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ISLAMIC MICROFINANCE FOR POVERTY ALLEVIATION: A SYSTEMATIC LITERATURE REVIEW

Erna Farina Mohamed[a,b], and Neneng Ela Fauziyyah[a,c]

[a]*Department of Economics, International Islamic University Malaysia, 53100 Kuala Lumpur, Malaysia. (Email:* [b]*ernaafarinaa.ef@gmail.com,* [c]*nenengelafauziyyah@gmail.com)*

ABSTRACT

This paper reviews and discusses the impact of *Islāmic* microfinance and its conventional counterpart on their borrowers. Another primary focus of this study is to identify determinants that could influence the microfinance borrowers. The study also promotes *Islāmic* microfinance and suggests it as one of the best poverty alleviation tools, especially among the Muslim society by reviewing some measurements taken and suggestions by other researchers through systematic literature review. This paper is a literature survey of more than 50 articles related to microfinance which tries to analyze the areas that researchers investigated in microfinance. This survey comprises not only an empirical analysis and comparative analysis but also the recommendation and suggestion with some theoretical works. Microfinance is lauded asan effective tool for eradicating poverty. It has improved the livelihood, well-being and economic development of the poor people. However, studies show that most conventional microfinance programs neglected the extremely poor population. Therefore, various modes and structures of *Islāmic* microfinance can deal with different activities and levels of poverty, including the extremely poor. The findings of this study suggest that *Islāmic* microfinance is one of the best tools to reduce poverty, especially in Muslim society.

JEL Classifications: D14, D31, G21, I38

Keywords**:** Microfinance, Microcredit, Islamic microfinance, Impacts, Factors.

1. INTRODUCTION

Financial services development is important to the social and economic life of households including the poor. Through loans from financial services, the poor may generate income, stimulate local transactions and create supply and demand for goods and services at any rate in their domestic economy (Abdelkader and Salem, 2013). Unfortunately, many financial institutions might not let the poor people to participate and access their services because the poor are deemed as having inability to service their loans. There is little profitability obtained from poor people (Rokhman, 2014). Hence, a poor household will eventually face financial problems and be destined in the cycle of poverty.

The emergence of microfinance, since a few decades ago, aims to eradicate the root problem of economy, poverty (Tammili, Mohamed, and Terano, 2018; Rokhman, 2014; Abdelkader and Salem, 2013; Saad, 2012) by strengthening the economy from the lowest level of socio-economy, particularly in developing countries. The pioneer of this idea was Professor Muhammad Yunus with the success story of Grameen Bank in Bangladesh. He designed a credit delivery system for the rural poor people, mostly women borrowers. It could create local economic enhancement, generate welfare and alleviate poverty in Bangladesh.

Rahman, Khanam, and Nghiem (2017) stated that developing countries consider women as the intentional target of microfinance programs. Beside getting limited access to labor's wages and have no power in their family, women have proven their ability to repay the loan and this is seen as a lower credit risk for microfinance. For instance, in the case of Bangladesh, Hashemi, Schuler, and Riley (1996) found that the existence of rural loan programs, Grameen Bank and Bangladesh Rural Advancement Committee (BRAC), enhance women empowerment. Women can support their families' needs especially in terms of child-specific requirements.

By giving loans or credits to poor people, microfinance plays a crucial role in facilitating the business environment. The existing domestic entrepreneurship will be developed, even unemployed people can be supported and have the opportunity to create their own business. However, poverty may create difficulties for them to go through this chance due to lack of entrepreneurial skill (Terano, Mohamed, and Jusri, 2015), limited financial management knowledge as well as lack of experience. Hence, microfinance can assist the poor and low-income families to overcome these problems by providing guidance through training programs (Tammili et al., 2018).Among the expected impacts of loans to poor people are increasing their revenue, enabling deserved education and health, opening job opportunities for micro-enterprises and particularly, offering the poor a better life. Microfinance providers not only supply micro-credit or loans but they offer other services such as payments, micro-savings, remittances and micro-insurance (Rokhman, 2014; Abdelkader and Salem, 2013). By doing so, they provide comprehensive financial facilitation and meet the particular needs of poor people.

