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The Role of Shariah Micro Financial Institution In Reducing Poverty

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Abstract:
Poverty is a multi-faceted phenomenon of food insecurity, lack of basic necessities, and physical handicap. Poverty basically contains three broad approaches: basic needs, income approaches, and capability approaches. Sharia microfinance is the convergence of Islamic finance and microfinance. It has great potential to combine Islamic principles that focuses on the poor and disadvantaged with the mission of microfinance to reach the poor and give them financial access. This study intends to find out the factors that influence poverty and to see how Islamic Microfinance (IMF) as an alternative solution for empowering the poor. This study takes a case study of KSPPS or BMT KUBE Colomadu Sejahtera in Karanganyar Regency, Surakarta. The method used is the Logit model. The variables that influence and significantly affect poverty are income, the number of dependents, and training that are followed.

Keywords: *Micro Financial Institution, Islamic Microfinance, Poverty, Logit Model*

I. Introduction

The prevalence of poverty originates from human existence and has now occupied almost all countries in the world with the most important development agenda. In poverty alleviation mechanisms, Islamic microfinance (IMF) is becoming increasingly popular, particularly in developing countries.

Islamic model in microfinance is rooted in Islamic values and is such a form of investment with socially responsible. From this point of view, economists believe that this is a general objective in Islam related to microfinance, in which it can be concluded that this way people can become independent, actively strive for their efforts and respect one another. The approach to achieving the poverty eradication goal is to use Islamic principles to practice microfinance. Empowerment policies and improved prosperity of the poor provide them with positive social gains and promote economic growth. (Elwardi, 2015).

Islamic microfinance is the convergence of Islamic finance and microfinance. It has great potential to combine Islamic principles that concern the poor and disadvantaged with the mission of microfinance to reach the poor and give them financial access (Mahmood, Abbas, & Fatima, 2017). Both are developing industries in Indonesia.

The social value of capital embedded in groups based on Islamic microfinance influences the behavior of the poor in paying their debts. As a policy recommendation, Islamic Bank must consider choosing a group based on Islamic microfinance as partners in realizing its linkage program for the poor so that poverty alleviation programs can be optimally implemented. (Sanrego& Antonio, 2013).

In September 2017, the number of poor people (population with per capita spending per month below the poverty line) in Central Java reached 4.20 million people (12.23 percent), decreasing by 253.23 thousand people compared to 4.45 million people (13.01 percent) in March 2017. (BPS, 2018).

The number of cooperative business units reached 150,223 business units, of which 1.5% were Sharia Savings and Loan Cooperatives (KoperasiSimpanPinjamPembiayaanSyariah/KSPPS). The total number of KSPPS was 2,253 units with 1.4 million members. The private capital reached IDR 968 billion and external capital was IDR. 3.9 trillion with a business volume of IDR 5.2

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trillion. The development of Islamic finance cooperatives is very potential. The current performance is very good, high quality in terms of health cooperatives, HR and IT (Depkop, 2018).

One study (Al-Mamun, Malarvizhi, Hossain, & Tan, 2011) noted that the average monthly income of returning customers is almost double that of new customers. The findings of this study also show that the participation of AIM's micro-credit program leads to an increase in household income and a reduction in poverty rates among AIM's customers in Malaysia Peninsula.

Based on the description above, this study is intended to determine the factors influencing poverty.

II. Literature Review

The number of micro businesses in developing countries must be higher because they contribute to job creation and benefit future generations. It is important to understand the dynamics of the growth of micro enterprises that are increasing over time in academic, policy and business practice fields because microbusiness plays a vital role in economic development and poverty reduction. (Alom, Abdullah, Moten, &Azam, 2016).

Microfinance could be an effective approach to reduce poverty. This success of microfinance programs in many countries has been well acknowledged, such as Bank Grameen in Bangladesh, Bank Rakyat Indonesia in Indonesia, AmanahIkhtiar Malaysia in Malaysia, KARTU in the Philippines, FINCA and ACCION in Latin America, and other micro financial institutions. Since the microfinance approach had been proofed to eradicate poverty, the United Nations in 2015 included microfinance in the list of potential contributions to reducing the number of people living in poverty by halve, which was the millennium development goals set in 2015. (Saad&Anuar, 2014).

Islamic microfinance is basically already in the correct path for economic growth and the prosperity of the Islamic principles-based socio-political system and includes similar principles of business, trade, investment and financing in Muslim societies. Islamic principles such as equal opportunities, entrepreneurial advocacy, risk sharing and non-collateral loan disbursement and the involvement of the poor support microfinance principles. (Saad&Anuar, 2014).

