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Review Essay

Islamic Microfinance and Poverty Alleviation in Indonesia: A Systematic Review of the Evidence

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Abstract

Many scholars have discussed how Islamic microfinance works to eradicate poverty. However, detailed studies reviewing the literature related to this topic in Indonesia are lacking. Using a systematic method to review, analyze, and synthesize the literature, this study highlights how IMFIs play their role in alleviating poverty in Indonesia. Seven databases of Emerald Management, Science Direct, Google Scholar (English keywords), Google Scholar (Indonesian keywords), ProQuest, Scopus, and Academic Search Complete were used to gather articles published from early January 2016 to the end of 2020. From the data collected, it is found that the number of published articles with the theme "Islamic Microfinance Institutions and poverty alleviation" decreased beginning in 2019, with most of the research consisting of case studies in West Java using qualitative research methods. The impact felt by the community through the implementation of these programmes includes increasing societal welfare and reducing the number of poor micro and small entrepreneurs. This perceived influence has economic, social, and spiritual benefits that can help Indonesia's economic and social growth. This review is expected to contribute to the evidence supporting poverty alleviation through Islamic microfinance in Indonesia. This becomes important in determining the direction of development and improvement of policies related to the problem.

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Keywords

Islamic microfinance, poverty alleviation, literature review.

Background

By mobilizing money for the poorest in the informal economy, Indonesia has the potential to be the greatest example of Islamic microfinance. The economic sectors such as charity (*infāq* and *ṣadaqah*) and compulsory Islamic taxation (*zakāh)* are typically used to assist the poorest communities. Islamic microfinance has a lot of promise for relieving poverty in Indonesia, but it is not without concerns and difficulties. For example, institutional functions incur considerable costs to preserve financial viability. The screening procedure, which involves collateral, might also prove challenging for the impoverished. Furthermore, the situation of a poor borrower defaulting in Baitul Maal Wat Tamwil (BMT), for example, becomes a concern that this institution must address.

Many researchers have discussed the strengths and weaknesses of Islamic microfinance, identified problems encountered, and provided possible solutions. Nevertheless, studies on the literature related to how Islamic microfinance institutions (IMFIs) can play their role in alleviating poverty are lacking. There seems to be a literary gap regarding this problem, and challenges remain, including what strategies have and need to be carried out, what policy support can be provided, and why the strategies and policies need to be carried out. Thus, this review aims to highlight the literature on how IMFIs play their role in alleviating poverty in Indonesia.

Literature Review

Introduction

Poverty is a major obstacle to economic growth, particularly in emerging economies like Indonesia. To minimize poverty and economic disparity, the government can promote policies that benefit the poor (pro-poor). Microfinance institutions are one type of capital provider that can offer underprivileged people access to financing.[1] Microfinance needs a creative strategy that goes beyond the function of typical financial

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[1] Wook Sohn and Laila Ume, "Impact of Microfinance on Poverty Alleviation: A Global Analysis," *Journal of Economics and Development Studies* 7, no. 2 (2019): 82–102, doi:10.15640/jeds.v7n2a6.

intermediaries. Building human capacity through social intermediation and establishing group-based lending programmes, among other things, has shown to be a successful technique. It also promotes improved information flow between lenders and borrowers, resulting in fewer adverse selections and moral hazards in the lending market.

The Islamic financial system can provide a variety of schemes and tools that may be created and used for microfinance objectives.[2] The *qarḍ ḥasan*, *murābaḥah*, and *ijārah* programmes are generally simple to administer and will ensure capital needs and equipment for prospective micro-enterprises and the underprivileged. Participatory schemes like *muḍārabah* and *mushārakah* have a lot of promise since they address the risk-sharing demands of micro-entrepreneurs. On the other hand, this strategy necessitates specialized expertise in controlling the risks inherent in the contract structure.