For Muslim countries and Muslim population, microfinance becomes a dilemma. Lack of ethical and moral value of microfinance due to *Ribā'-based* has been a major problem (Rahim, 2010). Because of prohibition of interest (*ribā'*) in Islam (Rokhman, 2014), *Islāmic* microfinance has been developed as an alternative. This institution may cover the goals of microfinance based on *Islāmic* principles. Saad (2012) revealed that assisting entrepreneurship of poor people with collateral-free loans and risk-sharing are the *Islāmic* principles that support microfinance purposes. She also said the dual functions of microfinance as a financial and development institution still left the poor under poverty condition. Thus, *Islāmic* microfinance plays an essential role for the poor Muslims.

Islāmic microfinance has grown rapidly along with the conventional one. *Islāmic* microfinance attempts to improve welfare of the poor by generating level of income, consumer spending as well as enhancing living standard (Ahamad, Bakar, and Lubis, 2016b) through *Sharī'ah* principles.

Therefore, based on the existing theories and past studies, this paper attempts to look at the impacts of microfinance and *Islāmic* microfinance on borrowers, socially and economically and at the same time to promote *Islāmic* microfinance as a financial tool for reducing poverty. The study also attempts to look into factors that could influence the microfinance borrowers.

2. LITERATURE REVIEW

As already mentioned, microfinanceis one of the major tools for poor people to improve their livelihood through small lending on businesses. It is dubbed to be an effective tool for poverty alleviation and socioeconomic development among the poor. Many studies have looked at the social as well as the economic impact of microfinance especially to its borrowers or clients and the results have been mixed. On top of that, microfinance is also considered as an alternative for women empowerment, and many studies have investigated the impact or relationship of microfinance with women's empowerment. According to Moll (2011), three aspects of microfinance impact on the poor have been highlighted namely an increase in the ability to consume, produce and invest.

Khandker (2003), Uddin (2008), Rahman and Ahmad (2010), Ahamad et al. (2016a, 2016b)and Choudhury, Das and Rahman (2017) through their studies confirmed that microfinance has positively affected borrowers' income and expenditure in Bangladesh. In contrast, Asyraf (2010) concluded that microfinance has not successfully reduced poverty in Bangladesh. In Malaysia, Amanah Ikhtiar Malaysia (AIM), one of the microfinance institutions, proved that its program has improved the social and economic situation of borrowers (Samer et al., 2015; Al-Mamun, Adaikalam, and Abdul Wahab, 2012; Saad and Duasa, 2010). In addition, some other studies found that microfinance can achieve its aim to reduce the level of poverty socially and economically (Rokhim et al., 2016; Mohapatra and Sahoo, 2009)

Islāmic microfinance has also been growing in poor Muslim countries. It is known to be an effective instrument that represents the two industries namely *Islāmic* finance and microfinance (Abdelkader and Salem, 2013). However, in their study, Abdelkader and Salem (2013) also found no significant difference between conventional and *Islāmic* microfinance in terms of efficiency. On the other hand, Ahmed (2002) argued in his paper that *Islāmic* microfinance can provide the needs to the poor people in addition to mitigating the problem of its conventional counterpart. Likewise, Asyraf (2010) also mentioned that *Islāmic* microfinance can be an alternative instrument for poor Muslim people after he found that the conventional microfinance program in Bangladesh did not successfully reduce poverty due to factors such as religious restriction and cost of credit because of interest. After thoroughly investigating previous empirical works and relevant literature, Abdul-Majeed Alaro and Alalubosa (2017) suggested *Islāmic* microfinance as a financial measure in eradicating poverty in Nigeria.

Indeed, several studies have found positive impact of *Islāmic* microfinance especially in improving livelihood and reducing poverty. For instance, Baitul Mal wat Tamwil (BMT) is an *Islāmic* microfinance institution (IMFI) in Indonesia, and many studies have found that it is indeed effectively reducing poverty in that developing country (Adnan and Ajija, 2015; Rokhman, 2014). Quraisy, Abdul Razak, and Alhabshi (2017) stressed that after joining BMT, borrowers have improved in terms of both physical and social well-being. This result shows an effective impact of IMFIs in Indonesia. Asimilar finding is also reported in studies by Bhuiyan et al. (2017), Zahid Mahmood, Abbas, and Fatima (2017), Aslam (2014), and Bhuiyan and Hassan (2013).

