. Despite this limitation, the findings of this study enable the construction of a model that highlights the issues and challenges that might arise in financing the poor in general.

Originality/value – The paper adds to the literature on Islamic microfinance by enabling researchers and practitioners to understand the model of Islamic microfinance in Indonesia. It also contributes toward enriching the knowledge in the Islamic microfinance area.

Keywords Financing, Qualitative analysis, BMT, Issues and challenges, Peculiarities

Paper type Research paper

1. Introduction

For a Muslim-majority country such as Indonesia, Islamic microfinance is potentially the best model for fund mobilization among the poor people because it provides a combination of social intermediation and social capital with added Islamic finance value (Abdul Rahman and Dean, 2013). Social intermediation is a process of financial intermediation mixed with capacity building component. The goal of Islamic microfinance is to provide financial services not only to the poor but also to the poorest

This research is funded by University of Indonesia and Lembaga Pengelola Dana Pendidikan. The data only covered the Jakarta and Makassar areas and maybe will result different perspective if it is applied in other areas.
in the informal sector of the economy, which is usually being funded using the third economic sector such as charity (infaq and sadaqah) and compulsory Islamic tax (zakah). Islamic microfinance is essentially interest-free microfinance as it provides funding without the charge of interest so as to comply with the Islamic financing principles. Islamic microfinance also maximizes social services using zakah, infaq and sadaqah (forms of charity giving to the poor people in order to gain God’s blessing and purify one’s wealth) to satisfy the poor’s financing needs (Hassan, 2014).

The practice of Islamic finance in Indonesia started in 1993 with the establishment of Bank Muamalat Indonesia (Saefullah, 2010). When Islamic finance started to be recognized, Islamic microfinance also expanded in the 1990’s through the formal institutions such as the Islamic banks and Islamic rural banking (Bank Perkreditan Rakyat Syariah), and non-banking institutions such as Islamic cooperatives, namely, Koperasi Pesantren and Baitul Maal Wa Tamwil (BMT) (Effendi, 2013).

BMT has many unique features compared to other microfinance providers in Indonesia. It uses family-based approach which is suitable to be implemented among the poor and being licensed and supervised by the ministry of cooperative and small medium enterprises (Masyita and Ahmed, 2013). Several BMTs are integrated with groups of micro-entrepreneurs (such as Kelompok Usaha Muamalat or Poskusma). The PINBUK or the small business incubation center play an important role in the functioning of the BMTs with more than 4,000 BMTs registered with the PINBUK. Other BMTs receive funding from Indonesia’s social ministry (BMT Kelompok Usaha Bersama (KUBE)) which consists of 87 branches in 19 provinces. Indonesia also has primary cooperative called Induk Koperasi Syariah (INKOPSYAH) with 372 BMTs mostly in Java area and South Sulawesi joining INKOPSYAH to get financing and other facilities such as financial literacy training and infrastructure building.

Furthermore, BMT offers dual functions as Baitul Maal (house of wealth), where it plays the role of collecting and distributing funds from zakah, infaq and sadaqah, and as Baitul Tamwil (house of financing) which essentially offering financial intermediation by managing funding and saving. These functions imply that the BMT is a social entity and simultaneously being a business entity. The social function of BMT is conducted by providing interest-free financing (qardhul hasan) to the deserving poor (Juwaini and Mintarti, 2010). As Baitul Tamwil, BMT plays the role as a cooperative using profit-loss sharing mechanism with additional Islamic values and group activities as its risk mitigating technique. The financing also comes with regular group or social activities including counseling and meetings. Additionally, a retail business is also set up to support the microfinance schemes. In fact, micro-enterprises search funding from BMT because it offers faster loan approval compared to other financial institutions (Obaidullah, 2008).

Under the APEX BMT project, it is targeted that one BMT will be built in every village in Indonesia, resulting in an expected encouraging expansion of the BMT. Despite this, the BMT is facing several issues and challenges particularly due to the stiff competitions from other microfinance providers in Indonesia. While many researchers have studied the advantages and disadvantages as well as identifying the problems faced and providing possible solutions to BMT, studies on the comprehensive aspects of issues and challenges facing BMT in Indonesia with additional policy implications have been lacking (see, e.g. Alaeddin and Anwar, 2012; Cokro and Ismail, 2009; Dariah, 2012; Effendi, 2013; Hasanah and Yusuf, 2013; Hosen
and Syukriyah, 2012; Nasution, 2013). There seems to be a literature gap on the issues and challenges confronting BMT in financing the poor, with specific practical applications of Islamic microfinance. Thus, this study aims to highlight the issues and challenges in providing financing to the poor people based on the experience of BMT in Indonesia.

This study employs a qualitative analysis by conducting a series of structured interviews with the chairman and staff of the BMT. The results from the structured interviews are analyzed in order to arrive at the model of the peculiarities in financing the poor in Indonesia. Results of the qualitative analysis are discussed in order to get a perspective from the microfinance provider on the issues and challenges in financing the poor in Indonesia.

2. Literature review

2.1 Microfinance and its role in poverty alleviation

Microfinance has been shown to be an effective tool to reduce poverty. Its main purpose is to break the cycle of indebtedness among the poor by providing cheaper financing than the formal and informal financial institutions. Microfinance is also created as an important tool to reach the Millennium Development Goals. According to Shirazi and Khan, microfinance could be the best strategy to reduce extreme poverty effectively and provide positive welfare impact. Another objective of microfinance is to provide improvement in long-term income. Several researches have shown that micro-enterprise credit has not been providing effective solutions to poverty, but it can work well for clients who are close to the poverty line.