The integration of the *waqf*-Islamic microfinance model is possible for alleviating poverty. Borrowers should also be given education and training.[3] When combined with loan services, educational activities may empower customers by assisting them in developing essential entrepreneurial knowledge and business skills.[4]

Internalizing Islamic spiritual beliefs into IMFIs is critical for the growth of microfinance providers and their consumers. One strategy that aids in edifying employees and clients is value-based education and training.[5] IMFIs should be able to contribute to poverty reduction and create opportunities for the community and society's economic, social, and spiritual growth.[6]

In Indonesia, I Gde Kajeng Baskara explained that MFIs spread from urban to rural areas on the initiative of the government, private

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[2] Abul Hassan, "The Challenge in Poverty Alleviation: Role of Islamic Microfinance and Social Capital," *Humanomics* 30, no. 1 (2014): 76–90, doi:10.1108/H-10-2013-0068.

[3] Mohamed Aslam Haneef et al., "Integration of Waqf-Islamic Microfinance Model for Poverty Reduction: The Case of Bangladesh," *International Journal of Islamic and Middle Eastern Finance and Management* 8, no. 2 (2015): 246–70, doi:10.1108/IMEFM-03-2014-0029.

[4] Rizali Hadi et al., "Education and Microfinance: An Alternative Approach to the Empowerment of the Poor People in Indonesia," *SpringerPlus* 4, no. 1 (2015), doi:10.1186/s40064-015-0995-6.

[5] Siti Nabiha Abdul Khalid and Sheirijah Sheikh Kamaruddin, "A Social Performance Management Framework for Islamic Microfinance Institutions," *The Journal of Muamalat and Islamic Finance Research* 16, no. 1 (2019): 53–69.

[6] I Gde Kajeng Baskara, "Lembaga Keuangan Mikro Di Indonesia," *Buletin Studi Ekonomi* 18, no. 2 (2013): 114–25.

sector, and non-governmental organizations (NGOs) in their formal or informal forms.[7] To be effective, the role of BMT as an Islamic microfinance institution in Indonesia, for example, requires many stage-specific structures and duties. There is a specific need to divide the functions of the financial institutions so that *qarḍ ḥasan* may focus on providing funding to the people at the "Bottom of Pyramide (BOP)."

BMT, as an Islamic microfinance institution, has improved the household incomes of micro-entrepreneurs as well as the income of their micro-businesses. Most BMTs in Indonesia are in a competitive condition of the financial industry that state their position for survival only. In other words, the choice of position is vulnerable to business turmoil, as it only survives. The commercial microfinance service competition in Indonesia occurs not only because of the awareness of the empowerment element inherent in its mission but also because of its promising business potential.

In Indonesia, there has been a commercialization of the microfinance sector. Therefore, BMTs that carry out the purpose of economic empowerment of people should focus on role selection and self-transformation. The transformation is accomplished by shifting the organization's function and position to one of two options: commercial or social, supported by excellent corporate governance.[8] Strategic cooperation between Islamic banks and BMTs is not just intended to address the issue of financial inclusion, as the contractual arrangement remains the primary relationship.[9]

Additionally, trust and transfer of knowledge are positively influenced by coordination, agreement, interdependence, and social capital.[10] Furthermore, Wahyudi asserts that commitment contributes positively to achieving an alliance's financial goals.[11] Coordination and initial agreement have a positive and significant influence on forming commitments from BMT and trust from Islamic banks.

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[7] Ibid.

[8] Uus Ahmad Husaeni and Tini Kusmayati Dew, "The Dynamics of the Development of Baitul Maal Wa Tamwil in Indonesia with the Swot Analysis Approach," *International Journal of Scientific and Technology Research* 8, no. 8 (2019): 1678–85.

[9] Triani Fitriasari and Zuliani Dalimunthe, "The Effectiveness of Linkage Programs: Case Study of BMTs in Indonesia," *International Journal of Business and Society* 20, no. S1 (2019): 210–20.

[10] Imam Wahyudi, "Commitment and Trust in Achieving Financial Goals of Strategic Alliance: Case in Islamic Microfinance," *International Journal of Islamic and Middle Eastern Finance and Management* 7, no. 4 (2014): 421–42, doi:10.1108/IMEFM-10-2013-0113.

[11] Ibid.

Credit defaults and collateral become issues when lending finance to the poor.[12] If they cannot return the funds they receive, charity and required Islamic taxes (*zakāh*, *infāq*, and *ṣadaqah*) will be critical in compensating for the financial default. Furthermore, as part of the risk management side of this organization, religious capacity building is a requirement.

