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Identifying Financial Exclusion and Islamic Microfinance as An Alternative to Enhance Financial Inclusion

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Abstract

Even though the banking industry is growing exponentially, but they are still out of reach from the hardcore poor. The population under poverty remains financially excluded from the mainstream banking facilities. The aim of this paper is to examine the main factors that hinder customers to access financing from mainstream banking in Indonesia province of East Java. The study also attempts to identify the possibility of Islamic microfinance, in this case *Baitul Maal Tamwil* (BMT) can be used as one of an alternative platform to enhance financial inclusion.

In quantitative data, the paper employs primary data with involving a sample of 243 respondents. To explore the micro-entrepreneurs' criteria of barrier access to finance, an exploratory factor analysis is employed. In qualitative data, a semi-structure interview used to generate information from the respondents. The interview involves seven experts in microfinance including practitioner and academicians.

The study reveals that, the religious factor is perceived as the most important factor to be considered as financing barriers factors, then followed by affordability, accessibility, eligibility, and availability factors. The study indicates that Islamic microfinance may be an alternative platform to integrate commercial and social objective in order to enhance financial inclusion.

Keywords:

Identifying barrier, Islamic microfinance

1. Introduction

Statistics Indonesia reported that around 28 million people live under the poverty which is about 4.8 million poor people live in East Java province (BPS, 2014). Since large number of population (15.42 percent of total Indonesia's population) live in East Java, they are certainly contributed significantly to the national poverty level. The significant number of poor in the country including East Java relies heavily on informal sector for their livelihood. They are predominantly microenterprises which are mostly concentrated in agriculture and trading sectors. These real sector activities continue to be central of economic development strategy for the poor and their development has potential to provide income growth and poverty alleviation.

Regarding the poverty issue, numerous governmental programs seek to increase access to financial services through microfinance programs. These include the liberalisation of financial regulations followed by the establishment of the People's Rural Bank (BPR – *Bank Perkreditan Rakyat*, specialised microfinance bank for serving the microenterprise in the rural area), and launching the People's Business Credit Program (KUR-*Kredit Usaha Rakyat*, a special loan program to solve collateral issues faced by microenterprises).

Despite these efforts, a large number of micro-entrepreneurs have difficulties accessing credit. According to data of Bank Indonesia, in East Java, credit allocated to micro-small medium enterprises (MSMEs) is dominated by medium enterprises with around 65 percent of total credit, followed by small enterprises with 29 percent while microenterprises receive only 6 percent of total credit allocated to this segment (World Bank, 2011). This indicates that microenterprises have limited access to financial services which may prevent it from achieving maximum capacity. Such conditions will affect millions of the poor particularly in East Java (World Bank, 2011). The question is what factors hinder their access to financing from financial services? In this context, the study thus aims to empirically examine the variables that hinder customers from accessing financing in East Java province, Indonesia.

In relation to the above-stated issues, identifying barriers to accessing finance is an important step in increasing financial inclusion that will impliedly lead to decreased poverty. The common barriers to access are affordability (high service charge and interest rate), complicated eligibility (inflexible collateral and complicated document requirement), accessibility (physical access), availability or lack of financial product features (financial product provided not to all segments), and the religious factor (Demirguc-Kunt et al., 2008). A study in Nigeria conducted by Adewale et al. (2012) confirmed that eligibility and affordability (classified as involuntary financial exclusion barriers), financial complacency, cultural capital and religious consideration (included as voluntary financial exclusion barriers) are perceived as hampering microentrepreneurs' to access financial services. These barriers exclude lower income groups from accessing financing services from conventional banks. However, this study further elaborates on these barriers as five factors using Exploratory Factor Analysis (EFA) to validate the constructs.

Also, there is concern that conventional financial products are not universally applicable to the culture and belief systems of the poor Muslims which stunt its reach in predominantly Muslim countries like Indonesia (Karim et al., 2008; Hassan et al., 2013). Hence, even when financial services are available, some low-income groups may avoid using such services on religious grounds. For these people, poverty may remain, and such rejection hampers the government's efforts of fighting poverty (Demirguc-Kunt, 2008).

In this respect, a faith-based financial inclusion platform like Islamic Microfinance may be a suitable alternative in the countries where the Muslims are predominant. The question is to what extent Islamic microfinance can address barrier access to finance which can indirectly enhance financial inclusion? Thus, the study attempts to examine the role of Islamic Microfinance as a model to integrate social and commercial seeking in order to enhance financial inclusion.

According to the Central Bureau of Statistics (BPS, 2014), the measurement of poverty counted based upon people's ability to meet their basic needs, consists of food (daily minimum requirement of 2,100 kcal per-capita per-day) and non-food (such clothing, education, health) consumption/expenditure per capita per month. In September 2013, the national poverty line is set at IDR 308,826 per month (or equivalent to around USD 28) which, particularly in East Java, is IDR 278,653 (BPS, 2014). Thus, if people are economically unable to fulfill their basic needs, or their expenditure per-capita is below IDR 308,826, they are considered to be poor according to BPS's national poverty line.

According to BPS data, there are around 28.55 million poor people living across the country, which corresponding to 11.47 percent of the populations. This number experienced slightly decrease compared to the previous year of September 2013, which recorded at 28.59 million or 11.66 percent (BPS, 2014:176). However, Economists presumed skeptically on this decreasing trend, despite sustained economic growth (http://www.eastasiaforum.org). World Bank reported that around 40 percent population lives around poverty line (World Bank, 2010) and more serious happened in terms of non-income poverty such as high malnutrition rates (28 percent of total children below age five in 2005), high illiteracy (25 percent in 2005) and low enrollment ratio while reaching to secondary education (65 percent) (BPS, 2005).

