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ISSUES FACING ISLAMIC MICROFINANCE AND THEIR POSSIBLE SOLUTIONS: EMPIRICAL EVIDENCE FROM AMANAH IKHTIAR MALAYSIA¹

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Abstract

Microfinance has become a widely accepted tool for poverty alleviation and being included in the national development agenda in many countries throughout the globe. It has served as an effective method to improve financial inclusion by increasing the access to finance to specific groups of the society who are often being marginalized by the mainstream finance, especially women micro-entrepreneurs and the poor. Despite this, microfinance continues to face various issues and challenges that hinder its effective functioning, resulting in many microfinance institutions (MFIs) to operate at sub-optimal level, thus fail to achieve their objectives. This study attempts to discern the issues and challenges facing the Islamic MFIs by focusing on the experience of Amanah Ikhtiar Malaysia (AIM), one of the world's largest Islamic MFIs, and subsequently propose possible solutions to address those issues. In methodology, the study conducts a survey questionnaire regarding potential issues and challenges of Islamic microfinance on 402 women micro-entrepreneurs who are currently clients of several AIM centres in Hulu Selangor. In efforts to get enriching insights, we further relate those issues with the demographic profile of the clients. Findings of this study provide new insights into the issues and challenges facing the women micro-entrepreneurs based on their direct experiences, and consequently relevant suggestions can be provided in addressing these issues facing the clients of the Islamic microfinance industry.

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Key words: Islamic finance, Islamic microfinance, Amanah Ikhtiar Malaysia, demographic background, social capital

1.0 Introduction

The focus on financial inclusion is highly relevant and crucial as income inequality remains a concern despite the rapid economic growth in many countries. In Malaysia, for example, the Gini coefficient which decreased only marginally from 0.44 in 2009 to 0.43 in 2012 and 0.40 in 2014, and in fact, it has never reached below 0.4 since 1980s, despite the various programs to improve the socio-economic status of the bottom 40% of the households (B40). To realize the vision of balanced and equitable growth, the socio-economic well-being of the low income group, particularly the B40 needs to be given priority. An excellent method to reduce poverty is through microfinance which has been proven to be an effective tool to alleviate poverty by providing accessibility to credit to those who are excluded from formal financial institutions, or also known as the "unbankables".

Currently, microfinance is a flourishing industry. With total loans granted standing at USD81.5 billion and number of clients at more than one hundred million globally in 2012², microfinance is contributing substantially to financial inclusion. Approximately 90% of the clients came from the poorest families living mainly in Asian countries³. Coupled with the expected increase of the population in the future, it is extremely important to ensure sustainability of the microfinance institutions (MFIs) so that the real objectives of their establishment, namely achieving a just and equitable economic growth can be achieved.

Despite its encouraging development and bright prospects, the microfinance industry is still facing various issues and challenges.

² Convergences Barometers, Microfinance Barometer 2014, accessed March 7, 2017 <http://www.citigroup.com/citi/microfinance/data/lebarometre.pdf>.

³ N. Fernando, "Managing Microfinance Risks: Some Observations and Suggestions", *Asian Journal of Agriculture and Development* 4(2), (2008), 1-22

Among the issues include capability of financial management, capability of risk management, diversified and unique characteristics of clients, reputation and trusts among customers and managerial team, wide regional and geographical gap, and familiarity with Information Technology (IT) and digital payment network⁴. The issue of sustainability of the MFI has commonly being highlighted in many studies, which critically depending on the sources of funds⁵, as well as the need to be more innovative in the effort of funds sourcing⁶. Additionally, internal factors such as lack of capital and innovation in marketing banking products, shortage of sources of funding, incapable employees, and outdated technologies are also being identified as issues and challenges facing the MFIs, while external issues include stiff competition with other MFIs, low level of public trusts, lack of networking and cooperation among other financial institutions, and weak supervision and guidance from the relevant authority⁷.

This study aims to explore the issues and challenges faced by the micro-entrepreneurs of different demographic background who are clients of AIM. An area of novelty offered by this study is by exploring the possible influence of socio-demographic factors on the specific issues of microfinance, an area which is currently lacking in the existing literature. Findings of this study would contribute towards further improving the microfinance products that are tailor-made to the socio-demographic characteristics of their clients in efforts to ensure the effectiveness of the microfinance program. In

⁴ M. N. Hosen & L. S. Sa'roni, "Determinant Factors of the Successful of Baitul Maal Wat Tamwil", *International Journal of Academic Research in Economics and Management Sciences* 1(4), (2012), 2226–3624

⁵ P. Wulandari & S. Kassim, "Issues and Challenges in Financing the Poor: Case of Baitul Maal Wa Tamwil in Indonesia", *International Journal of Bank Marketing* 34(2), (2015), 216–234

⁶ M. Asmy, M. O. Mohammed & M. A. Abdullah, "Developing Cash Waqf Model as an Alternative Source of Financing for Micro-enterprises in Malaysia" *Journal of Islamic Accounting and Business Research* 7(4), (2016), 254–267

⁷ Hamzah, Z. Rusby & Z. Hamzah, "Analysis Problem of Baitul Maal Wat Tamwil (BMT) Operation in Pekanbaru Indonesia Using Analytical Network Process (ANP) Approach", *International Journal of Academic Research in Business and Social Sciences* 3(8), (2013), 215–229

achieving this objective, the study analyses the influence of socio-demographic factors, namely age, education level, duration with AIM, and times of receiving financing on the following issues: cost of repayment, financing period, amount of financing, distance to AIM center, group lending mechanism, discipline among members, problematic group members, and consultation services, on the issues and challenges in the Islamic microfinance.