Microfinance and Poverty Alleviation

Advocates argue that the microfinance movement has helped eliminate poverty, enhance education, and create or grow millions of small enterprises. Microfinance is a viable option for microentrepreneurs who are ineligible for commercial bank loans or are otherwise unbankable. The most well-known of these was Grameen in Bangladesh, established in 1976 and following a major famine in 1974.

The Grameen model believes that the poor's expertise is exploited. Microfinance offers a lending alternative because they have been identified as uncreditworthy by the traditional banking system. Loans are made available because "people should not go to banks, but banks should go to people."[13]

Comparison between Conventional Banks, Microfinance Institutions, and Islamic Microfinance Institutions

Microfinance Institutions (MFIs) are banks for the vulnerable, whereas commercial banks are for profit.[14] MFIs are either governmental organizations or non-profitable NGOs founded to offer much-needed financing to the underprivileged. Unlike traditional banks, which bring consumers to them, microfinance institutions (MFIs) go to the people to provide financial services. They also feature a pick-up option for financing with a small nominal sum and an annual payback plan that is weekly or monthly.

Scholars and practitioners have mostly disregarded issues related to Islamic microfinance until recently. Microloans for groups act as

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[12] Permata Wulandari and Salina Kassim, "Issues and Challenges in Financing the Poor: Case of Baitul Maal Wa Tamwil in Indonesia," *International Journal of Bank Marketing* 34, no. 2 (2016): 216–34, doi:10.1108/IJBM-01-2015-0007.

[13] De Aghion and Morduch Rahim Abdul Rahman, "Islamic Microfinance: An Ethical Alternative to Poverty Alleviation," *Humanomics* 26, no. 4 (2010): 284–95, doi:10.1108/08288661011090884.

[14] Habib Ahmed, "Financing Microenterprises: An Analytical Study of Islamic Microfinance Institutions," *Islamic Economic Studies* 9, no. 2 (2002): 27–64.

social collateral and help mitigate the asymmetric information problem in financial intermediation. MFIs' unique working model is ideal for the vulnerable, who cannot borrow from traditional commercial banks due to a lack of physical collateral. While the fundamental framework of IMFIs is identical to that of their conventional counterparts, it contains several differences.

Apart from the fact that they are interest-free, IMFIs differ from regular MFIs in several significant respects, summarized in several points.[15] On the liability side, international donors, the government, and the central bank are the primary sources of traditional MFI money. *Waqf*s and other kinds of philanthropy may also provide funds to IMFIs.

Due to their diverse operations, the assets of conventional MFIs are mostly interest-based debt. Financial capital cannot expect a return on its own under Islamic finance, and the transaction must contain a genuine item or object. Apart from interest-free loans (*qarḍ ḥasan*), Islamic finance may be divided into two categories: partnership (*shirkah*) and trading contracts (*mu'āwaḍāt*). The focus of a partnership might be for profit or output sharing. A price-delayed or object-deferred sale is an example of postponed trading. The IMFI finances the project, while the client manages it, according to the *muḍārabah* idea. The *mushārakah* principle may be used to promote both agricultural and non-agricultural production. In commerce, the IMFI and the customer can fund the purchase and sale of such items equally and split the profits. *Murābaḥah* and *ijārah* forms of financing can also be used in manufacturing. In trading, profit-sharing agreements and deferred trading contracts can be used. Both the mark-up and leasing principles can be implemented in transport services. For example, if a client wants to buy a rickshaw, the IMFI will purchase it and sell it to the client at a mark-up.

Zakāh is one of Islam's five pillars, and it is mandatory for all wealthy Muslims. To enhance engagement in the development of the poor, *zakāh* and other types of voluntary philanthropy can be employed. It can be given to the impoverished as a gift or a *qarḍ ḥasan*, and it can be utilized for both consumption and investment. Integrating *zakāh* with microfinance would not only help the poor, but it will also ensure that the funds are returned to the IMFI.