Through microfinance, poverty can be reduced by extending credit to poor or by permitting them an access to credit. It is important to highlight that microfinance is a mechanism to build good relationship between the microfinance institutions (MFIs) and the customers based on trust and commitment. MFIs should be built using a community-based framework concept where it could help to reduce poverty to a reasonable degree. Knowing the credibility of the borrowers would also help to reduce the incidence of non-performing loans. Furthermore, the MFIs should capture the poor people’s awareness in order to reach to them.

Several studies focussed on assessing the relationship between microfinance and poverty reduction, with most of them found a positive relationship between the two. Imai et al. analyze the impact of microfinance on household poverty and found positive effect of microfinance accessibility to multi-dimensional welfare indicator, suggesting that microfinance plays a significant role in poverty reduction. However, the results varied between rural and urban areas. Studies comparing government organization (GO) and non-GOs (NGOs) MFIs in Bangladesh find different impact of microfinance on poverty with the GO MFI is found to be more effective in increasing the wealth of the poor compared to those affiliated to the NGOs. In particular, the GO agencies are concerned about the outcome of the program, while the NGOs are concerned with loan delivery, rate of interest and repayment schedule.

Other studies in Bangladesh and Pakistan also show positive impact of microfinance on poverty through combined efforts among government, MFIs, and donor agency. Imai et al. conducted a study using cross-country data from MFI Information Exchange and the World Bank and finds that a country with a higher microfinance loan portfolio per capita has lower levels of poverty indices. In practice, microfinance not only reduces poverty incidence but also reduces its depth and severity. This finding provides the reasons for the governments, particularly in the
developing countries to channel funds to the MFIs as a way to distribute subsidized credit for the poor. Subsequently, microfinance enables improvements in family income and children’s education. The accessibility to microfinance also increases family health and nutrition in view of the better family incomes.

Miyashita reviewed the practice of MFIs in Indonesia and showed that microfinance is effective in helping the Indonesian people to combat poverty. The massive unfulfilled demand for financial services among poorer communities is being resolved by the MFIs existence like the Bank Rakyat Indonesia-UD Program (Bimbingan Massal; Kredit Umum Pedesaan; Tabungan Nasional; Simpanan Pedesaan (SIMPEDES); Urban version of SIMPEDES SIMASKOT); locally based MFI programs (Central Java’s BKK Program, South Kalimantan’s BKK Program, BKD Program), and various NGOs involvement.

Although there are many research evidences on the positive relationship between microfinance and poverty reduction, research conducted in Sri Lanka arrives at contradictory findings. Shaw documented that micro-enterprise development programs must be complemented with social and physical infrastructure investment. A lack of rural financial service accessibility and affordability must be solved by capital spending from government and international donors to bring in positive results from the microfinance programs. Gehlich-Shillabeer conducted a research in Bangladesh and found that microfinance existence did not show a positive impact on poverty level since the existence of financial constraints resulting from the lower debt capacity, higher indebtedness and poverty trap. In addition, Nkamnebe and Idemobi explained that higher indebtedness in the MFIs caused by lack of ability of the MFIs staff and poor infrastructure. These conditions are the challenges for the MFIs in reducing the incidence of low-credit recovery.

For the Islamic MFIs, there are various available schemes and instruments to alleviate poverty. Khaleequzzaman conducted an extensive review by suggesting an alternative mechanism of Islamic MFI to alleviate poverty. Islamic values provide a mechanism of trust between clients and the MFIs. Moreover, Bhuiyan et al. reviewed rural development scheme of Islami Bank Microcredit in Bangladesh and found that this scheme is important for socio-economic development and improve the living standard of the poor without interest charge. In practice, the need to link Islamic commercial bank and Islamic microfinance is important to create accessibility to credit by the poor. However, in the current practice of Islamic banking, the linkage between MFIs and Islamic banks is difficult to be implemented. Based on this problem, Dusuki suggested the use of special purpose vehicle (SPV) for the Islamic bank to channel funds to the poor people. The role of the SPV is important to protect Islamic banks from MFI failure.

Furthermore, participatory schemes such as mudharabah and musyarakah can satisfy risk sharing needs of the poor people. The main objectives of Islamic MFI are to alleviate poverty and enable the poor acquainted closer with Islamic ethical principles (unity, equilibrium, free will and responsibility). For example, the Muslim NGO in India conducts a poverty alleviation program by linking Islamic MFI programs with income generating activities (Hassan, 2014).

Lastly, zakah and waqf are also tools in Islamic MFI to reduce poverty by covering loss from default, and expense coverage. Another method has been done by providing qardhul hasan financing and building capacities. This means that the Islamic MFIs not only provide credit for the poor, but also provide credit-plus service to alleviate poverty.
2.2 BMT and microfinance in Indonesia

Studies on BMT have focussed on various aspects of its operations. Several studies analyze the efficiency of the BMTs such as that of Cokro and Ismail (2009) which found that the efficiency of the BMTs in Central Java is relatively low and below the optimal level. The study finds that the BMTs face issues in managing resources due to management weakness, tendency to serve many micro-enterprises resulting in increased operating costs, zakah obligations and payment result in reduced profitability, increasing salary and allowance of employee, double mission, and double jobs of the manager. Despite the issues, the BMTs have been successful in benefiting the society by increasing saving and ability to fulfill borrowers need, providing Islamic micro-financing for many people in the long run, giving easy procedure and requirement, and creating job opportunities for the poor.