2. Development of Microfinance in Malaysia

The microfinance programme in Malaysia started with 'Project Ikhtiar', which was launched in 1985, at the instigation of the Science University of Malaysia (Universiti Sains Malaysia) and supported by the government. The programme sought to achieve several objectives, including to serve as a platform in elevating the economic condition of the poor by providing them with small loans as seed capital to enable them to embark in entrepreneurial activities. There are mainly four MFIs in Malaysia, namely Amanah Ikhtiar Malaysia (AIM), Yayasan Usaha Maju (YUM), Economic Fund for National Entrepreneurs Group (TEKUN) and People's Credit Cooperation (KKR). AIM, YUM and TEKUN are fully subsidized by the government to help cater for the financial needs of the poor throughout Malaysia, while the KKR is particularly to cater for the poor in Sabah.

Since then, continuous efforts have been undertaken to enhance the sustainability and market outreach of the MFIs. In recent years, budget allocations for the MFIs were further increased. For example, TEKUN received a higher budget allocation of RM300 million in 2012 compared with only RM120 million in 2011; while for AIM, continuous increases in budget allocations has resulted in its funds to reach RM2.7 billion in 2018⁸. In addition, a 100% stamp duty exemption had been given to loan agreements of up to RM50,000 that are grouped under microfinance schemes in order to reduce operational cost of microenterprises. In the Financial Sector Blueprint (2011-2020) issued by Bank Negara Malaysia, efforts are

⁸ Datuk Seri Najib Abdul Razak. "2018 Budget: RM2 Million for Amanah Ikhtiar Malaysia", *New Straits Times*, 27 October 2017.

being outlined for the financial institutions to reinforce the government's initiatives for an inclusive financial system through, among others, Islamic financial inclusion and microcredit⁹. The World Bank has crowned Malaysia the top place within 183 countries in terms of "Getting Credit" to recognize its effort in improving access to financing to especially to the lower income group¹⁰.

Consequently, there is ample availability of funds for the lower income group to tap from. At end-2009, the outstanding credit facilities amounting to RM2.4 billion were distributed to 449,703 micro-finance borrowers in Malaysia through the formal channel of financial system and government agencies¹¹. Realizing the key economic role played by SMEs operating in Malaysia, in 2006, a sustainable micro-finance framework known as *Pembiayaan Mikro* was approved by the National SME Development to support the development of micro-enterprises through an improved access to the formal financial system as prior to that, the industry relies heavily on government agencies in serving the poor and the informal financing system¹².

There are significant improvements of the micro-finance industry at the instigation of the new framework which includes easy application procedures, minimal documentation and prompt approval and disbursement of funds with no requirement of collateral in consideration of the unique financing nature of micro enterprises¹³. To ensure a better financial inclusion among the entrepreneurs, numerous efforts were implemented to promote the *Pembiayaan Mikro* like the process of creating and showcasing the product logos at premises which offer the services, advertising the product to the

⁹ R. A. Rahman A. Al Smady S. Kazemian, "Sustainability of Islamic Microfinance Institutions through Community Development", *International Business Research* 8(6), (2015), 196–207

¹⁰ Bank Negara Malaysia (BNM). *Financial Stability and Payment Systems Report 2009: Malaysia's Microfinance Framework*. Bank Negara Malaysia, accessed March 3, 2017 at http://www.bnm.gov.my/files/publication/fsps/en/2009/cp01_003_whitebox.pdf.

¹¹ Ibid

¹² Ibid

¹³ Ibid

general public through mass-media and the distribution of flyers to over 397,000 micro-enterprises¹⁴.

The implementation of the project is proven fruitful as the initial number of participating financial institution increased to ten, consisting of three development financial institutions, namely Agrobank, Bank Rakyat and Bank Simpanan Nasional and a total of 7 banking institutions, which are Alliance Bank, AmBank, CIMB Bank, Public Bank, Maybank and United Overseas Bank and Bank Muamalat¹⁵.