For various funds (group and emergency funds), conventional MFIs exclude a portion of the principal. This is not allowed in Islamic financing techniques. As a result, the beneficiary's effective interest rate to the MFI increases. After the money has been earned, it is easy for the

[15] Ibid.

recipient to divert it to non-productive uses. The group's assurance to refund the funds back to the IMFIs, which takes the form of a *kafālah*, makes the group members the guarantors for repayment in the context of group dynamics. Members of the group may agree to help one another if one of them cannot make a payment.

Although women represent the majority of Islamic MFI recipients, the reasons for their selection are extremely varied. IMFIs target women because they are more convenient and effective. It is considered that imparting Islamic ideals to women is more suited to spreading these values to other household members (especially children). IMFIs look for persons with an Islamic perspective and a desire to work for the benefit of the needy for work incentives of staff members. Employees, as such, work not merely to make a living but also to fulfil a religious commitment. Furthermore, when dealing with arrears and defaults, traditional MFIs rely on community and centre pressure to manage them. When this fails, threats are frequently made, and in severe cases, properties are sold. The Islamic idea that not repaying debts is immoral is frequently used to drive people.

Method

A systematic review was used to examine, assess, and synthesize the literature on the function of IMFIs in poverty alleviation in Indonesia. Emerald Management, Science Direct, and Google Scholar were utilized to collect papers. This research spanned six years, from January 2015 to the end of 2020. The initial phase in this investigation was to collect as many articles as possible. A broad taxonomy was used to collect items.

Results and Discussion

Description of the Articles Used in the Research

The search process from seven databases with three types of combination of keywords, namely: 1) “Islamic microfinance” and “poverty alleviation in Indonesia” via Google Scholar, Emerald, ProQuest, Scopus, and Academic Search Complete; 2) “Islamic Microfinance Institutions” and “poverty in Indonesia” via Google Scholar; 3) “Islamic Microfinance and Poverty Alleviation in Indonesia” via Science Direct 2016-2020.

The total search found 112 articles which were screened in three stages: 1) Relevance to the theme “Islamic microfinance institutions and poverty alleviation in Indonesia”; 2) Affordability of access to articles; and 3) Similarity or inequality of articles between databases.

From the three screening stages, the following data were found:

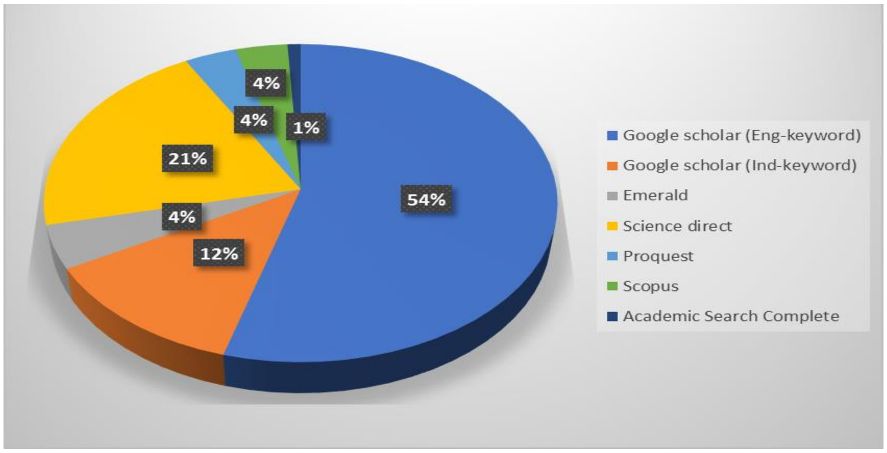

Figure 1: Articles found by databases

From figure 1, it can be seen that the majority of articles came from the Google Scholar database with the English keyword (54%), followed by articles from Science Direct (21%) and articles from Google Scholar with the Indonesian keyword (12%). Articles from the Scopus, Emerald, and ProQuest databases had the same percentage, namely 4% of the total articles, and articles from Academic Search Complete had the lowest number (1%).