Islamic financing system applies loans without interest and investment. Although it is known that zero interest rates are important for efficient allocation of resources, it still seems impossible to work without interest when interest is considered as an important variable in today's business world (Khan &Url, 2016).

People who are isolated from other parts of the world are a source of losses that contribute to the cycle of poverty. While the world is progressing economically, most Muslims are economically left behind. However, poverty is not only in economic aspect. This extends to social poverty which has an impact on ignorance, apathy, drug dependence, crime, and immorality. This causes spiritual poverty (Hunter, 2014).

This study notes that the average monthly income of returning customers is almost double that of new customers. The findings of this study also show that the participation of AIM's micro-credit program leads to an increase in household income and a reduction in poverty rates among AIM's customers in Malaysia Peninsula (Al- Mamun et al., 2011).

To understand Islamic microfinance, it requires a minimum understanding of Islamic-based financial principles. Four principles derived from sharia law (Islamic jurisprudence) and agreed upon by most scientists, formed the base of the modern Islamic finance and are also important for Islamic microfinance. The principles are: 1. Interest prohibition 2. Sharing risk: creditors share the business activities of a funded business. (Elwardi, 2015).

There was as study examined the relationship between microfinance and poverty reduction in the state of Bayelsa, Nigeria. By using the chi-square statistical test, ANOVA, and the descriptive approach, the study showed that the relationship between microfinance and poverty reduction in Bayelsa State was clearly significant. It was also recorded that there was a significant difference between microfinance and conventional rotation schemes, also a significant difference between women's lending and poverty reduction. (Appah, John, & Wisdom, 2012).

The conclusion is that microfinance can not reduce poverty in communities where there is inadequate provision of basic infrastructure, such as highways,

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reliable electricity supply, good transport systems. It is therefore recommends that governments in developing countries like Nigeria provide basic infrastructure facilities as a matter of national priority.

Tariq et al (2015) concluded that microfinance profitability has a direct correlation with per capita income, which also means that the microfinance sector's profitability could increase the income of society. This is beneficial to policymakers because it shows that microfinance is beneficial for increasing household income and population numbers from middle school graduates, but it has no influence on people from elementary school. The results of this research show both positive and negative aspects of the performance of microfinance.

Memon et al. (2010)'s previous research concluded that microfinance is contributing to job opportunities in rural and urban Pakistan. Microfinance has supported an independent low-class community without depending on others or government. In this scenario, the government should also take steps to improve the microfinance sector, as it can be a powerful factor in increasing employment opportunities. If the government does not provide the majority of the general public with job opportunities, then microfinance can be the right hand to solve the problem of unemployment and can also control the level of poverty in the future. This study also suggests that, in addition to the lending facility, microfinance is also attempting to provide additional customer services such as micro-level savings and insurance. There is a proverb about the efficacy of microfinance loans distribution that allows individuals to live as "entrepreneurs and not as workers".

Education and microfinance are one unity because each activity “does not stand independently.” In other words, non-financial innovation like education is highly needed to support microfinance industry in improving knowledge, and credit is needed to offer financial support for the poor. Most customers feel happier because the services provided by microfinance institutions. Orientation towards education with the aim of microfinance services is expected to empower customers. Therefore, customers will be able to maintain their business without facing difficulties. Furthermore, providing credit and saving is a good service for poor customers who do not have insurance to access money from formal institutions. This study has proven that the poor could also change their circumstances. It can be concluded that to implement education with micro credit approach should be done slowly until customers could reach their goal. (Hadi, Wahyudin, Ardiwinata& Abdu, 2015).

Based on field observations at BMT MMU Sidogiri, it was found that BMT is effective in reducing poverty. Most of the users confirmed that their income was imcreased after receiving BMT financial supports. BMT products, especially the BBA and *mudarabah*, can empower poor people in various productive businesses so as to reduce severe poverty level. Therefore, an integrated program for the poor designed by BMT, which is the provision of financial and non-financial services including spiritual development through the internalization of Islamic moral values, is an important tool in alleviating poverty. BMT not only has an important role in reducing poverty and encouraging economic improvement but also alleviating illegal loans harks who trap poor people. Using the *Qard Hasan* scheme, BMTs succeeded in reducing the number of people who borrow from loan sharks and educate people about the dangers of usury. (Adnan &Ajija, 2015).