Table 1: Source of Financing for Low Income Group in Malaysia

Types of Fund Providers	Examples of Institutions	Sources of Funding
Development Financial Institutions	<ul style="list-style-type: none"> ● Agrobank ● Bank Simpanan Nasional 	Government grant, equity capital, deposits, commercial funds
Cooperatives	<ul style="list-style-type: none"> ● Bank Rakyat ● Koperasi Muslim ● Malaysian Limited Military Cooperation ● Koperasi Permodalan Felda Berhad ● Koperasi Kebangsaan Permodalan Tanah Berhad 	Banking, Building Rental, Investment, Sales of Community Product, Insurance agents etc.
Banking Institutions	<ul style="list-style-type: none"> ● Alliance Bank ● AmBank ● CIMB Bank ● Public Bank ● Maybank ● United Overseas Bank ● Bank Muamalat 	Deposits, equity capital, commercial funds

¹⁴ Ibid

¹⁵ Bank Negara Malaysia (BNM), "Questions and Answers on Pembiayaan Mikro and Micro Enterprise Fund", Bank Negara Malaysia, (2014), accessed on March 20, 2017 at http://www.bnm.gov.my/documents/sme/FAQ_on_Pembiayaan_Mikro_English.pdf.

Types of Fund Providers	Examples of Institutions	Sources of Funding
Government Agencies	<ul style="list-style-type: none"> • AIM • YUM (specialized for Sabah) • TEKUN Nasional 	Government grant, soft loans, and commercial activities

Source: Adapted from Bank Negara Malaysia (Industry, 2007)

3. Issues and Challenges in Islamic Microfinance

3.1 Ethical Issues, Mission Drift and Commercialisation

In terms of the objectives of the Islamic MFIs, there seems to be a conflict of priorities whereby most of them seek to achieve both the social mission - by way of distributing zakat, alms and *infaq* and the economic mission - through the distribution of financial loans. This sort of priority dilemma then leads to a mission drift in the Islamic MFIs. Mission drift could simply be understood as a result in the deviation of the genuine mission of poverty eradication through microfinance.

As an example, AIM has undergone a mission breakdown for a seven-year period starting from 1992 until 1999 when the funds were abused to attract political supporters¹⁶. The existing members of top management were removed and replaced by new ones which have vested political motives. There were reports of loans leakages along with the introduction of two new loans schemes namely “Skim Pinjaman Nelayan” (SPIN) and “Skim Khas Ibu Tunggal” (SKIT)¹⁷. A huge amount of loans were uncollectible since the borrowers could not afford to repay the loans. This later resulted in the highest non-loan repayment in the institution’s history. It took the AIM many efforts since 2004 to restore trust from the public, and following these efforts, currently, AIM is one the most outstanding MFIs in the world.

Further ethical problem is commercialization which is also

¹⁶ S. Kasim, Financing South East Asia’s Economic Development. Institute of South East Asian Studies, (2000).

¹⁷ Ibid

caused by mission drift. According to a study by Cinca and Nieto¹⁸, commercialization becomes a major ethical problem in MFI especially in conventional microfinance. It arises because of donor uncertainty and high transaction cost in MFI due to lack of economies of scale. Commercialization is deemed as the best way to sustain MFI to cover its expenditures. It is argued that even though MFI is established to fulfill social obligations, it must also be conducted in a commercialized way to get profits. Following this, high financing amount is imposed to cover the transactional costs incurred. This situation is contradictory to one of AIM's mission to provide opportunities to the poor segments of the population and microenterprises to participate in income generating economic activities, thereby equalizing opportunities and reducing inequalities¹⁹. In a study conducted by Mokhtar (2012)²⁰, it was discovered that a group lending design imposed by AIM had good loan repayment performance as compared with the individual lending designs used by YUM and TEKUN. However, this study found that the higher repayment rate recorded by AIM is contributed by other group members who have run out of options but to pay off the loan on behalf of the defaulters.

Peer pressure which is inherent in the group lending mechanism since all members in a particular group will not be able to obtain a new loan should there be a default from any of the group members, thus inducing loan repayment. It can be concluded that the high repayment rates achieved by the AIM are not merely due to the commitment of all members but rather the obligation of the rest of group members in the group to repay the loan if other members failed to make the repayment.

¹⁸ C. S. Cinca & B. G. Nieto, "Microfinance, the Long Tail and Mission Drift", *International Business Review*. 23(1), (2014), 181-194

¹⁹ Amanah Ikhtiar Malaysia "The Role of Microfinance in Poverty Alleviation: AIM's Experience", *International Islamic Accounting and Finance Conference*, (2012).

²⁰ S. H. Mokhtar, G. Nartea & C. Gan, "The Malaysian Microfinance System and a Comparison with the Grameen Bank (Bangladesh) and Bank Perkreditan Rakyat (BPR-Indonesia)", *Journal of Arts and Humanities* 1(3), (2012), 60

3.2 Legal Restriction from Deposit-taking Activities

The Malaysia Banking and Financial Act 1989 which states “*No person shall carry on banking receiving deposits on current account, deposit account, savings account or no other similar account, without a license as a bank or financial institutions*”²¹ has resulted in the dearth of wide-ranging financial services in Malaysian microfinance institutions, unlike that of diversified products offered by Grameen Bank in Bangladesh and Bank Perkreditan Rakyat (BPR) in Indonesia²².