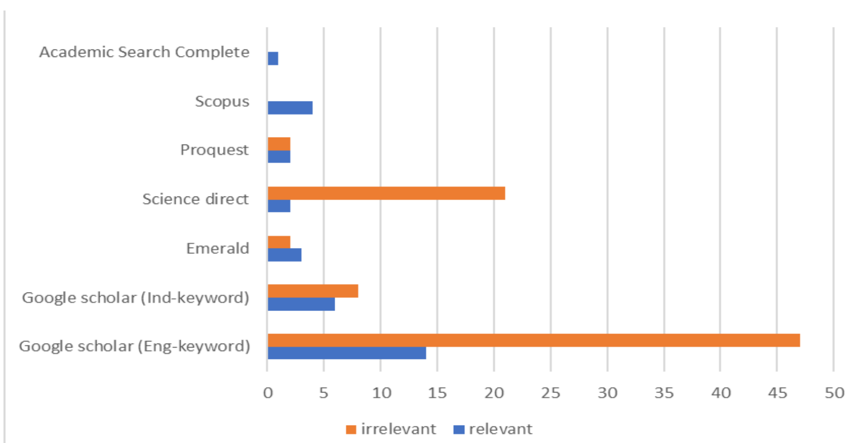

Figure 2: Data based on article relevance

From figure 2, it can be seen that, after the screening process, it was found that only articles from ProQuest were irrelevant. On the other hand, all Scopus and Academic Search Complete articles were relevant. The articles from Google Scholar (English keyword), Google Scholar (Indonesian keyword), Science Direct, and Emerald had the percentage of relevant articles of 23%, 43%, 8%, and 60%, respectively. From this data, most of the relevant articles used in this study came from Google Scholar (English keyword).

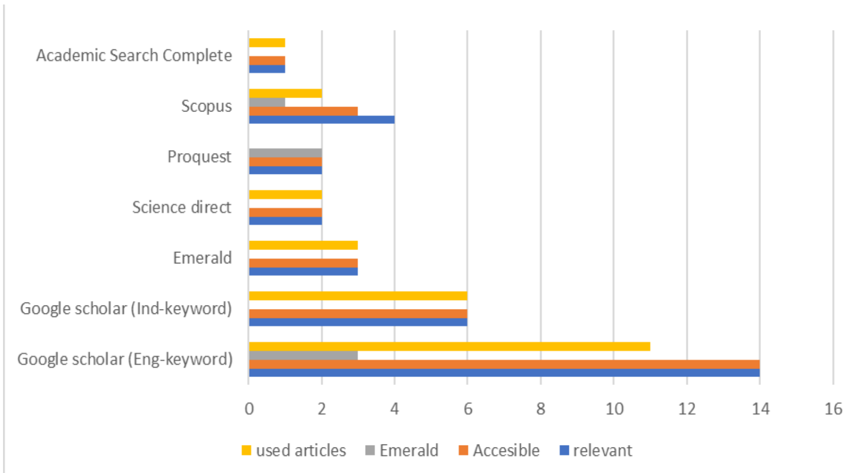

Figure 3: Relevance of data for used articles

Figure 3 depicts the relevant articles used in this study, totalling 25. This number was reached after several stages of the screening process, namely articles that were relevant, accessible, and not found in other databases. The existing data shows that most articles used came from Google Scholar (English keyword).