Similarly, Nasution (2013) analyzes the efficiency of BMTs using the data envelopment analysis. In total, 12 BMTs were involved in the research and the results show that financing and human resource are the two main sources of the inefficiency. The inefficient BMTs are suggested to optimize input and maximize output practice as being adopted by efficient BMTs.

Hamzah et al. analyze the issues facing the BMT and found that many BMTs suffer bankruptcy problem because of operational failure. Focussing on the case of BMT in Pekanbaru, the study documents that the BMT faces problems such as lack of quality human resource and absence of specific regulations. It is suggested that the problem of lack of quality human resource can be resolved through education and training.

In addition, Alaeddin and Anwar (2012) studied the diverse funding in BMT Amanah Ummah Surabaya Indonesia. They found that BMT Amanah Ummah faced a bad debt problem because of inadequate screening process. Furthermore, BMT Amanah Ummah does not have any source of subsidy especially for cheap credit. The study suggests that a smart subsidy application to be implemented to cover the costs of extending small financing.

Another research attempts to provide solution on how to improve the effectiveness and efficiency of BMT (Hadisumarto and Ismail, 2010). The implementation of Islamic MFI preceded by selection process of micro-enterprises with additional business control, create a good relationship and incentive system is effective in micro-enterprises development and also improve household income. Thus, the study concludes that designing integrated program to improve BMT effectiveness is highly important to ensure sustainability of the BMT.

Apart from studying its efficiency, other studies look at critical factors ensuring the determinants of BMT’s success. Hosen and Syukriyah (2012) study the determinants of BMT success which include characteristics of customers, capability of financial management and risk management, information technology and network and familiarity among customers and managerial team of BMT. Dariah (2012) analyzes the procedure of social capital in BMT Lathifah in Sumedang, Indonesia and finds that the financing issues faced by the BMT can be resolved by rescheduling, restructuring and reconditioning using human resources development, creating good accounting management, building good relationship with customer, and increasing qardhul hasan financing (interest-free loan) using the zakah, infaq and sadaqah which reflect the social capital.

From the literature review, it is obvious that the BMT faces several issues and challenges in their operation and financing activities, which are sometimes unique in
the case of financing for the poor. There is an urgent need to re-assess these issues and provides practical solutions so that the role of BMT in alleviating poverty in Indonesia can be enhanced.

3. Research methodology

There are several stages of qualitative research involved in this study, namely: development and preparation of topic selection, design, ethics, initial trustworthiness decision and selection of research team members; data collection; data analysis and interpretation; and, application (Lyons et al., 2013). By conducting the qualitative research, this study aims to discover interesting aspects that could not be achieved through the quantitative research approach (Ambert et al., 1995). In particular, the qualitative analysis is the most suitable approach in describing the behavior of the respondents in this research area (Effendi, 2013).

In adopting the qualitative analysis, this study conducts a series of structured interviews with the chairman and staff of the Central BMT (INKOPSYAH) in Jakarta which is the head-quarter of 382 BMTs throughout Indonesia. In addition, the chairman and shari’ah supervisor of the Central BMT (Pusat Koperasi Syariah) in Makassar which headquartered 15 BMTs in East Indonesia were also interviewed. These samples were selected because they generally represent the BMTs in Indonesia. Moreover, these samples are selected as representatives of those who design the suitable product for the poor being implemented in other BMTs. As a consequence, they have more knowledge about issues and challenges faced by the poor before designing the product. Representative from the 382 BMTs throughout Indonesia always attend Central BMT meeting at least once in a year to discuss the problem related to issues and challenges which are faced by the poor.

The selection of the two BMTs is highly suitable since the Central BMT in Jakarta represents the BMTs in the central region, while the Central BMT in Makassar represents the BMTs in the Western region. Subsequently, the results from the structured interviews are analyzed using the qualitative analysis to arrive at the model of the peculiarities of financing for the poor in Indonesia. There are five employees involved as a sample in this research. These respondents are selected because they fulfill the required criteria of the research: employee of Central BMT; minimum employment duration of at least two years; involve in the capacity of processing financing at BMT; and keep a record of Central BMT annual meeting related to issues and challenges that faced by the poor. The profiles of the respondents are shown in Table I.

The interviews were based on open-ended questions to enable the respondents to express freely about the issues and challenges faced by BMT in financing the poor in

<table>
<thead>
<tr>
<th>Gender</th>
<th>Age</th>
<th>Level</th>
<th>Place of work</th>
<th>Working experience</th>
<th>Transcript details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>48</td>
<td>Chairman</td>
<td>Central BMT</td>
<td>10 years</td>
<td>5,401</td>
</tr>
<tr>
<td>Male</td>
<td>32</td>
<td>Staff</td>
<td>Central BMT</td>
<td>2.5 years</td>
<td>7,739</td>
</tr>
<tr>
<td>Female</td>
<td>33</td>
<td>Staff</td>
<td>Central BMT</td>
<td>4 years</td>
<td>4,244</td>
</tr>
<tr>
<td>Male</td>
<td>42</td>
<td>Chairman (Makassar)</td>
<td>Central BMT</td>
<td>5 years</td>
<td>7,679</td>
</tr>
<tr>
<td>Male</td>
<td>45</td>
<td>BMT shari’ah supervisor (Makassar)</td>
<td>Central BMT</td>
<td>6 years</td>
<td>2,718</td>
</tr>
</tbody>
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Table I. Profile of respondents

Issues and challenges in financing the poor
Indonesia. Each interview lasts for approximately 150 minutes and being recorded. The researcher then transcribed the audiotapes and coded the data. Issues and challenges were summarized and reported.