Several studies also have found that microfinance is not significantly giving a positive impact to the poor, mainly due to the economic and social problem created by microfinance (Jose and Chacko, 2017; Khan and Sulaiman, 2015; Rooyen, Stewart, and Wet, 2012; Hassan, 2002). Ahmed (1997) as cited by Hassan (2002) found that microfinance will cause perpetual debt for the clients. Empirically, Jose and Chacko (2017) noted that microfinance is unsustainable for the borrowers as it leads to low generating income due to high-interest rate charged by microfinance institutions in India. This situation is when cost of borrowing is higher than the rate of return. In addition, Karlan and Zinman (2009) also found no evidence of increases in borrowers' income and consumption. On top of that, it only increases stress especially among men after joining microfinance program.

Furthermore, many studies looked at microfinance as a strategy for women's empowerment (Rahman et al., 2017; Ringkvist, 2013; Mahmood, 2011; Bali Swain, 2006; Cheston and Kuhn, 2002). Most studies confirmed that gender discrimination is one of the reasons for poverty, especially in developing countries. Thus, it is important to ensure that women are also involved in the development process especially female heads of families. Besides helping women in promoting entrepreneurship skills through training by microfinance institutions, such institutions enable access to financial services (Misnan, Manaf, and Othman, 2015). Nevertheless, studies also found that microfinance is not an appealing poverty alleviation tool especially among women due to its great risk which would eventually lead to losses (Ukanwa, Xiong, and Anderson, 2018). Mahmood (2011) found that women have improved their empowerment after microfinance especially in decision making related to household and health expenses.

However, the impact of microfinance on its borrowers is very much dependent on some determinants. Ahamad (2016) studied the determinants of microfinance performance and concluded that fund size, time length with microfinance, training under the microfinance program, age, education level, and marital status are among the important factors in determining microfinance impact. As found by Saad and Duasa (2010), Ahamad et al. (2016a) and Ahamad (2016) the loan amount is significantly affecting client income and economic performance. Berhane and Gardebroek (2012) and Samer et al. (2015) suggested that loan duration really matters. Lack of training from the microfinance institutions is also said to be the major factor for some women in Pakistan to take out loans but not starting the new business (Mahmood, 2011).

3. METHODOLOGY

This paper is a systematic literature review on microfinance. The scope of this study area is quite limited. This study focuses on Asian countries with major practicing and successful cases of microfinance institutions such as Bangladesh, India, Pakistan, Malaysia, and Indonesia. However, the scope is restricted by past studies which mostly did the research in those countries, mainly Bangladesh. To ensure the validity of the study, the articles chosen are only from reputable journals. Some steps are taken similar to the method adopted by Ahamad et al.(2016b).

Three databases have been used to gather articles. Most articles are from Emerald Management, and some are from Science Direct and Springer Link. There is no specific time period to this study because it aims at identifying the impact of microfinance on borrowers regardless of the time of the study.

Therefore, this present study attempts to provide a comprehensive analysis of the impact of microfinance and *Islāmic* microfinance on its borrowers as well as determinants that could affect the impact level. This study also gives suggestions and recommendations to promote *Islāmic* microfinance for poverty alleviation based on gathered articles which are not only restricted to empirical analysis but also comparative analysis.

4. IMPACT OF MICROFINANCE AND ISLĀMIC MICROFINANCEON BORROWERS

In order to ensure microfinance or *Islāmic* microfinance are indeed reducing poverty and improving the livelihood of the poor, it is important to look at two crucial aspects which are the economic and social well-being of the people. Thus, this section will discuss in detail the impact of microfinance and *Islāmic* microfinance on the borrowers' income, expenditure, consumption, as well as their welfare.

4.1 IMPACT ON INCOME, EXPENDITURE, AND CONSUMPTION

Studies have found that the loans given will improve the borrowers' financial ability. They utilize the funds for investment in business activities. As a result, it will eventually increase their expenditure and consumption because of increased income. This circle also happened in microfinance programs. Poor people may improve their living standards, well-being, and even economic development. The loan from microfinance will also be successful and able to reach poor households if it is developed based on the expenditure and income flows (Cheng and Ahmed, 2014). As stated by Grameen Bank founder Professor Muhammad Yunus in Ahmed (2002), it is a virtuous circle of "low income, credit, investment, more income, more credit, more investment, more income" (32).

Since the Grameen Bank was the first established microfinance institution in Bangladesh, many studies of microfinance focused on this country. For instance, Khandker (2003) found that participants' level of consumption has improved overall, especially on food. Using different methods of multiple regressions, Choudhury et al. (2017) discovered that the microfinance program named Association for Social Advancement (ASA) in Bangladesh has increased the income, expenditure as well as savings of the borrowers.