In essence, the Malaysian MFIs are allowed to only offer microcredit loans, while Grameen Bank for example does not only offer microcredit loans as its core products, but also offers micro-insurance, micro savings and pension funds to its clients. This is in view of higher climatic change faced by the borrowers, Grameen is protecting both itself and the borrowers by providing micro-insurance. In particular, micro-insurance holds a few advantages when disaster strikes because it helps reduce the burden shouldered by the borrowers and simultaneously save its own financial accounts from bearing losses caused by uncollectible loans²³.

MFIs in other countries have also put emphasis on the importance of micro-savings. In Indonesia for example, the Bank Nagari-BPRs which is located in West Sumatra obligates its customers to put some savings even as low as 1,000 Rp (less than USD1) in the BPR before they can borrow money. In addition, the borrowers are only eligible to apply for additional financing that does not exceed their total savings in the bank.

However as stated in the legal clause above, Malaysian MFIs are legally restricted from taking any deposits as such power is only granted to the banking institutions. Since the financial products

²¹ McGuire PB, Conroy JD, & Thapa, G.B. Getting the framework right: Policy and regulation for microfinance in Asian, (1998), accessed on March 22, 2017 at <http://dev.bwtp.org/wp-content/knowledgecentre/books/Getting-the-Framework-Right.pdf>.

²² Ibid

²³ Ibid

offered by AIM are only limited to credit facilities, AIM cannot grow to its fullest potential as in other countries like Bangladesh and Indonesia which have ventured into deposit-taking, pension fund and micro-insurance, hence enabling them to get involved in investment activities as well.

3.3 Sustainability of Sources of Funds

In Indonesia, a commercial bank called Bank Nagari has set up several BPRs (Bank Perkreditan Rakyat) in many districts and villages. The management of these micro-credit divisions is separated from the management of the bank itself. Initially, Bank Nagari provided capital and management support to BPRs which gradually started hiring qualified local people as workers. Apart from obtaining capital from the Bank Nagari, the village folks enjoy dividends from the profits generated by the BPR annually²⁴. This situation depicted a financial self-sufficiency within the MFIs in Indonesia which in turn make them independent of the government's subsidies, thus become financially sustainable.

On the other hand, the Malaysian legal restrictions on the MFIs have resulted in the sole dependency on the government subsidies because these institutions are bounded by the law and are unable to generate income on their own. According to a study by Siwar and Talib (2001)²⁵, the Malaysian government considers subsidised microcredit programmes in Malaysia as part of social cost it needs to bear. The programme is a favourite project of the government as it can be used as a tool to attract political supporters, especially those in financial needs²⁶.

3.4 Inflexibility in Loan Schemes

Compared to the Malaysian MFIs, MFIs in Bangladesh and Indonesia are found to be more flexible in terms of loan repayment modes, duration, amount, grace periods and interest rates which are charged

²⁴ Bank Nagari, Bank Perkreditan Rakyat's operation reports. Padang: Bank Nagari Sumatra Barat, Indonesia, (2009).

²⁵ C. Siwar & B. A. Talib, "Micro-Finance Capacity Assessment for Poverty Alleviation: Outreach, Viability and Sustainability", *Humanomics* 17(1), (2001), 116-133

²⁶ Ibid

accordingly to borrowers. In the practice of the Grameen Bank, different loan contracts are imposed on different groups of borrowers in consideration of the nature of the borrowers' businesses and their affordability²⁷. As an example, borrowers whose business activities are involved in dairy farming are permitted to pay their loans to the Grameen Bank according to the milking cycle²⁸. Islam (2007) in his studies concluded that loan repayments are made based on the cash flow cycles of the borrowers' businesses. All the flexibilities inherent in these loan schemes could help to ease the burden for borrowers and some of the practices should clearly be emulated in Malaysia as well. In the case of Malaysia, most of the microfinance providers such as AIM and YUM collect loan installments on a weekly basis irrespective of the types of business run by the borrowers and their revenue cycles. The grace period granted by both institutions is between one to two weeks²⁹ only.

3.5 Segregation of Islamic MFIs from Mainstream Banking and the Need for a Centralised Supervision

Islamic microfinance in Malaysia lags behind those in Indonesia and Bangladesh due to the fact that in Malaysia such facilities are usually provided by specialised institutions such as non-government organisations, and not by Islamic banks, despite the compatibility between the objectives of microfinance and the broader objectives of Islamic banking³⁰. AIM is one such government agency where it complements the objectives of the government in redressing poverty.

For the industry to give its full impact for the betterment of the society, Islamic microfinance should be integrated into a country's mainstream banking and financial system. This will in turn help to create greater awareness of products, encourage product innovation to avoid stagnancy in the industry, improve access to microfinance to better serve its purpose by strengthening the distribution channels, standardise regulation and to improve

²⁷ Ibid

²⁸ M. Yunus, *Creating a world without poverty: Social business and the future of capitalism*. (New York: Public Affairs, 2007).