In preparing the qualitative content analysis, one cannot differentiate the data collection and content analysis process as the early involvement in analysis phase will benefit the researcher to move back and forth between concept development and data collection, especially in inductive area where the research question may be developed further depending on the situation. To conduct reliable inferences, qualitative content analysis involves a set of systematic and transparent procedures for processing data, similar to the traditional quantitative content analysis procedures. Qualitative content analysis can be used to analyze various types of data, but mostly in written text data. The process of defining unit analysis of the data refers to the basic unit of text to be classified during content analysis. The unitized data have a significant impact on coding decision, as well as the comparability with the similar study.

The unit used in the qualitative analysis can be word, sentence or paragraph, and this paper chooses sentence and word as the units of analysis. Categories and a coding scheme could be developed from previous related studies, theories or data generated. It could also serve as the inductive or deductive data development. Glaser and Strauss suggested when inductive method is used during raw material development, constant comparative method is recommended. The constant comparative method is essentially the systematic comparison of each text assigned to a category with each of those already assigned to that category, to reveal the theoretical properties of the category; and second, integrating categories and their properties by developing interpretive memos. After the categorization and abstraction, the final output of this paper is to reveal patterns, themes and categories important to a social reality. The main theme of this research is to reveal the issues and challenges in BMT financing for the poor in Indonesia. In the classical literature, it is always started with the categorization of the main issues from the previous literature which are divided into five variables: the practice of subsidy, the role of collateral, the role of joint liability, credit-plus financing and financing default case. Table II shows selected examples of interview questions and focus group discussion’s materials.

4. Results and findings

4.1 Financing sources for the poor

The Islamic microfinance providers face the issue of high operating costs in order to maintain financial sustainability despite the lack of economies of scale. High margin in financing will be implemented to cover high cost (Hosen and Syukriyah, 2012). In providing financing for the poor, BMT relies on subsidy since the cost of financing incurred is the same regardless of the size of the loans. The Chief of BMT Jakarta said:

Every rupiah that I lent to the poor means that I must spent half rupiah as the cost of financing. It is because poor borrowers also need monitoring to make sure that they can repay on time and it is fixed cost for BMT. Although several people said that poor people are trustworthy people, they still need monitoring to prevent moral hazard.

Moreover, the staff of BMT Jakarta also agrees with this statement:

Financing for the poor is expensive without subsidy. If BMT only depends on internal funds, they will lose their profit. Many BMT cannot survive for two years or more without subsidy. Subsidy will create sustainability.
Moreover, high margin will reflect the problems of high transaction cost in the case of loan processing. In addition, the problems of high cost will conduct as a road block in financial inclusion areas (Serrano-Cinca and Gutiérrez-Nieto, 2014). This problem also occurred in BMT. Since BMT usually handle people at the bottom of the pyramid, funding nominal that BMT distributed usually around US$80-US$400. This is categorized as small loan. The administration cost that must covered by BMT is around 50 percent from the nominal funding. It means that if there is no subsidy in BMT, they must charge high margin to borrowers. So, the subsidy role is very important for BMT success. The sources of subsidy in Indonesia BMT came from many institutions.

About the sources of BMT subsidy in Indonesia, chairman BMT Jakarta said:

BMT gets funding from many sources like from national company. National companies usually give their corporate social responsibility fund for community engagement to BMT. In Inkopsyah, we use this fund to build new BMT which focus on giving funding to the poor, infrastructure, and training. After that, this new BMT established and get profit. Next, this new BMT must give initial funding back to Inkopsyah then Inkopsyah build new BMT again using that funding. This is the scheme in Inkopsyah to realize one village one BMT.

Similar to INKOPSAYH, chairman of Central BMT in Makasar also said that government give subsidy to BMT by creating BMT KUBE with 87 branches in Indonesia:

In Makasar, we have 5 BMT KUBE which are subsidized BMTs in Indonesia with total 87 branches all around Indonesia. This BMT focuses on poor borrowers financing which is supported by Social Ministry in Indonesia.

BMT shariah supervisor in Makassar also adds that BMT has another source of funding, i.e. from an international donor:

Although it does not exist in Makassar, several BMTs (because I am in BMT Mataram before) have a source from international funding like Muslim aid. They will give cheap credit to BMT sometimes without margin which requires BMT to distribute again to the poor. Besides distributing funding, they usually held cheap market for the poor in special events like Holly day.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Questions</th>
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<tbody>
<tr>
<td>The practice of subsidy (Becchetti and Pisani, 2010; Hudon and Traca, 2011; Caudill et al., 2012; Chakravarty and Pylypiv, 2015; D’Espallier et al., 2013; Nawaz, 2010; Sama and Casselman, 2013; Pischke, 2012)</td>
<td>How are the subsidy practices in BMT especially in providing funding for the poor? Who are the donors providing subsidy in BMT? What is the role of donor in BMT? Does collateral play a role in BMT funding to the poor? Please explain How is the concept of joint-liability work in BMT?</td>
</tr>
<tr>
<td>The role of collateral (Turvey et al., 2011; Jia et al., 2010; Masyita and Ahmed, 2013)</td>
<td></td>
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<tr>
<td>The role of joint liability (Ghatak, 2014; Chowdhury, 2005; Gangopadhyay et al., 2005; Karlan et al., 2009; Kropp et al., 2009)</td>
<td></td>
</tr>
<tr>
<td>Credit-plus financing function (Serrano-Cinca and Gutiérrez-Nieto, 2014; Nor and Hashim, 2014)</td>
<td>How does credit-plus financing scheme work in BMT? What are the components of credit-plus financing offered by BMT? What are the solutions when the case of default occurred in BMT?</td>
</tr>
<tr>
<td>Financing default case (Raini et al., 2014; Hassan, 2010; Yunna and Clarcke, 2009; Kamla and Rammal, 2013; Junaidi and Rizkiyah, 2013)</td>
<td></td>
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</table>