Poverty reduction is influenced by employment status, respondent's education level, migration, and residential areas. In previous findings, parents’ level of education and family composition were not statistically significant; therefore, they were not important factors in reducing poverty. The results of this study also explain that remittances from migrants help alleviate poverty. The level of education is very different for individuals living in urban areas if compared to those who live in rural areas. It also shows that sending money mostly to rural areas is very helpful in eradicating poverty (Mukli& Mersini, 2013).

In a study conducted by Biyase and Zwane showed that the level of education of the head of household, provincial dummy, the race of household head, dependency ratio, the sex of the head of household, the employment status of the head of household, and marital status of the head of the household were statistically significant in affecting the household welfare. In particular, there were findings showing that traditional rural

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areas (used as reference categories) and households living in urban areas and in agricultural areas tend to be poor and may become poor for households in Eastern Cape, KwaZulu- Natal, Northern. Cape Province or Region is significantly higher than Western Province or Region. Moreover, the level of education (primary, secondary, matrix, and tertiary) of the head of household reduces the possibility of becoming poor. These results showed that education investment and improving the economic conditions of the rural population (traditional rural areas) must continue to be the main focus of poverty alleviation efforts in South Africa (Biyase&Zwane, 2018).

Human skill is very important to improve the fortune of the poor. Households headed by women show a higher risk of poverty than male headed households. Poverty among senior citizens shows that older people are part of the disadvantaged group. The study suggested that the government should focus on older adults and put forward effective social policies to improve the economic status. Families with dependent children are more likely than families without children to encounter poverty, suggesting that the burden of raising children is associated with poverty. In this study, the relationship between household heads under the age of 30 and the risk of poverty is not clear. Less than 4% of people living in poverty who are heads of households under the age of 30. Divorced families are not poorer than families who are unmarried. Few married families and widows living in poverty show that the burden of raising a family lies with the unmarried. (Chen & Wang, 2015).

Poverty

Poverty contains three broad perspectives: approaches to employment, basic needs, and approaches to ability. Approaches to income and basic needs are predominantly characterized by quantitative measures, while quantitative and qualitative indicators describe the approach to human capacity. The capability approach usually includes more qualitative metrics that incorporate approaches to income and approaches to basic needs.

Income metrics are used to assess poverty in monetary approaches and basic needs approaches, while welfare is understood as an extension of human capacity in the approach to income. The latter approach assesses health and policy goals in terms of individual rights in order to lead a valuable life in the realization of their true potential. It can also be divided into capacity approaches and participatory approaches. (Sen, 2014).

Monetary Approach

Assessments of different income or consumption components are performed at market prices requiring multiple items to calculate monetary values. Calculating monetary value is very important for products that can not be measured at market prices, such as food output and public goods.

The benefit of this approach lies in the potential to optimize the effectiveness of household activity with expenditure representing the marginal value put on the asset by individuals. For individuals or families, welfare is measured as total consumption, and poverty is defined as resource scarcity below the minimum level of poverty. (Sen, 2014).

Basic Needs Approach

The United Nations Development Program (UNDP)'s Human Poverty Index (HPI) aims to reduce the problem of income estimation by using metrics showing the extent of cross-country poverty (UNDP, 1997). HPI is a composite index used to assess poverty by three indicators: lack of basic education, simple life style and lack of access to public and private services. The first factor relates to early-age survival and death susceptibility. In developing countries, an index measures the percentage of people expected to die before age 40 while in developed countries, the index reflects the percentage of people expected to die before age 60. The second factor relates to information acquisition and is calculated by the percentage of adults. The final portion of the index relates to the overall living standard and is a combination of three variables: the percentage of children under the age of 5, and the percentage of people with access to safe health and water services. (Sen, 2014).

Capability Approach

Monetary income is not accepted as a measure of welfare and an indicator of freedom to live a valuable life is highlighted. In this view, poverty is defined as deprivation in the space of ability or failure to achieve certain minimum or basic

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abilities. The ability to perform certain important functions at a certain minimum level is the basic of capability. Welfare is seen as the freedom of the individual to live a life valued in terms of achieving human potential and thus a fundamental approach.
Such tools may not be regarded as reliable indicators of ability as achievement (or functions) that differ depending on the individual's characteristics or context in which the person resides. Skilled individuals and people with disabilities, for example, require varying amounts of resources to achieve similar outcomes. There may also be different contexts in which people live, such as areas where basic public services are provided and areas where such services are not available. (Sen, 2014).