Furthermore, Hamdan, Othman, and Wan Hussin (2012) made a comparative study by using univariate and multivariate analysis of four microfinance institutions' (MFIs) performance in Selangor, Malaysia, and revealed that all four MFIs have increased the participants' income upon joining the program after 3 years. The Amanah Ikhtiar Malaysia (AIM) program is the most effective one in increasing client income. The effectiveness of AIM was also evidenced in another study done by Tammili et al. (2018), through different methods of multiple regression that again discovered a positive change in client income after receiving microcredit. A similar finding was also revealed in other studies such as Mohapatra and Sahoo (2009) in India, Sayvaya, and Kyophilavong (2015) in Lao PDR. On the other hand, Karlan and Zinman (2009) and Jose and Chacko (2017) found a negative impact of microfinance on borrower's income and consumption in Manila and India, respectively.

As mentioned in the literature, *Islāmic* microfinance has also emerged as the counterpart of conventional microfinance. Many

Islāmic microfinance institutions (IMFIs) have been established to fulfil the need of poor Muslim. However, many questioned the effectiveness of these IMFIs to their clients especially with regard to their external funds and efficiency of their operations (Ahmed, 2002). Nevertheless, a number of studies have found that that *Islāmic* microfinance has positive impact on income, expenditure, and consumption of their borrowers. The most notable case is in Indonesia, which is through Baitul Mal wat Tamwil (BMT). Rokhman (2014) through the simple regression method concluded that income and expenditure of the BMT clients have improved post borrowing. Quraisy et al. (2017)who studied the impact of *Islāmic* microfinance on social well-being and quality of life through BMT, using the simple OLS method, found most of the clients have positively improved their income, food expenses and savings.

Similarly in Pakistan, Aslam (2014) found that Islāmic microfinance has increased $3 of income per capita of their borrowers per day. By adopting the mean difference model (MDM), multiple regression and descriptive statistics methods, Khan and Sulaiman (2015) too proved there is a slight increase in clients' income after joining the IMF program in Pakistan. And they also concluded that conventional microfinance is not beneficial to the extremely poor population. Using a different approach of paired sample t-test in pre and post borrowing, Zahid Mahmood et al. (2017) suggested that borrowing from an IMFI has significantly expanded the expenditure on food and monthly income of the participants.

In the case of Bangladesh, Ahamad et al. (2016a, 2016b) in their study found that the *Islāmic* microfinance program is indeed improving the living standard of poor people. Through their first study, empirically they found Muslim Aid Bangladesh (MAB) has increased borrower income and expenditure. An impressive 94 percent of the respondents agreed that their income has increased after receiving the loan. On top of that, all respondents have improved in their food consumption. Through multiple linear regressions, the authors also found a similar result of the positive improvement in borrowers' income and expenditure. In the latter study, through systematic literature survey, they resolved that the *Islāmic* microfinance program has positive impacts on the borrowers.

A comparative study done by Bhuiyan and Hassan (2013) has confirmed the finding by proving that Islami Bank's clients have increased their operating income more than the Grameen Bank's clients after utilizing the loan. Another study on the Islami Bank's borrowers by Bhuiyan et al. (2017), found that the respective clients indeed have enhanced their operating income-generating activities. Likewise, Rahman and Ahmad (2010) and Uddin (2008) empirically found that Islami Bank microfinance program through the Rural Development Scheme (RDS) increased the participants' income as well as expenditure on food and medication, on average of 33 percent and more than 50 percent, respectively. Jariya (2013) also revealed that IMFIs in Sri Lanka gave positive impact on the clients' income generation.

In addition, microfinance itself was established in order to help poor women to earn income being as head of household to support their family. Microfinance beneficiaries are mostly concentrated on women (Antoh, Kwesi, and Addison, 2015). A study by Acheampong (2018) revealed through the pure gender effect that women are better in using microcredit compared to men for business and entrepreneurial purposes. Some studies also concluded that microfinance definitely can increase the income of these women as clients. As reported by Mahmood (2011), women in Pakistan agreed that they experienced an increase in income after obtaining the loan for their businesses.

4.2 IMPACT ON WELFARE

The existence of microfinance has been part of the financial inclusion system reaching lower level of community and providing financial assistance for them. Not only that, microfinance also benefits poor people in terms of their well-being through better quality living standards, access to proper children education, better health services, good sanitation, pure water as well as raising asset and wealth that could repay the loan. As a result, the borrowers will rise above the poverty line and have a better life. In other words, microfinance has been designed and was expected to give a wider impact on the borrower's welfare.