Table II. Questionnaire

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Subsidy has an impact to microfinance. Subsidized lending will have a positive impact on reducing financing rate/margin, especially in BMT. Moreover, it is explained that donor funds are more effective to have more benefit in group lending scenario rather than individual lending scenario which is supported by collateral. Private subsidies will decide to share part on MFI's lending risk and reduce loan rates. Most MFIs usually do not ask for public subsidies but rely on private donor (Becchetti and Pisani, 2010). This theory also occurred in BMT which many of them searching for private donor because the administration is easier than public subsidies. In this case, subsidy has a positive impact on microfinance efficiency (Hudon and Traca, 2011).

On the other hand, subsidy shows bad impact and also good impact to BMT operation. The bad impact comes because subsidy will force a manager to operate more efficiently and it will create cost. Because of that, microfinance can be more efficient without subsidy (Caudill et al., 2012). But Chakravarty and Pylypiv (2015) said that donor funding will promote better microfinance performance because donor funding usually increase as well as increasing institutional performance. Subsidy also associated with better social performance and un-subsidized microfinance is more suitable to target fewer poor clients (D'Espallier et al., 2013). Because BMT specialized in giving funding to poor people, the subsidy existence is important. Although the way to get a subsidy incurred a lot of costs, the cost that spent to get a subsidy is cheaper than the cost to cover high margin. In this practice, the bad impact of subsidy will not occur in BMT since they specialized on poor people financing.

Subsidy is needed to create business sustainability (Nawaz, 2010). Sustainability is building positive flow of benefit as long as poor people need. Moreover, sustainability implies the continuance of microfinance production to alleviate poverty and this concept helps microfinance to balance social value with financial goals. There are three level of sustainability: financial, organizational and benefits sustainability (Sama and Casselman, 2013). First is financial sustainability which is the operational cost of lending retrieved by mix income from microfinance income and subsidy or grants. Second, organizational sustainability which defines as capabilities to back up programs that added social values. Last, benefit sustainability which explain as benefit available to clients in the form of income generation (Hermes and Lensink, 2011).

The issue of financial sustainability becomes an important aspect in microfinance since poverty lending approach focussed on distributing credit to the poor with lower margin (Doshi, 2010). Subsidy is one approach which contributes to a sustainability problem. Moreover, subsidy existence takes a part in economy life but subsidy from donor usually targeted to the biggest microfinance. This condition because donor provide subsidy based on performance record (internal control existence, efficient staffing, response to market condition and good IT system; Hartarska, 2009). There two types of subsidy in microfinance: type A and type B. Type A (commercial) views subsidy as compulsory thing for start-up microfinance while type B (non-profit) views subsidy as important thing for sustainability (Pischke, 2012). In reality, many financial subsidies from external to microfinance are unstable because it usually depends on the performance. Furthermore, unstable subsidy will cause a problem to sustainability. The issue that occurred in BMT is many BMT only sustain in the first two years without subsidy. After that, many of them collapse. Subsidy from external is important for BMT sustainability especially for small BMT. Maintaining BMT performance by maintain subsidy stability is a challenge for BMT sustainability.
4.2 Screening process

The role of collateral. Collateral is the value of the asset or valuable items that can conduct as a guarantee of the borrower for a specific amount of financing. Micro-credit bank usually used a combination of guarantees and collateral in the loan award. The practice of collateral also occurred in Islamic microfinance. Islamic microfinance finances only real transactions with underlying assets and any debt created must be backed by collateral. As a result, only well-performing clients are financed by Islamic microfinance (Masyita and Ahmed, 2013).

In BMT practice, chairman of BMT said that:

To propose financing even poor borrowers and under the scheme of qardhul hasan financing, poor borrowers must sent their collateral to BMT usually 50 to 100% nominal value of collateral from their total financing. It is to make sure that they have an effort to repay and also conduct as risk management aspect in BMT. Otherwise, they must join group lending with joint liability scheme but only small percentage of BMT that have this program.

Furthermore, this concept was agreed by Central BMT staff:

Collateral requirement will decrease margin given to the poor people because BMT can make sure that poor borrowers can repay their financing or their collateral will be confiscated by BMT.

This statement align with Turvey et al. (2011) who conducted a research to study relationship between borrowing capacity and asset to farmers. The result shows many disagreements that having asset will affect the interest rate increase. Moreover, farmer with greater assets will be credited as trustworthy person that can access and obtain more credit. Another research Turvey et al. (2011) strengthen the relationship between collateral and interest rate. This research found that collateral has an impact to interest rate with opposite direction. Collateral conducted as risk mitigation to cover default financing from the poor borrowers. In contrast, poor borrowers view the collateral requirement as incriminating requirement because they cannot fulfill the collateral that BMT asked. The value of collateral is sometimes too high for the poor borrowers.