Islamic Micro Finance

Microfinance is a powerful tool for alleviating poverty. This includes providing financial services to disadvantaged and low-income people who are excluded from formal financial systems by their low economic status. Access to services such as credit, venture capital, investments, insurance, and remittance is offered on a micro-scale that allows those with severe financial resources to participate. Providing financial services to the poor increases household income and economic security, builds assets, and decreases vulnerability; creates demand for other goods and services (especiallyhealth care, nutrition and education); and boosts local economies.
However, a large number of poverty studies indicate that excluding the poor from the financial system is a major factor that contributes to their inability to participate in the process of development. The formal financial system does not represent more than twenty to thirty percent of the population in a typical developing economy. The vast majority of excluded people are poor. Without access to financial services, these households find it extremely difficult to exploit economic opportunities, build assets, finance the education of their children, and protect themselves from financial shocks. Consequently, financial exclusion binds them to a vicious.

Therefore, creating inclusive financial systems is a central goal of global policymakers and planners. Such issues are expressed in the 2000 United Nations Millennium Development Goals (MDGs) and the subsequent international initiatives. (Obaidullah& Khan, 2008)

The IMF idea adheres to Islamic values and is a socially responsible form of investment. Investors use their money for IMF ventures only invest in halal projects that benefit the wider community. These projects include zakat based on charity or the development of the economy of a country through commercial and industrial projects. Islamic Micro Financial Institutions are at the center of most societies ' economic growth and development today due to their key roles in human resource development. It also contributes significantly to alleviating poverty and bridging the gap between rich and poor. (Elwardi, 2015)

Microfinance has a lot in common with Islamic finance. Islam stresses legal, political, social and religious considerations in order to promote equality and justice for the benefit of the whole of society. Principles promoting risk sharing, individual rights and duties, property rights, and contract sanctity are all part of the financial system's Islamic code. In this light, many microfinance elements are consistent with Islamic finance's broader objectives. (Obaidullah& Khan, 2008).

In order to improve their role in poverty alleviation, it is proposed that BMTs provide higher support, provide their customers with more social services, provide the wider community with more knowledge on their financing products, better educate their customers to improve their understanding of Islamic words used in product financing, and innovate their financing products to meet their needs. (Riwajanti, 2014).

Financial Products of Islamic Finance

There have been a number of financial instruments designed to adapt Islamic finance principles to modern banking. Financing instruments can be broadly classified into four.

i. Participatory forms of profit-loss-sharing (PLS), namely *mudaraba* and *musharaka*,
ii. Modes of sale, such as *murabaha*,
iii. Modes based on leases or *ijara*,
iv. Service-charged loans or *qard-hassan*.

These financial products are show in Figure 1.

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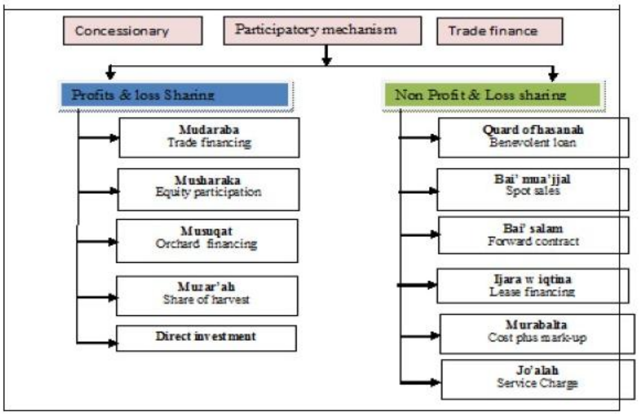

Figure 1. Different financial products

III. RESEARCH METHODS

This work is a quantitative descriptive analysis explaining the role of Sharia microfinance institutions in poverty reduction. The research duration was from February to June 2018 in Colomadu District, Karanganyar Regency. This type of research is quantitative research with a customer analysis unit of BMT KUBE Colomadu Sejahtera which proposes financing for business capital.

The population in this study is a Savings and Loans and Sharia Financing Cooperative (KoperasiSimpanPinjamdanPembiayaanSyariah/KSPPS) or BMT in Great Surakarta region. This study took a case study of KSPPS or BMT KUBE Colomadu Sejahtera in Karanganyar Regency.