As mentioned, Choudhury et al. (2017) conducted the study on the Association for Social Advancement (ASA), one of the largest NGOs concerned in the microfinance area. They mentioned that ASA could motivate the rural poor people to enhance their living standards by competing with urban people. In Malaysia, Amanah Ikhtiar Malaysia (AIM) has proved that its customers in rural

Peninsular Malaysia have improved their quality of life after joining AIM programs. They could have a comfortable house and kitchen, access to safe toilet facilities as well as an accessible source of drinking water and light (Al-Mamun, Mohiuddin, and Mariapun, 2014). In the case of Indonesia, Mariyono (2018) focused on farmers given financial assistance by microcredit institutions in order to reach technological adoption. He revealed that farmers achieved better welfare after they obtained access to microcredit and used the fund to finance the technology needed.

Historically, Grameen Bank distributed loans to assist the poor women and successfully enhanced Bangladeshi women's living standards. Kay (2003) stated that the self-help microcredit program achieved its objective to create a better life for poor women. After being given microfinance, women were more empowered to make decisions in children's education, medical services, and other noticeable decision making (Rahman et al., 2017). Different findings were found by Bali Swain (2006). In India, the self-help group Bank linkage program was not effectively empowering women in making decisions. The study found that women still had no power in family planning or in selling and purchasing land. Furthermore, Nigerian women who lived in rural areas believed that microcredit programs would cause a more difficult life for them because their livelihood was only assumed to fulfil basic needs rather than as a potential business. Thus, micro-financing was seen as debt and would be impossible to repay unless they have the ability for repayment (Ukanwa, Xiong, and Anderson, 2018).

Asyraf (2010) promoted *Islāmic* microfinance as a potential institution with the same main objective as the conventional one. Bhuiyan and Hassan (2013) who conducted a study on both microfinance and *Islāmic* microfinance in Bangladesh supported statement by Asyraf (2010). As mentioned before, the Islami Bank microfinance program outperformed Grameen Bank microfinance in terms of client economic improvement. A similar result is also evident with regard to their clients' welfare in term of improving the borrower's livelihood and encouraging their children to obtain an education. The above study has a similar result with Rahman and Ahmad (2010) whereby the effect of the Rural Development Scheme (RSD) in Islami Bank have improved the borrowers' living standard in terms of utilizing higher quality of drinking water, proper sanitation and health awareness. In Pakistan (Aslam, 2014) and Sri

Lanka (Jariya, 2013), *Islāmic* microfinance programs have improved living standards of their customers, developed customer self-confidence and mitigated poverty.

Baitul Mal wat Tamwil (BMT) in Indonesia assists poor people in obtaining a better life and improving well-being (Quraisy et al., 2017). Rokhman (2014) conducted a similar survey study in 13 BMT in Demak, Central Java and had broadened the area in his second study to 20 BMT in Demak and Kudus regencies, Central Java (Rokhman, 2014). Both studies stated that BMT was effective in assisting borrowers to raise educational access for children and business progress of needy people through its financing, but it was not effective in promoting health awareness. In India, through the *Islāmic* Welfare Society (IWS), rural people benefitted the most by having lower cost of utilizing local common resources (LCRs) such as irrigation, water resources, grazing land, and forest(Hassan, 2014). Rahman and Ahmad (2010) also found that the borrowers could have additional assets such as a house, furniture, radio, television, cart, kitchen and so forth after engaging with the *Islāmic* microfinance program in Bangladesh.

5. FACTORS AFFECTING MICROFINANCE IMPACT ON BORROWERS

The current study observed the factors influencing microfinance borrowers. Most of the past studies utilized amount of loan to borrowers, engaging time with microfinance, training given by microfinance, religiosity as well as demographic factors such as borrowers' age, level of education, and so forth as variables contribute to borrowers' welfare, spending and also income.

5.1 LOAN AMOUNT

Hamdan et al. (2012) stated that total micro-funds given by three programs in Malaysia raised business earnings and automatically escalated borrowers' income. The same result is also evident in studies of Saad and Duasa (2010) and Terano et al.(2015) . In contrast, the total loan given to women showed a negatively significant impact because the loan causes stress and pressure to pay back with high interest rates (Ringkvist, 2013).