Moreover, the difference in collateral requirement depends on the advantage of information availability about the clients characteristics (Jia et al., 2010). This concept is being implemented in BMT. For repeated financing in BMT, they get easier access to financing compare to the new one. Lower margin is usually given by BMT to repeated borrowers with good payment history. For repeated borrowers, some BMT do not require them to guarantee their financing. Based on Islamic practice, the challenge to both Islamic micro-bank and MFIs must have a purpose that everyone in the economy is entitled with economic justice (believe that every consumer is creditworthy) and must offer collateral free loans (Masyita and Ahmed, 2013). Yet, this practice is difficult to be implemented. It is the challenge to BMT to make sure that their borrowers’ especially poor borrowers do not face constraint by collateral implementation in BMT.

The role of group lending joint liability. Joint liability is a mechanism in the case of asymmetric information that involves local information to reduce credit market failure. Moreover, joint liability can conduct as a solution when dealing with credit rationing constraints related to collateral requirement for the poor people even in some region they still need group collateral. This mechanism can be utilized to give solution to borrower asymmetric information (Ghatak, 2014). Furthermore, it can improve efficiency comparing with standard debt contracts in the existence of asymmetric...
information (Gangopadhyay et al., 2005). Moreover, group lending scheme involves sequential financing or combination between lender monitoring and joint liability. In the case of serious default, joint liability lending is not feasible. The feasible one is group lending schemes with sequential financing without joint liability. In contrast, if the default is not serious, group lending schemes should also involve joint liability (Chowdhury, 2005).

In the case of BMT, chairman of central BMT said that:

Sometimes I found that many poor people did not have any collateral to show as BMT requirements but several BMTs provide group lending with joint liability scheme. This scheme usually consists of 5 to 10 people with one leader. The leader will conduct as liaison officer to BMT and manage the funding amount to every member. In the case of one member default, other member will responsible to repay (managed by the leader). Group member also need to show join collateral as screening process.

The benefit of joint liability is efficiency improvement because it can handle asymmetric information about unknown borrowers compare with conventional debt contracts. An example of joint liability lending in BMT show that collateral can be used easier than the case in developing countries. It is because even poor people can have collateral, it cannot be used because of lack financial institution or the collateral does not meet the microfinance requirements in developing countries. Moreover, credit rating that informs financial condition of the poor also available in developed countries. It means that joint liability lending in developed countries is not proper to be used to handle credit market failures (Ghatak, 2014).

Furthermore, like in BMT, factor that influence success in group lending performance is social cohesiveness between members with peer monitoring which can use as insurance substitutes. Group which is located in different area will enforce repayment among their member by simulation of intra-group insurance with intensive monitoring. However, it is really difficult to measure group lending in rural areas (Tassel, 2000). Poor borrower will prefer joint liability/group lending because the amount of loan is larger and cheaper. But the amount is smaller than individual loan for wealthy people (Madajewicz, 2011). As a result, group lending is an effective way to alleviate poverty in developing countries which face a problem of asymmetric information. Group lending is effective in the area where social ties between members are strong (Tassel, 2000). Many micro-credit lenders offer joint-liability loans as an access of poor borrower to microfinance funding (Gangopadhyay et al., 2005).

To be more specific, the staff of Central BMT said that:

Group lending scheme sometimes has negative sides in the case when borrower doesn’t know each other. Sometimes they envy to other members who get more funding but have more probability to default. Monitoring from BMT to this kind of group is important but sometimes people in the group said that they fell uncomfortable because they will think they are under pressure.

This statement is aligned with Karlan et al. (2009). Although group lending offered many benefits for poor borrowers, it also contained negative sides. Many clients do not like the pressure among peer in group lending scheme. The tendency of joint liability/group lending situation is older clients borrow more than newer clients. This condition will cause high tension among members because newer clients do not want to take responsible of larger loans. Social capital is a solution of group lending program that offers not only joint liability lending but also community building, infrastructure
improvement and lower transaction cost. This concept is being made for microfinance sustainability that purpose to improve welfare of the poor (Kropp et al., 2009). Islamic microfinance has been adopted social capital in their daily funding activities. The practice of joint liability must be implemented in BMT because BMT provide financing for the poor who usually do not have individual collateral as guarantee. This practice must be followed by good monitoring to make sure the repayment performance.

4.3 Credit-plus financing
Credit-plus financing is a factor that contributed to the microfinance success. This concept must be applied in Islamic microfinance. Hereinafter, the term of credit plus means that a focus of microfinance not only provide financing to the poor but also integrate other service like leadership training, soft skill, religious aspect and so on (Serrano-Cinca and Gutiérrez-Nieto, 2014).

Credit-plus financing is being implemented in BMT. One of the practices of credit-plus financing is the weekly/monthly religious event conducted by BMT (depends on BMT policy). Moreover, this religious event not only conducts meeting and training but also as risk management aspect. Every client is being asked about his/her financing status in this meeting. The moderator of religious meeting also teach financial planner for the poor so they can learn how to pay their financing on time. Sometimes, BMT held a business and entrepreneurial skills training to enhance the capacity of poor people to repay. Staff of Central BMT said:

BMT has uniqueness financing program on which other microfinance maybe not concern about it. How to build the community is our target not just focus on giving financing to the poor people. Several BMT provide religious event every week to enhance customer knowledge and also giving financial training. Besides training, if we found bad infrastructure condition in several villages, BMT will take care to that problem. This condition will give positive impact to BMT that every borrower will easier to reach BMT and BMT can perform their operational activity properly.