²⁹ Ibid

³⁰ B. K. Grewal, "Constraints on Growth in Islamic Finance", IFSB 4th Lecture on Financial Policy and Stability, (2011).

transparency³¹. In order to achieve all these objectives, there is a need to establish an association to manage Islamic MFIs to be self-sustainable, hence reducing their dependency towards donor funding, especially from government grants. Being a self-sustained organisation would enable the MFIs to be stronger competitors against the big commercial group of financing service providers³².

4. Methodology

In efforts to gain insights into issues relating to MFI from the perspective of the clients, this research adopts quantitative methodology where data is collected via survey based on closed-ended questionnaires distributed among 402 women micro-entrepreneurs under AIM at several centers of the Hulu Selangor branch. Simple descriptive, cross-tabulation, and ANOVA analyses are conducted to observe the issues and challenges encountered by the micro-entrepreneurs based on their various demographic background. Detail analysis of the results is presented in next section. For the demographic question, it was computed using a nominal scale as typically conducted in other studies. For questions on the clients' view on the issues that they are facing, responses are provided based on a five-point Likert type scale, ranking as 1 (strongly disagree), 2 (disagree), 3 (neutral), 4 (agree), 5 (strongly agree). Respondents then would choose a point on the scale reflecting his or her position towards the statement. Extant literatures have been used to extract the constructs and the items. All the constructs and items were adapted and modified to suit the purpose of this study. Of the 402 questionnaires distributed, 380 could be used for this analysis, representing a response rate of 94.5%.

5. Results and Analysis

5.1 Profile of respondents

The first part of the analysis involves understanding the

³¹ Ibid

³² R. A. Rahman, A. Al Smady & S. Kazemian, "Sustainability of Islamic Microfinance Institutions through Community Development", *International Business Research*, 8(6), (2015), 196–207

socio-demographic background of the respondents. Of the women micro-entrepreneurs surveyed, majority of them are above 40 years old (about 67.2%), with the age group of more than 50 years old being the largest group at 34.4%. While a significant number of the respondents are married (about 84%), there are also those who are single (4.8%) and those who are single parent (11.5%), either due to death of spouse or divorce. In terms of education level, majority of the respondents have secondary level education (about 73%), and a few having certificates and diplomas (17%). It is important to note that 7.1% or 28 clients are having only primary school level of education.

In terms of employment, majority of the respondents are in the self-employed category, of which 80.7% (or 317 respondents) rely on AIM funds as capital. In terms of duration being clients of AIM, the largest group is the more than three-years group with 197 respondents (or 50.6%), with generally, majority of the respondents have been clients of AIM at least more than a year (87.4%) compared to less than a year (only 12.6%). More than 50% of the respondents have been receiving loans for more than three times (220 respondents or 56%), and only 15% or 59 respondents received the loans for the first time. This indicates that majority of the clients are repeat clients of AIM.

Table 2: Background of Respondents

Demographic Information		Frequency	Percentage (%)
Age	20 years old and below	4	1.0
	21-29 years old	24	6.1
	30-39 years old	101	25.7
	40-49 years old	129	32.8
	Above 50 years old	135	34.4
Marital Status	Single	19	4.8
	Married	329	83.7
	Single parent	45	11.5
Level of	Primary School	28	7.1

Demographic Information		Frequency	Percentage (%)
Education	Secondary	286	72.8
	Certificate	28	7.1
	Diploma	39	9.9
	Degree	11	2.8
	Others	1	0.3
Occupation	Permanent (government sector)	3	0.8
	Permanent (private sector)	9	2.3
	Self-employed (own capital)	64	16.3
	Self-employed (AIM capital)	224	57.0
	Permanent government and self-employed (AIM)	13	3.3
	Permanent private and self-employed (AIM)	14	3.6
	Self-employed (own and AIM capital)	66	16.8
Duration with AIM	< 1 year	49	12.6
	1-2 years	70	18.0
	2-3 years	73	18.8
	>3years	197	50.6
	No answer	4	-
Times receiving AIM financing	1 time	59	15.0
	2 times	49	12.5
	3 times	65	16.5
	>3 times	<u>220</u>	<u>56.0</u>
Total Respondents		380	

5.2 Issues and challenges facing AIM women micro-entrepreneurs

Table 3 below highlights the responses of 380 AIM clients regarding their views on the issues and challenges facing them. All major scale items are based on a five-point Likert-scale ranging from strongly disagree (1) to strongly agree (5). Possible issues and challenges are listed, mainly based on the literature as well as researchers' observation during the pilot study conducted before the full-scale

survey was done. There are 11 items being presented to the respondents as indicated in Table 3.