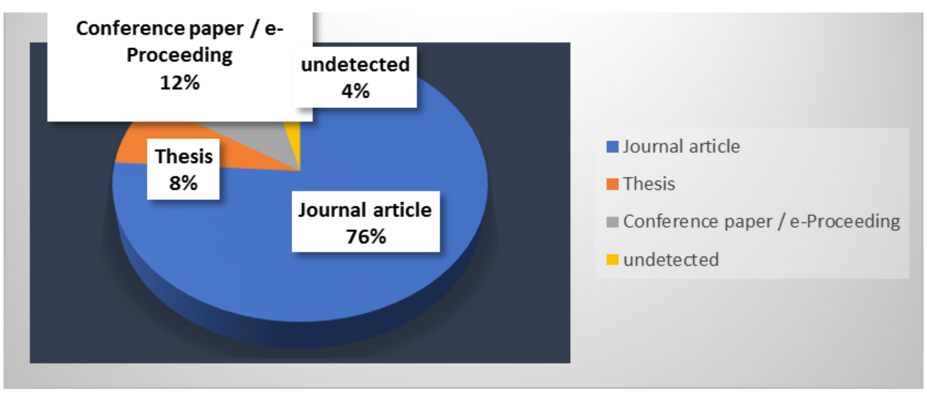

Figure 4: Diagram of articles based on the type

Figure 4 presents articles based on their type divided into four categories: journal articles, conference papers/e-proceedings, final student works in the form of theses, and undetected articles. From the data, it can be seen that more than 70% of the articles were journal articles (76%), followed by conference papers/e-proceedings (12%), theses (8%), and articles that were not detected (not included in the other three categories) which was 4% of the total articles.

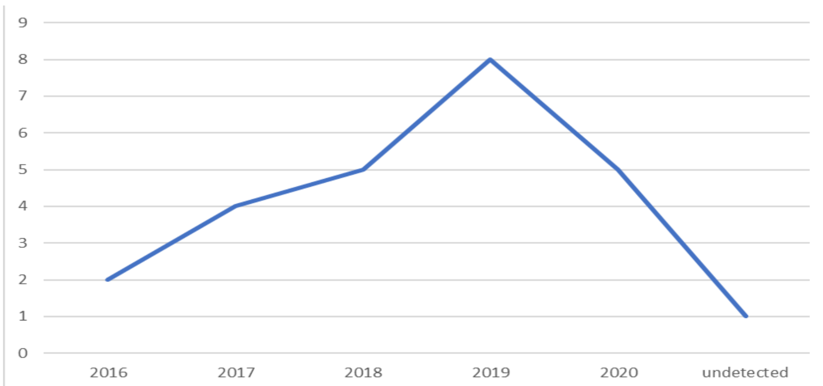

Figure 5: Article data based on year of publication

Figure 5 depicts a graph of the articles by year of publication. The data shows that the number of published articles increased from 2016 to 2019, from two articles in 2016 to eight in 2019. However, in 2019 - 2020, the number of articles decreased drastically by 37 % of the total number of articles in 2020.

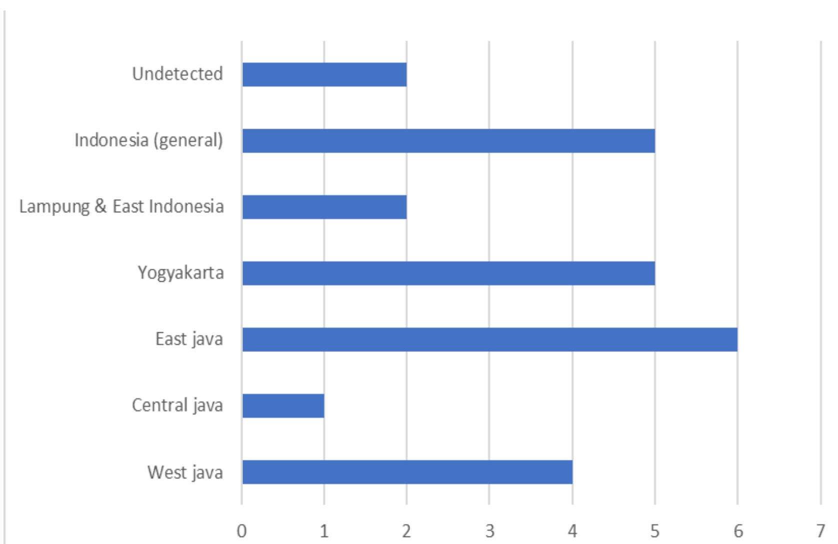

Figure 6: Article data based on research location

Figure 6 describes the article data based on the research location, which includes five regions in Indonesia, Indonesia in general, and undetected locations. From the data, it can be seen that most research was in East Java, namely 6 studies. On the other hand, the least research was in Central Java with only 1 study. Research in Yogyakarta and Indonesia in general and research outside Java (Lampung & East Indonesia) and undetected locations had the same number, namely 5 and 2, respectively. Interestingly, research in West Java also had a relatively large number of 16% of the total existing research. From this data, it becomes evident that the number of studies on the role of IMFIs in alleviating poverty in Indonesia is minimal and needs to be improved to produce more valid and relevant research results.