5.2 LOAN DURATION

People who engage in microfinance for a longer time may have more experiences and are able to use their funds wisely. Hence, they can generate profit from the business (Ahamad, 2016; Ahamad et al., 2016b). Rahman and Ahmad (2010) employed the study on Rural Development Scheme (RDS) in *Islāmic* Bank in Bangladesh. Their study revealed that the length of time of having loans had a positive and significant impact on members' welfare and also could improve income and eliminate the borrowers' poverty as found by Rulindo and Pramanik (2013). Terano et al. (2015) strengthened the result in which their respondents who joined the AIM microcredit program in Malaysia could enhance total income after having loans at a certain time. Nevertheless, Hamdan et al. (2012) found a contrasting finding in terms of the frequency of loans received by borrowers. The borrowers could not increase their income after having the fund.

5.3 TRAINING

Some of the rural poor people are uneducated. Thus, training will be the best way to teach them some knowledge to utilize funds efficiently and improve their business management. Samer et al. (2015) revealed that training would enhance women's business knowledge. Thus, they had the ability to increase their profit and household income. Furthermore, Rahman and Ahmad (2010) stated that lack of training is one of the problems faced by IBBL's customers in Bangladesh. So, they could not upgrade their business skills and knowledge even after joining the RDS program. Sayvaya and Kyophilavong (2015) also found that the Village Development Fund (VDF) program in Lao PDR had a minimum benefit to household income and expenditure due to lack of training provided.

5.4 RELIGIOSITY AND MORALITY

This variable is only applicable in *Islāmic* microfinance studies. Rahmanand Ahmad (2010)found that the clients' welfare depended on their ethics and morals. They did not use the loan for unproductive business if they have the right ethics and morals. Asyraf (2010) also stated that the restriction from religion has a tight correlation with borrowers' living standards and income in Bangladesh. Since conventional microfinance could not reach their goal to reduce poverty, *Islāmic* microfinance was proposed to be a potential scheme that takes into consideration religious factors. This result was proven by Rulindo and Pramanik (2013) in which the spiritual level that customers have might be able to enhance the welfare and higher religiosity also encourage only the best economic activities conducted by customers. They also suggested that the value of *Islāmic* teaching such as hard work and discipline might be a motivation for Muslim people to maximally utilize *Islāmic* microfinance funds. Thus, it could increase their income and enable them to survive under poverty conditions.

5.5 BORROWERAGE

Age is one of the crucial factors in ensuring productivity. Young people may have more ability and motivation rather than the very old ones to reach their target (Uddin, 2008). Furthermore, age may also show experience. The higher age people are, the more experience they have. Mature people will be ready to use the loan from microfinance properly and have greater prosperity (Khanand Usman, 2010). Samer et al. (2015) revealed that in the case of Amanah Ikhtiar Malaysia (AIM), age has positive impact on women borrowers' income and women empowerment (Mahmud, Shah, and Becker, 2012; Ringkvist, 2013) as well as total income (Terano et al., 2015). In *Islāmic* microfinance, borrowers' age could also raise household income in terms of experience (Rahman and Ahmad, 2010; Saad and Duasa, 2010; Choudhury et al., 2017), enhance standard of life (Khan and Usman, 2010) and increase possibility of eliminating poverty (Rulindo and Pramanik, 2013).

In contrast to previous studies, Hamdan et al. (2012) discovered that the age of *Islāmic* microfinance borrower has a negatively significant effect toward Amanah Ikhtiar Malaysia (AIM), Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN), and Lembaga Zakat Selangor (LZS) programs. Mariyono (2018)also stated that the older the farmers, the less possibility to get access to financing and adopt novel agricultural technology. Consequently, the chance to increase welfare will be lost.

5.6 EDUCATION LEVEL

Education is an essential and basic factor needed by the people. Educated people are inclined more easily in partnership and managing funds profitably. This is needed particularly in the rural region (Ahamad, 2016; Uddin, 2008). Education played a key role in increasing microfinance borrowers’ income (Choudhury et al., 2017; Khan and Sulaiman, 2015; Sayvaya and Kyophilavong, 2015). Mariyono (2018) identified education as one of the human capital factors that could facilitate poor farmers to access credit in microfinance. Only then will they attain more prosperity. Khanand Usman (2010) proved that higher education of rural people will reduce poverty in regard to both *Islāmic* microfinance and microfinance cases in Pakistan. Nevertheless, there was a negative significant influence of education on income in Bangladesh after joining the Rural Development Scheme (RDS) provided by Islami Bank Bangladesh Limited (IBBL). This condition might cause a short period of rural poor people’s school (Rahman and Ahmad, 2010). Hamdan et al. (2012) showed the linear result in the case of Amanah Ikhtiar Malaysia (AIM), Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN), and Lembaga Zakat Selangor (LZS) programs in which low education give negative impact on income.