Of the 11 items presented to the respondents, item number 11 on “*Services provided by AIM require further improvements*” showed the highest mean responses at 3.55, suggesting that majority of the respondents identified that service quality of the MFI as the main concern of the clients. In particular, a total of 67.4% of the total respondents agreed that the service quality of the microfinance providers needed to be improved further. The next item with high mean responses (3.06) is item number nine “*Financing taken are used for pressing/urgent needs*”, with 38.2% of the respondents agreed with the statement, while 19.1% are unsure, and 36.7% disagreed. This indicates a high possibility of moral hazard on the side of the women micro-entrepreneurs on the loans taken. Another item that has high mean responses (3.04) is item number 6 “*Problematic group member(s) in repayment of financing*” with 44% of the respondents agree to the statement, 13% are unsure, and 43% disagreed. The remaining of the survey items have mean responses of less than 3, with item number 4 “*Far distance centers resulting in high cost of travelling*” has the lowest mean responses (2.3 and 73% of the respondents do not agree with the statement); followed by item number 1 “*High and burdensome cost of repayment*” and number 10 “*Unsure of the Shari’ah-compliance of the AIM financing products*” with means responses of 2.4. Specifically, 67% of the respondents stated their disagreement to item number 1 and 65.4% to item number 10.

Table 3: Issues and Challengers Experienced by Woman Micro-entrepreneurs

No	Statements	Level of Agreement (%)					Mean	Standard deviation
		1	2	3	4	5		
1.	High and burdensome cost of repayment	15.3	51.7	14.2	16.8	2.0	2.39	1.00
2.	Very short repayment period	10.2	53.9	13.7	19.3	2.8	2.51	1.00
3.	Inadequate amount of financing	10.7	56.5	13.5	17.8	1.5	2.43	0.95
4.	Far distance centers resulting in high cost of travelling	17.8	55.2	10.9	14.5	1.5	2.27	0.97

No	Statements	Level of Agreement (%)					Mean	Standard deviation
		1	2	3	4	5		
5.	Ineffective group lending mechanism	12.7	47.6	14.2	22.6	2.8	2.55	1.06
6.	Problematic group member(s) in repayment of financing	10.7	32.3	13.0	30.5	13.5	3.04	1.26
7.	Low discipline among group members	7.1	35.6	16.0	34.1	7.1	2.98	1.13
8.	Absence of financial consultation service	8.4	42.2	22.4	23.2	3.8	2.72	1.03
9.	Financing taken are used for pressing/urgent needs	7.4	29.3	19.1	38.2	6.1	3.06	1.10
10.	Unsure of the <i>Shari'ah</i> -compliance of the AIM financing products	14.8	50.6	17.0	14.8	2.8	2.40	1.00
11.	Services provided by AIM require further improvements	5.6	16.5	10.4	52.4	15.0	3.55	1.10

Note: 1=strongly disagree, 2=disagree, 3=Unsure, 4=agree, and 5=strongly agree

5.3 Do Demographic Factors Affect Perception on Issues and Challenges?

In efforts to gain more detailed information about the issues and challenges facing the microfinance clients, we probe further into the relationship between the issues and demographic variables. For this purpose, the chi-square (χ^2) analysis is applied to test if there are significant differences in the responses to the issues by the different demographic group. The results of the analysis are reported in Tables 4-14.

As shown in Table 4, on the perception regarding burdensome cost of repayments, results from the chi-square analysis show that there are significance differences in the responses of respondents with different status as head of family and having different duration with AIM. The chi-square statistics showed significant values at the 5% level for duration with AIM and 10% for head of family. This finding suggests that respondents who have been clients of AIM for longer duration perceive the cost of borrowing from AIM differently compared to those who are new clients. Similarly, clients who have

greater responsibility as the head of family showed greater concern with the costs of borrowing, thus perceive this issue as significant compared to those who are not the head of family.

Table 4: Relationship between Demographic Factors and Cost of Repayment

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	19.478	16	0.245
2.	Level of education	10.094	20	0.966
3.	Marital status	3.029	8	0.933
4.	Head of family	8.567*	4	0.073
5.	Type of job	21.275	24	0.622
6.	Monthly income	16.050	12	0.189
7.	Duration with AIM	25.148**	12	0.014
8.	Financing amount	27.420	20	0.124

Note: * and ** denote significance at 10% and 5% levels, respectively.

When the issue of repayment period is related to specific demographic factors, we find that different age group, duration with AIM, and financing amount responded to this issue differently (Table 5). The chi-square statistics for these three demographic factors are shown to be significant. Clients who are younger, having lesser duration with AIM and taking greater financing amount perceive the issue of repayment period as burdensome for them as borrowers.

Table 5: Relationship between Demographic Factors and Repayment Period

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	30.441**	16	0.016
2.	Level of education	25.371	20	0.188
3.	Marital status	3.619	8	0.890

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
4.	Head of family	1.735	4	0.784
5.	Type of job	24.301	24	0.444
6.	Monthly income	10.469	12	0.575
7.	Duration with AIM	28.694***	12	0.004
8.	Financing amount	29.574*	20	0.077

Note: *, ** and *** denote significance at 10%, 5% and 1% levels, respectively.