The type of data used and this study are primary data. Primary data comes from survey results, through interviews with selected respondents, namely customers from BMTs who have businesses. Interviews are conducted based on a list of questions (questionnaires) that have been prepared. A list of questions is arranged according to the information or variables needed. In-depth interviews with 80 respondents were selected at the research location in January - April 2018, so that the data collected was in the same time frame. The sample used in this study was 69 customers.

Logit Model

Logit Model is a non-linear regression model with a categorical dependent variable producing binary numbers 0 and 1. The resulting numbers represent a particular category resulting from the probability calculation of the occurrence of the category.

The Logit model used in this study is as follows: (Gujarati, 2004), (Achia, Wangombe, &Khadioli, 2010). (Xhafaj&Nurja, 2014)

$$L_i = \ln\left(\frac{P_i}{1-P_i}\right) = \beta_1 + \beta_2 X_i + u_i \quad (1)$$

Pi = 1 if the BMT customer is in the poor category and *Pi* = 0 if the BMT customer is not in the poor category. Customers are in the poor category if the cost of living in the household is less than \$1.9 per day according to World Bank standards. The independent variables used in this study are gender, customer's education, involvement of family members in the business (involved: 1, not involved: 0), attended training: 1, did not have training: 0, number of family dependents, customer's age, and the customer's loan to BMT.

In this equation, $Li$is log of odds ration that is not only linear towards X but also linear to parameter β. The value of $\beta 1$ is intercept, which means that the probability of poverty is $\beta 1$ when other variables are 0.

The value of β_2 and so forth is the measurement of contribution of each variable that becomes the determining factor of dependent variable. Positive $\beta 2$ value means that on each one unit increase of the variable will raise the probability of poor customer in the amount of $\beta 2$. On the other hand, negative $\beta 2$ means that on each one unit increase of the variable will decrease the probability of poor customer. High $\beta 2$ value means that the variable has high influence towards the probability of poor customer; whereas, low$\beta 2$ value means the variable is relatively not significant in the probability of poor customer.

IV. RESEARCH RESULT

The results of data processing showed that of 69 respondents interviewed, 19 were declared poor and 50 were declared not poor. Poor criteria if the cost of living in the family is less than $ 1.9 USD / day or less than IDR 26,030.00 / day or less than IDR 780,900.00 / month.

A. Data Description

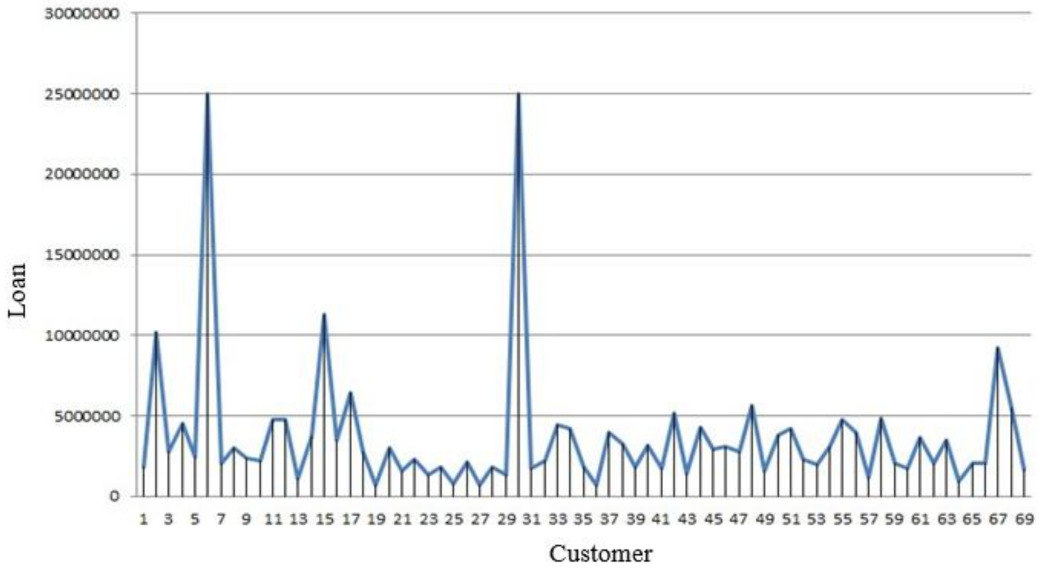

Figure 2. Total Income

Figure 2 shows that most of the average customer's income is still below IDR 5,000,000. The graph also shows customers with low income below IDR 1,000,000, in which customer 64 has IDR 967,000, customer 25 has IDR 790,000, customer 36 has IDR 725,000, customer 19 at IDR 705,000, and customer 27 has IDR 681,000. Except for these five customers, all customers already have income above IDR 1,000,000. Based on the graph, there are nine customers who have revenues with more than IDR 5,000,000, in which customers with the highest income from the 69 customers are customers 6 and customers 30 with revenues of IDR 25,000,000.