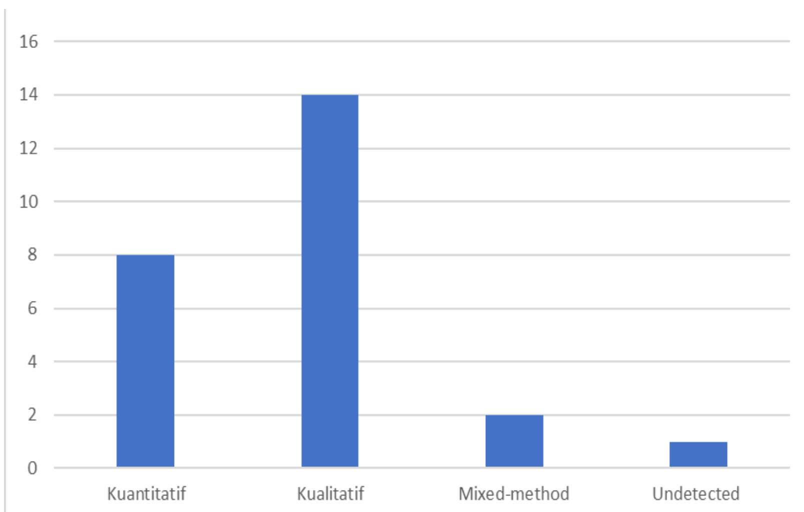

Figure 7: Article data based on the research method used

Figure 7 shows article data based on the research method used, including quantitative, qualitative, mixed-method, and undetected methods. The existing data shows that more than half of the total articles used qualitative research methods. On the other hand, only two studies used a mixed method. The research that used quantitative methods was 32% of the total research. For the remaining categories, 1 study used undetectable research methods. From this data, mixed-method research needs to be improved to get more comprehensive research results, including quantitative and qualitative analysis.

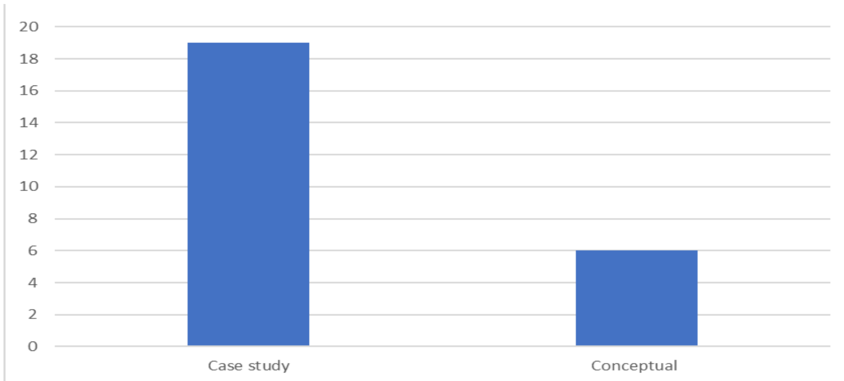

Figure 8: Article data based on the type

Article data based on the type of research includes case and conceptual studies and can be seen in figure 8. From the available data, it can be seen that 19 articles were in the form of case studies while the remaining 6 articles were conceptual studies. Moreover, conceptual studies related to IMFIs and poverty alleviation in Indonesia are minimal and need to be improved.

Programmes Implemented by IMFIs and Their Impact on Poverty Alleviation

The main programmes implemented by IMFIs in the context of poverty alleviation in Indonesia are financing which can be categorized into several schemes:

1. *Qarḍ ḥasan* financing for the benefit of education, health, and economy (meeting the needs) of its members
2. *Mustaḥiqq zakāh*-based micro-business capital financing
3. Micro, Small, and Medium Enterprises (MSMEs) financing
4. Financing with a joint-liability scheme

Some of the programmes implemented by IMFIs have had an impact on the community, including

1. Reducing customer poverty, including in the form of a) Increasing the welfare of members, especially those with financial limitations; b) Alleviating debts owed by customers to loan sharks; c) Economic empowerment of poor women; d) Increased income of the rural population
2. Impacting poverty alleviation for micro and small entrepreneurs, marked by a decrease in the number of poor micro and small entrepreneurs, increased capabilities, bargaining power, and independence of micro and small business actors
3. Generating benefit in economic, social, and spiritual terms

4. Assisting Indonesia's economic and social growth, with a favourable influence on financial inclusion and poverty reduction.