Next, we test the relationship between demographic factors and the issue of amount of financing, and found that demographic factors of age group, duration with AIM, and financing amount responded differently to this issue (Table 6). Again, the chi-square statistics for these three demographic factors are shown to be having significant relationship with the issue of amount of financing. In particular, microfinance clients who are younger, having lesser duration with AIM and having the need for greater financing amount perceive the issue of insufficient amount of financing as an important issue and burdensome for them as borrowers.

Table 6: Relationship between Demographic Factors and Amount of Financing

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	23.662*	16	0.097
2.	Level of education	12.362	20	0.903
3.	Marital status	4.940	8	0.764
4.	Head of family	1.682	4	0.794
5.	Type of job	30.509	24	0.168
6.	Monthly income	10.469	12	0.575
7.	Duration with AIM	25.225**	12	0.014
8.	Financing amount	29.205	20	0.084

Note: * and ** denote significance at 10% and 5% levels, respectively.

With regards to the issue of distance to the meeting centers, two demographic factors are shown to be having different impact on the clients' perception on the issue of high cost incurred due to far distance to meeting centers. Clients with different level of monthly income and financing amount responded differently to this issue (Table 7), with the chi-square statistics for these two demographic factors are shown to be having significant relationship with the issue of distance from AIM centers. The results imply that microfinance clients who are having lower level of monthly income and taking smaller amount of financing are concerned with the cost incurred due to distance compared to those otherwise.

Table 7: Relationship between Demographic Factors and Distance to AIM Centers

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	13.444	16	0.640
2.	Level of education	16.631	20	0.677
3.	Marital status	4.189	8	0.840
4.	Head of family	5.767	4	0.217
5.	Type of job	30.800	24	0.160
6.	Monthly income	20.945*	12	0.051
7.	Duration with AIM	18.099	12	0.113
8.	Financing amount	39.953**	20	0.005

Note: * and ** denote significance at 10% and 5% levels, respectively.

We also tested the relationship between the various demographic factors against the group lending mechanism that is practiced by AIM (Table 8). The results showed that none of the clients responded differently, regardless of their different demographic characteristics. Relating to the earlier results, clients of AIM are all agree that the group lending mechanism is effective and feel satisfied with this mechanism of lending.

Table 8: Relationship between Demographic Factors and Group Lending Mechanism

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	14.488	16	0.562
2.	Level of education	23.009	20	0.288
3.	Marital status	4.935	8	0.765
4.	Head of family	2.553	4	0.635
5.	Type of job	16.602	24	0.865
6.	Monthly income	14.533	12	0.268
7.	Duration with AIM	6.834	12	0.868
8.	Financing amount	24.556	20	0.219

Note: * and ** denote significance at 10% and 5% levels, respectively.

When the demographic factors are tested with the issue of problematic group members (Table 9), those who are taking large amount of financing responded differently compared to those taking smaller amount of financing, as reflected by the significant chi-square statistics between amount of financing taken and the concern of problematic group members. In the context of AIM, while the group members are responsible for each other's commitment, thus repayment, each of the group members are entitled for different amount of financing, depending on their eligibility and track records. Consequently, the perception of problematic group members as an issue would naturally depends very much on the amount of lending made to each members of the group.

Table 9: Relationship between Demographic Factors and Problematic Payment among Group Members

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	19.055	16	0.266

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
2.	Level of education	9.879	20	0.970
3.	Marital status	6.530	8	0.588
4.	Head of family	2.039	4	0.729
5.	Type of job	23.970	24	0.463
6.	Monthly income	9.496	12	0.660
7.	Duration with AIM	14.381	12	0.277
8.	Financing amount	37.339**	20	0.011

Note: ** denotes significance at 5% level.

We also tested the relationship between the various demographic factors and the concern regarding low discipline among the group members (Table 10). The results showed that none of the clients responded differently, regardless of their different demographic characteristics. Relating to the earlier results, clients of AIM are not concern of the discipline among their members since what actually matters is that they make regular repayment as stipulated by the schedule of payment.

Table 10: Relationship between Demographic Factors and Group Members' Low Discipline

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	21.205	16	0.171
2.	Level of education	18.848	20	0.532
3.	Marital status	5.317	8	0.723
4.	Head of family	3.284	4	0.512
5.	Type of job	22.931	24	0.524
6.	Monthly income	9.547	12	0.656
7.	Duration with AIM	7.218	12	0.843
8.	Financing amount	24.186	20	0.234

Note: * and ** denote significance at 10% and 5% levels, respectively.

There seems to be a concern of absence of advisory services especially among the clients with different educational level (Table 11). The significant chi-square statistics for the level of education and the absence of advisory services could reflect that the clients are concern that advisory services are needed especially for clients with lower education level.

Table 11: Relationship between Demographic Factors and Absence of Advisory Services

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	16.709	16	0.405
2.	Level of education	34.189**	20	0.025
3.	Marital status	3.023	8	0.933
4.	Head of family	5.497	4	0.240
5.	Type of job	24.799	24	0.417
6.	Monthly income	12.111	12	0.437
7.	Duration with AIM	15.298	12	0.226
8.	Financing amount	16.933	20	0.657

Note: * and ** denote significance at 10% and 5% levels, respectively.