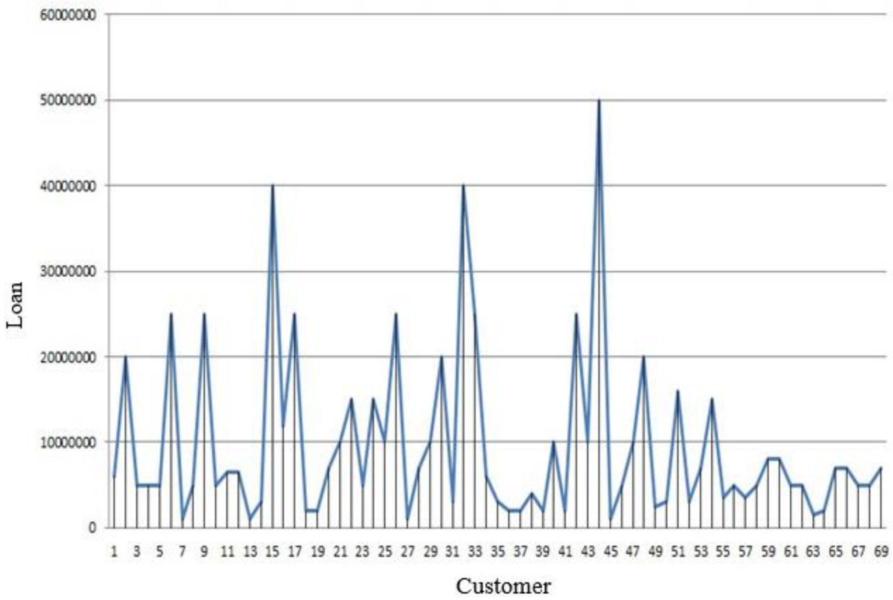

Figure 3. The amount of loan of customers at KSPPS or BMT KUBE Colomadu Sejahtera

Based on Figure 3 above, it is shown that the loans owned by each customer vary, there are customers who have low loan amount and some have high loan amount. On average, most customers have loans below IDR 10,000,000; customers with the lowest loans among the 69

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customers are customers 7, customers 13, customers 27, and customers 45 with a loan amount of IDR 1000,000. There are 17 customers who have loans above IDR 10,000,000, in which customer with the highest loan is customer 44 with a loan of IDR 50,000,000.

B. Research Results.

Statistical results presented in table 1 shows that ^{2}Log L is 34.134 and is statistically significant. This means that the addition of independent variables into the model improves the fit model. The Cox & Snell R Square is 0.495 and Nagelkerke R Square is 0.715, which means that the variability of dependent variable that can be explained by the variability of the independent variables by 71.5%.

Table 1. The results of data processing using Nagelkerke R-Square

Step	^{2}LogLikehood	Cox and Snell R-Square	Nagelkerke R-Square
1	34.134	0.495	0.715

Table 2. Analysis with Logit Model

	B	S.E.	Wald	df	Sig	Exp (B)
Involvement	0.616	0.919	0.449	1	0.503	1.851
Training	2.499	1.272	3.859	1	0.049	12.165
Number of dependents	-1.394	0.492	8.042	1	0.005	0.248
Log income	8.189	2.835	8.345	1	0.004	3599.975
Log amount of loan	1.122	1.465	0.587	1	0.444	3.072
Age	-0.046	0.054	0.707	1	0.400	0.955
Constant	-54.506	19.138	8.112	1	0.004	0.000

Table 2 shows that the independent variable Training has a positive and significant effect on probability 0.049, the variable number of dependents has a negative and significant effect on the probability of 0.005, and the income variable has a positive and significant effect on the probability of 0.004. Thus, as the household income is higher, the household is considered as not poor. The more the number of family dependents, the family is considered poorer, and the more skills training followed, the family is not poor.

V. CONCLUSION

This study concludes that microfinance institutions play a role in reducing poverty in Colomadu area of Karanganyar District. Financing by BMT to customers has a significant role in improving business skills, so that it can also increase income and reduce poverty.

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