6. ISLĀMIC MICROFINANCE AS A POVERTY ALLEVIATION TOOL

Islāmic microfinance is usually considered as the solution for its counterpart of conventional microfinance. *Islāmic* microfinance is usually being adopted in *Islāmic* countries due to the rejection of conventional practices that involve many prohibited elements. Not only that, conventional microfinance only concerns on sustainability and profitability. Noted that *Islāmic* finance was also seen as a huge success during the global financial crisis, thus people's awareness of *Islāmic* finance has emerged. Honohon (2008) mentioned, as stated by Abdelkader and Salem (2013) in their paper, that about 72 percent of Muslim people in Muslim countries did not use conventional financial services because these services against *Sharīʻah* principles. A study conducted by the Consultative Group to Assist the Poor (CGAP) and International Finance Corporation (IFC) also indicated that a significant percentage of clients preferred *Sharīʻah* compliant institutions (Khaled, 2011).

Even though many studies have found its positive impacts, some studies pointed out that microfinance left out the extremely poor people (Ahmed, 2002; Khan and Sulaiman, 2015). Therefore, *Islāmic* charity instruments such as *zakāh, waqf,* and *sadaqat* can be used as the basis of *Islāmic* microfinance especially to sourcethe funds to provide microfinance services to the poorest (Abdelkader and Salem, 2013; "Models of *Islāmic* Microfinance" 2011; Rahman, 2010; Ahmed, 2002). Tisdell and Ahmad (2018) also stressed on the importance of charity in microfinance to help the poor. In addition, microfinance is also considered as the perpetual debt or debt trap. Due to the high interest, the borrowers usually cannot enhance their income and develop the business (Hadisumarto and Ismail, 2010; Rahman, 2010; Hassan, 2002). Targeting women as the recipient will also create frustrations and tensions. This is because, while women obtain the loan, usually men are the ones who used the funds and spend it for consumption instead of doing business. Hence, under *Islāmic* microfinance, its target group would be the family. Thus, it may reduce the asymmetric information problem arising in conventional microfinance(Ahmed, 2002; Rahman, 2010).

Besides, various kinds of financing mode in *Islāmic* finance principles can be used to finance different activities, for example, *muḍārabah, mushārakah*, *ijārah* and *murābaḥah* (Saad, 2012; "Models of *Islāmic* Microfinance" 2011; Rahman, 2010; Ahmed, 2002). On top of that, Jariya (2013)and Rahman (2010) mentioned that the partnership model can diversify the risk between the borrowers and IMFIs, unlike the conventional financial institutions. Therefore, various modes can be explored under *Islāmic* finance as the instruments in IMFI operations. Noticeably, Saad(2012) has proposed a suitable mode of *Islāmic* financing for different activities involving AIM's clients.

Section 4 has discussed the effectiveness of most IMFIs especially in giving positive impacts to their clients, economically as well as social well-being. As already stated, Asyraf (2010) also suggested *Islāmic* microfinance as an alternative after finding that conventional MFIs in Bangladesh did not successfully reduce poverty. Similarly in Nigeria, Abdul-Majeed Alaro and Alalubosa (2017) also see the potential of *Islāmic* microfinance in inducing financial inclusion for most Nigerians. In Malaysia, Saad (2012) and Saad and Duasa (2010) revealed about 97 percent of clients under AIM are overwhelmingly interested in *Islāmic* financial products. Besides, evidence has proven IMFIs have outperformed their conventional counterparts (Ahmed, 2002).

BMT in Indonesia is one of the best examples of the successful IMFIs that could enhance most of the businesses run by their clients. Thus, Hadisumarto and Ismail (2010) listed 4 criteria that can be learned from BMT including selection process, business control, incentive system and construct good relationship (cooperative). According to them, for the selection process, it is important to include credibility (*akhlāq*/honesty) beside any other characteristics such as business skills and business worthiness. On top of that, it is also crucial to ensure having a capable business partner who is *Amanah* to maintain the principle of justice. Through the *murābaḥah* or *bai' bithaman ajil* and *ijārah* financing, it can reduce the probability of misuse of capital for other purposes beside business. This is because the capital received is in the form of a product, not the fund. Hence, business control can be done by monitoring a business's progress by visiting the business location. Giving incentives due to good repayment performance will also encourage the clients to improve their businesses. The last one is establishing good relationships with the clients either in the forms of religious activities or assistance. So, all these four criteria are important to ensure that clients are improving their businesses beside the IMFIs ensuring lower non-performing financing (NPF) or to have a higher rate of repayment to maintain effectiveness of financing.