Clients of different age group and those with different status as head of family perceived the issue of misused of funds (not for business purposes) as a major issue in Islamic microfinance (Table 12). The chi-square statistics for these two demographic factors are shown to be having significant relationship with the issue of misuse of loan or moral hazard issue among the microfinance clients. In particular, microfinance clients who are younger, and having greater responsibility as the head of family perceive the issue of misuse of funds borrowed as a major issue and could likely happen if not mitigated.

Table 12: Relationship between Demographic Factors and Misuse of Loan

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	26.457**	16	0.048
2.	Level of education	27.982	20	0.110

3.	Marital status	13.332	8	0.101
4.	Head of family	13.787***	4	0.008
5.	Type of job	27.564	24	0.279
6.	Monthly income	10.725	12	0.553
7.	Duration with AIM	8.330	12	0.759
8.	Financing amount	20.164	20	0.448

Note: *** and ** denote significance at 1% and 5% levels, respectively.

Next, we test the relationship between demographic factors and the issue of *Shari'ah* compliancy of AIM's financing products (Table 13). The chi-square statistics for financing amount is shown to be having significant relationship with the issue of doubts about *Shari'ah* compliancy of AIM products. In this regard, clients taking bigger financing amount have different perception about the issue of *Shari'ah* compliancy compared to those taking smaller amount of financing.

Table 13: Relationship between Demographic Factors and Doubts about *Shari'ah*-Compliance

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	18.838	16	0.277
2.	Level of education	18.022	20	0.586
3.	Marital status	3.949	8	0.862
4.	Head of family	4.552	4	0.336
5.	Type of job	21.446	24	0.612
6.	Monthly income	8.613	12	0.736
7.	Duration with AIM	15.678	12	0.206
8.	Financing amount	32.223**	20	0.041

Note: ** denotes significance at the 5% level.

Lastly, we tested the relationship between the various demographic factors against the services quality of the MFI (Table 14). The results showed that none of the clients responded differently, regardless of their different demographic characteristics, as reflected by the insignificant chi-square statistics for all the demographic variables. Relating to the earlier results, clients of AIM are all

agreeable that service quality is an important issue to be tackled in the microfinance program.

Table 14: Relationship between Demographic Factors and Service Quality

No.	Demographic Variables	Pearson Chi-square	Degrees of Freedom	Significance Value
1.	Age group	21.448	16	0.162
2.	Level of education	14.765	20	0.790
3.	Marital status	5.103	8	0.747
4.	Head of family	7.460	4	0.113
5.	Type of job	17.260	24	0.837
6.	Monthly income	6.826	12	0.869
7.	Duration with AIM	10.602	12	0.563
8.	Financing amount	24.792	20	0.210

Note: * and ** denote significance at 10% and 5% levels, respectively.

6. Conclusion and Recommendations

With the objective of identifying the issues and challenges facing the micro-finance clients, the study found that the issue of service quality is of utmost concern to the respondents, followed by the issue of possibility of moral hazard among the group members. Interestingly, the findings show no concern among the respondents regarding the financing product itself such as cost of repayment and repayment period. In this regard, while the financing offered by AIM is well received by its clients, further refinement is needed in terms of the services being offered and the risk mitigation mechanism to control the possibility of non-repayment by the group members. Most of the respondents are having issues with the group lending mechanism where concerns are highlighted about members' discipline and repayment of financing which is unfair for the other members. Since the group cooperation system that is practiced requires all members to be responsible towards each other especially for financing repayment, in case of any of the members do not pay their weekly financing installment, the other members need to pay the installment of their behalf. This basically would bring issue of mistrust and dissatisfaction towards the system for the members that become

victims caused by others' irresponsibility.

When the issues are related to the socio-demographic background, the study finds that clients with different demographic background perceive the issues differently. In particular, clients with different age group, duration with AIM, level of family responsibility, and taking different amount of financing would have different perception about the issues highlighted. This finding concurs well with the earlier result that the clients have not raised any issue regarding the product of AIM, but rather their concern is mainly on the financial discipline of the borrowers. Consequently, in moving forward, the study suggests that the clients to be given the prerogative to select their own group members so that the level of mistrust among the group can be reduced substantially. Clients would normally be comfortable with the people of their own kind, as it would be easier for them to cooperate and help each other in good time as well as bad times.

The study clearly highlighted that it is important for the MFIs to recognize the diversified and unique characteristics of their clients in ensuring a successful microfinance program. It is also important for the MFIs to recognize the importance of social capital in building a successful group lending system. In this regard, building the trusts, care and mutual responsibility among the group members are highly important, as the group members are acting as collateral for each other. MFIs should be innovative and creative in building social capital among the group members, with clear responsibility to select the group members to be given to the members themselves. Additionally, in the era of internet technology, it is also suggested that AIM to enhance its cooperation system by utilizing technology to manage human and payment system in order to further improve their products offering and to be able to mitigate risk better.

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AL-SHAJARAH

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