If this training concept success in application, it can create easy access to credit, availability of skill training and easy to access information like what have done in women micro entrepreneurship in Bangladesh. Besides training, MFI also provide intermediation service both financial and social intermediation. In this concept, microfinance positioned its self as development tool which involves “small loans for working capital, informal appraisal of borrowers and investments, collateral substitutes, such as group guarantees and compulsory savings, access to repeat and larger loans, based on repayment performance, streamlined loan disbursement and monitoring and secure saving products” (Nor and Hashim, 2014). Agree with this statement, chairman of Central BMT said:

We call it credit plus financing for financing plus community engagement in BMT. Based on BMT practice, it provides small loans usually from (Rp 500.000/US$ 35) to (Rp 5.000.000/US$350). Some of BMT require collateral from the borrowers but only a little of them require to join a group guarantees. Poor people can only ask for repeat and larger financing if they have paid all previous financing to prevent from spiraling debt. Beside financing, we also have saving that we target in 2015 to have APEX BMT to make sure every saving is guaranteed and secured which is treat like the function of deposit insurance agency in bank.

The other uniqueness of credit-plus financing in BMT is the value added for the poor. Poor people must not be afraid to go to BMT whatever clothes they wear. Many poor
borrowers can come to BMT using informal clothes even farmer usually used dirty clothes after farming and using sandals. Many poor people afraid to go to the bank because many bank usually require more formal clothes. This characteristic characterize low profile in BMT compare to formal one. Creating and maintenance of credit-plus financing in BMT are challenges for BMT success.

4.4 Poor borrower case of default

Many people (around 40 percent) in the world now dealing with poverty on which world bank describe as a condition on which people will live with income less than US$2 per day. As a solution, Islam has been equipped with multiple weapons to fight poverty through zakah, awqaf and interest-free loan (qard hasan). Moreover, (Raimi et al., 2014) describe the problems and consequences of poverty in Muslim-majority nations and integrate corporate social responsibility, awqaf system and zakat system as faith-based intervention tool for poverty reduction in Muslim-majority nations.

There are four meanings of poverty: “inadequacy of income and lack of material things apart from food; lack of physical capacity and lack of assorted human needs ranging from material and non-material needs that are essential for quality well-being (Raimi et al., 2014).” Furthermore the conceptualization of poverty has four approaches: monetary approach, capability approach, social exclusion approach and participatory approach. Monetary approach is a condition of lack of financial which appear from people inability due to paucity of income, lower income and inflation effect. Capability approach is a condition of lack of capability to fulfill basic needs as a survival requirement. Social exclusion approach is an unfair situation which marginalized people from having basic need access. Last, participatory approach is a condition when people are not allowed to have socio-economic input.

Poverty usually concentrated in rural area because urban area will provide more job opportunities. Moreover, the bad impact of poverty can create violent and extreme behavior (Raimi et al., 2014). It also can said that poverty is economic problem which has linkage with political and social issues (Hassan, 2010).

As a solution, there are two strategies of poverty alleviation programs: indirect strategy and direct strategy. Indirect strategy is a strategy by formulating macro-economic policy to maintain stable growth while direct strategy is a strategy which targeted to poor population and give credit, education and health access to reduce poverty. Indonesia, Malaysia and Thailand is the success of indirect strategy while Bangladesh is direct strategy (Hassan, 2010). The poverty alleviation based on Islam said that a condition of which individual failed to meet five basic requirements: religion, physical self, knowledge, offspring and wealth (Hassan, 2010). Islam require more than faith but also human being freedom (Yumna and Clarcke, 2009). The first issue from (Raimi et al., 2014) stated that poverty, unemployment, low per capita income, large unutilized population are the bane of crises in the Muslim-majority nations.

The current approach to alleviate poverty is using corporate social responsibility. But the practice still questionable because many company usually conduct mission drift when they are doing corporate social responsibility (Raimi et al., 2014). There are several alternative models to curb poverty. Faith-based model is a solution for Muslim-majority nations. Since Islamic finance system grow rapidly, Islamic financial institutions dealing with ethical business. As a solution,
institutions will pay zakah, waqf and conduct CSR programs to alleviate poverty (Raimi et al., 2014). Raimi et al. (2014) stated that corporate social responsibility, zakah and waqf could be integrated in faith-based system to alleviate poverty in the Muslim-majority nations.

There are three components of faith-based system: corporate social responsibility, zakah and waqf (Raimi et al., 2014). Corporate social responsibility is a voluntary obligation like the practice of zakah in Islam (Raimi et al., 2014). Corporate Social responsibility is an action of a company to the society. It is involved five areas: social, environment, voluntary, economics and stakeholder. Moreover, the common forms of corporate social responsibility are charity and how to save environment. Furthermore, helping the poor also conduct as a part of corporate social responsibility. The applicability of this concept can be used both ethically and socially (Kamla and Rammal, 2013).

While, awqaf is a tool that has been developed to fulfill crucial needs like education, transportation, health care, etc. (Mohsin, 2013). It also refers as valuable property or tangible assets as a gift to God. In practice, it could be monetized as leasing facility but cannot be sold that can improve social well-being (Raimi et al., 2014). Moreover, awqaf is a charity to hold specific property for sustainability (Hassan, 2010). There are three kinds of awqaf: religious awqaf (focus on building and maintenance religious institutions), philanthropic awqaf (providing support for the poor like health service) and family awqaf (given to family first) (Hassan, 2010). Nowadays is the era of cash awqaf by using several amount of money to build property in order to create the welfare of the society (Mohsin, 2013). Several awqaf integrated with microfinance. Waqf-based Islamic MFI will give microfinance and facilitate wealth construction of the poor. It can reduce financing cost which can create wider access to the poor (Ahmed, 2007).