The poverty alleviation programme described above is also supported in its implementation by several additional companion programmes, namely multifunctional assistance for businesses run by financing customers. Social empowerment and fraternal relationships between client partners and IMFIs are also built to increase religious capacity, which can be used as part of the risk management of the IMFIs. Islamic ethical values are also instilled in IMFIs' activities through mentoring, training, and recitation forums. In social finance activities, collection management, client management, financial and accounting management, and utilization management are carried out to make the existing programmes successful.

Findings Based on Empirical Studies

Based on the data collected from existing articles, there are several findings, including:

1. Equity-based financing leads to debt-based financing in terms of performance.
2. Evaluation of *sharīʿah* compliance indicates that the customer receives financing according to the provisions of the Indonesian National Sharia Board.
3. Age, sex, and income influence the marginal population's access to finance from IMFIs, with older individuals with higher income having the best access to finance from IMFIs.
4. Male customers prefer to access finance from IMFIs more than female customers do.
5. In practice, guarantees are used in IMFIs as an appropriate tool for the poor as collateral for various sorts of lending. If there is no assurance, prospective customers must choose joint-liability financing. If poor customers cannot repay their financing money, *zakāh, infāq*, charity, and *waqf* funds can play a crucial role in covering the risk of default.
6. "Religious capacity building" is used as part of risk management.
7. The ICMI (Indonesian Muslim Intellectuals Association), *Sharīʿah* Economic Community Organizations, NGOs, and Local Governments are four types of organizations that play an essential role in developing BMTs in Indonesia.
8. From the results of the evaluation of internal and external factors, it is found that the strength of IMFIs, namely their segmentation of MSMEs, is supported by the high initiation of local communities. The weaknesses of IMFIs are human resources and the high cost of entrepreneurship training, followed by the high cost of registering business legality. On the other hand, IMFIs have high opportunities

with increased flexibility in the economic sector accompanied by an increased public desire to use *sharīʿah*-based transactions as an alternative to conventional transactions. Even so, IMFIs face challenges, namely high competition with other IMFIs, regulatory support, and weak IMFI legality. A joint commitment between stakeholders such as legal power holders, academics, and practitioners is needed to support the development of IMFIs as part of the Islamic finance industry.

9. IMFIs are expected to be an alternative form of integrating commercial and social objectives to increase financial inclusiveness.
10. Transparency and trust affect the interest in providing cash *waqf*s in Islamic financial institutions.
11. BMT's preference for female clients is motivated by realistic economic reasons, particularly the concept of independent sustainability in their company operations, rather than a knowledge of gender injustice.
12. Eight elements determine the business model in IMFIs: organizational orientation, business and social functions, sources and allocation of capital, investors and customers, use of financing, types of contracts, allocation techniques, and membership.

Conclusion

After the three-stage screening process was carried out, that is, the relevance of the theme, the affordability of access to articles, and the inequality of articles with other databases, it was found that the majority of the included articles were journal articles, with the highest number of research publications in 2019 and the most common research method being qualitative case studies. The main programme implemented by IMFIs in the context of poverty alleviation were financing with several schemes: a) *qarḍ ḥasan* financing for the interests of education, health and the economy (meeting the needs) of its members; b) *mustaḥiqq zakāh*-based micro-business capital financing; c) MSMEs financing; d) *sharīʿah* financing with a Grameen Bank model; e) Financing using a joint-liability scheme. In its implementation, the poverty alleviation programmes through financing by IMFIs were also supported by additional activities in the form of multifunctional assistance, social empowerment and brotherly relations, and the inculcation of Islamic ethical values in their activities. The impact felt by the community with the implementation of programmes from IMFIs includes increasing the welfare of members and reducing the number of poor micro and small entrepreneurs. The impact felt has benefits in economic, social, and spiritual terms that can contribute to economic and social development in Indonesia.

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