Islāmic microfinance is yet to reach its scale compared to its counterpart. Some recommendations given are by Khaled (2011) that made a full theoretical paper on building a business model for *Islāmic* microfinance especially focuses on three outreach conditions (breadth, depth, and length). According to Ahmed (2002), IMFIs largely depend on the availability of external funds and operational efficiency to ensure their sustainability and growth. *Islāmic* microfinance is having a problem with limited external funds or financing resources (Khaled, 2011; Ahmed, 2002). Therefore, IMFIs may follow the criteria listed earlier by Hadisumarto and Ismail (2010) to ensure operational efficiency, and to adopt the *Islāmic* charity instruments to overcome the problem of external fund availability. Hence, government intervention in this said program is very important so that it will effectively impact on poverty eradication.

Poverty alleviation is not only related to economic aspect, but also moral and social aspects. *Islāmic* finance similarly aims to achieve *Maqāṣid al-sharīʻah* which promotes social justice and welfare. Therefore, *Islāmic* microfinance that promotes the *Islāmic* moral vision such as cooperation, honesty, patience, *Amanah*, diligence, and justice may achieve poverty reduction, especially in Muslim society. Similarly, Tisdell and Ahmad (2018) expressed the importance of ethics in microfinance. As suggested by Rahman (2010), the ethical principle of *Islāmic* finance is very important to be adopted by *Islāmic* microfinance through socio-economic policies to deal with poverty eradication. In addition, Rulindo and Pramanik (2013) found that spiritual and religious enhancement program is needed to boost the positive impacts from *Islāmic* microfinance. Thus, this is in line with Naqvi (1994) who developed four basic doctrines of *Islāmic* ethical system which are unity *(tawḥīd),* equilibrium *(al-adl wa'l-Ihsan),* free-will *(ikhtiyar)* and responsibility *(fard).*

7. CONCLUSION

In developing countries, microfinance has evolved as a development tool. It has not only improved the living standard of the poor but also has contributed to the emergence of micro-enterprises in the low-income region. As this study, from the systematic literature review, it is found that microfinance indeed has an impressive positive impact on most of the borrowers in terms of both economic development and social well-being. Even though microfinance is a tool that can help to reduce poverty, many studies have expressed concern on the extremely poor population who always been neglected. Thus, this is where *Islāmic* finance plays an important role to overcome this problem.

Microfinance and *Islāmic* finance cannot be separated if the enhancement of social welfare is the ultimate aim. Some studies have stressed on the ethics that need to be supplemented in microfinance. Besides, various modes and structures of *Islāmic* microfinance also have proven their ability to deal with different activities and level of poverty, including extreme poverty. Thus, this will eventually provide a foundation for microfinance institution sustainability. Nevertheless, the presence of *Islāmic* microfinance which has a huge potential market still cannot be compared to the conventional. Most of the *Islāmic* microfinance institutions only concentrated in a few countries. Therefore, this study also suggests *Islāmic* microfinance to be used as an alternative to improve the living standards of poor people in all developing countries regardless of their state of religion.

On top of that, the poverty eradication effort has become the clarion call after the United Nations introduced 17 Sustainable Development Goals (SDGs) in 2015 to be achieved by 2030. Some key initiatives and transformations are needed in many poor Muslim countries. Many studies revealed that in an effort to achieve SDGs, *Islāmic* finance could be a great potential contribution to materialize them. Through *Islāmic* microfinance, several SDGs can be achieved specially to combat poverty, enhance health care, and education, improve clean water and sanitation availability, and reduce gender inequality in many poor Muslim countries. Therefore, *Islāmic* microfinance would become an impactful measure through many innovative products and instruments in achieving those SDGs.

Even though it sounds not that plausible for poor Muslim countries to adopt *Islāmic* microfinance in a short time due to a lack of expertise, financial and other resources, it would be possible with strong political commitment and immediate and ambitious actions.

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