The last is zakah which is a compulsory tax to be paid by wealthy Muslim at 2.5 percent from taxable amount (nisab) equals to 20 dinar (gold) or 200 dirham (silver) (Raimi et al., 2014). It is a unique instrument for poverty alleviation. It can be used on eight purposes. Five are meant for poverty eradication such as the poor, the needy, the debtors, the slaves (to free them from captivity) and the travelers in need. Other are the administrative cost of zakat, “those whose hearts are made inclined” (to Islam), and in the way of Allah called asnaf (Hassan, 2010). Zakat usually integrated with microfinance like the case in Indonesia. Zakat and Islamic charities can be used as microfinance’s source of fund. Moreover it has targeted to low-income people. It usually conduct as a tool for alleviate poverty especially extreme poverty. They usually given qardhul hasan financing scheme (without interest and margin) (Yumna and Clarcke, 2009). Zakah is compulsory, while awqaf is voluntary. It is usually fixed rate and spent only one in a year and it only applied to Muslim (Hassan, 2010).

The practice in BMT shows dual functions. First is Baitul Maal and second is Baitul Tamwil. Since BMT perform two functions: Baitul Maal (managing zakah, infaq and sadakah) and Baitul Tamwil (managing saving and funding). BMT can manage charity fund by collecting zakah, infaq and sadakah donation. The main purpose of BMT not only provide funding but also community development by cutting the role of money shark in community (Kamla and Rammal, 2013).

Moreover, BMT distribute zakah, infaq and sadakah in the form financing that do not requires collateral with zero margin (or known as qardhul hasan loan or benevolent
Poor borrowers have obligation to pay. BMT never stated that the source of fund comes from zakah, infaq and sadakah to prevent moral hazard. Other form, BMT used zakah, infaq and sadaqah as source in the case of borrowers default. Chairman of BMT said:

As you know that we have separate functions which are mixed into one Baitul Maal wa Tamwil. Ideally every BMT has these two functions with different department but we only found it in big BMT like BMT Beringharjo Yogyakarta. Other BMT usually do not separate these functions. Besides distributing qardhul hassan financing, BMT also used zakah, infaq and sadakah as a buffer in the case of poor borrower default.

Furthermore, zakah, infaq and sadakah can increase the welfare of the poor because it will be given to the poor people to alleviate poverty by creating additional income (Junaidi and Rizkiyah, 2013). Zakah, infaq and sadakah will create value for society (Kamla and Rammal, 2013).

The challenge that occurred in BMT in Indonesia is most of them rarely used the concept of Baitul Maal. This condition occurred because only poor people come to them for funding and only small percentage of wealthy people come to pay their zakah, infaq and sadakah in Indonesia. This makes many microfinance depends on donors to distribute qard al hasan financing. Revitalization of the Baitul Maal concept is really important since donor fund is not unlimited. So, Islamic microfinance can continuously give cheap fund for the poor and qard al hasan for the poorest of the poor.

Based on the qualitative analysis, the output post-categorization of issues and challenges in BMT can be summarized as in Figure 1.

5. Conclusion
While BMT has been effective in alleviating poverty in Indonesia by enabling the poor to have access to credit, it faces several issues and challenges in providing financing to the poor. This study observed the practices of BMT in Indonesia to highlight the issues and challenges faced by BMT in order to understand factors that are critical to ensure the sustainability of this institution.

Based on the qualitative analysis, the study documents four categories of issues facing BMT in providing financing to the poor. First is financing sources for the poor in BMT. The first issue states that government, national private company and international donor to provide subsidized financing sources for the poor using BMT. Maintaining subsidy stability is a challenge for BMT sustainability. Second is screening process. This issue describes two screening process in BMT: poor people must send their individual collateral as a requirement when proposing funding to BMT or in the case of individual collateral absence, poor borrowers must joint group lending scheme with joint liability. BMT must conduct good monitoring to make sure the repayment performance. Third is credit-plus financing. This issue suggests that the BMT to provide credit-plus financing which is not only giving financing but also build infrastructure building and maintenance and give routine training plus religious activities to borrowers. Creating and maintenance of credit-plus financing in BMT are challenges for BMT success. The last is poor borrower case of default issue. This issue states that zakah, infaq, sadaqah and waqf to take a role in the case of poor borrowers financing default.
Issues and challenges in financing the poor

Figure 1. Issues and challenges faced by BMT in financing for the poor

Source: Qualitative analysis
5.1 Policy implication

The findings of this study have several important implications for the BMT and policy makers. This study highlights the need for a range of strategies to ensure success and sustainability of BMT. This includes maintaining the flow of subsidy into BMT by showing good financial and operational performance; providing group lending scheme as an alternative of poor borrowers’ lack of collateral; creating good credit-plus program with innovative and uniquely designed programs and activities; and optimizing the Baitul Maal function in BMT as a division focussing on managing the funds from zakah and charity.

In order to effectively addressing these issues and challenges, the role of the government is indeed crucial. Specific strategies in terms of special incentives and support from the government would go a long way in supporting BMT’s success and effectiveness and to remain sustainable. Additionally, the government’s role to create good business climate is an important contributing factor toward improving the socio-economic standing of the poor in Indonesia.

References


**Further reading**


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