In terms of GDP growth, Indonesia has recorded an increasing trend over the last two years, from 6.2 percent in 2010 to 6.5 percent in 2011 (World Bank) (http://data.worldbank.org). However, increase in economic growth is not line with reduction of poverty significantly. Silva and Sumarto (2014) identified current poverty in Indonesia into three key attributes. Firstly, many non-poor households categorized are close to the national poverty line, delivering them vulnerable to poverty. As a study indicates that between 2007 and 2009 around half of the poor in one year were not poor the previous year (Dartanto and Nurkholis 2013 cited in Silva and Sumarto, 2014). Second, the income and monetary poverty measures do not always capture the true picture of poverty in Indonesia; many households that are not income poor could be categorized as multidimensional poor, owing to lack of access to basic services and poor human opportunities and development outcomes (Wardhana, 2010 cited in Silva and Sumarto, 2014). Third, given Indonesia's vast size and heterogeneity, regional disparities are an entrenched feature of poverty in the country and national averages mask stark differences. As explained above, it is obvious that although there is an increase in economic growth (as measured by using GDP), it has a bit impact on poverty alleviation in Indonesia.

In terms of unemployment level, BPS data in 2013 recorded around 7.39 million unemployment in Indonesia, which is around 6.25 percent of total labour force (118.19 million) (BPS, 2014:88). Meanwhile, in East Java alone, there are around 871 thousand unemployment in 2013 which is around 4.33 percent of total economically active in East Java (http://jatim.bps.go.id). The province has the highest number of labor force in Indonesia, and can still be considered as a "labor surplus" with total number more than 19 million workers in 2013 (BPS, 2014: 88). Despite there are an increase in both terms of number of labor force and number of working, but is not enough yet to decrease number of unemployment significantly. This is due to be low absorption of labor force while the numbers of labor force increases significantly. According to data from East Java Statistics, the number of labor force increase about 236 thousand from 19.901 million in 2012 to 20.137 million in 2013 while the number of working people also increase around 185 thousands worker in 2013 compared to previous year (BPS-East Java, 2014:11). However, the number of employment rate climb up to 52 thousands as compared to the previous year. Again, availability of job opportunity is very limited and consequently much labor force cannot get a job and they would eventually be unemployment.

There are around 66 percent workers working in informal and this experiences an increase in line with limited of job opportunity provided by formal sectors. Meanwhile, employment structure is consistently unchanged in 2013. Agricultural sector (37 percent), trading sector (21 percent) and service sector (16 percent) and industry sector (14 percent) are the largest contribution to employment. They are mostly low skill workers as it can be seen from their education level that majority dominated by people primary education and below (52%); other educational levels include Secondary school (40%), University (6%) and Diploma I/II/III/Academy (1.52%) (BPS Jatim, 2014) (http://jatim.bps.go.id/). Thus, low education in majority of workforce in East Java is still relatively high and may be one of the challenge for the local government to reduce the unemployment rate.

Since the significant number of poor in Indonesia especially East Java depends heavily on informal sector, development of micro, small and medium enterprises (MSMEs) play an important role in translating into poverty reduction. These types of enterprises are dominant attributes in emerging countries (Cull et al., 2007). MSMEs contribute the income and employment with significant proportions of workers in most instances. It is undeniable true the role of MSMEs in poverty alleviation has been generally known since over decades ago. In the late 1990s when the financial crisis hit the country, the existences of MSMEs even could help the poor to make persisted and recovered from the crisis. In this sense, the importance of the existence of MSMEs as a foundation of economy for capabilities enhancement and poverty alleviation is indisputable.

Literature indicates many factors that causes financing barriers. Among the common features of financing barriers are affordability barrier (high service charge and interest rate), complicated eligibility (inflexible collateral and complicated document requirement), accessibility barrier (physical access), and availability barrier or lack of financial product features (financial product provided not to all segments) (Ghosh, 2013; Jha et al., 2014; Demirguc-Kunt et al., 2008; Hamada, 2010; Cull et al., 2007; Shankar, 2013; Ledgewood and Gibson, 2013). Besides that, the religious factor is also perceived as one of important factor to be considered as financing barriers factors. Some Muslim perceived that conventional financial products contain interest or usury (*riba*) which is indeed prohibited by Islamic financial principles (Karim et al., 2008). Therefore, they will not chose this type of product even-though they have access. A survey conducted in East Java by Bank Indonesia (2000), reported that 49 percent of the rural population considers interest prohibited and would chose free interest-based of Islamic financial institutions once they are available (OIC Outlook Series, 2012). This is actually not a surprising result since the majority in East Java are Muslim which covers almost 96 percent of its population (BPS, 2010).

Affordable price is one of important factors to attract the consumers in involving financial institutions. There are some issues in relating to affordable price. Excessive transaction cost is one of major barriers to financial inclusion. From bank perspectives, dealing with very small transactions lead to high overhead cost. Moreover, if they operate in remote locations with few financial transactions which is costly and may be unfeasible (Jha et al., 2014). Hence, they have inclined to be more interested in serving for middle-to-high income groups. Another barrier to financial inclusion in relating to affordable prices is high minimum balance requirement. Minimum balances required by them to open accounts frequently are found to be too high, and also accounts are closed by some banks due to infrequent use (Shankar, 2013). Beside high minimum balance requirement, high interest rates is an important barrier. A survey reported by ICS (Investment Climate Surveys) in 2002, found that a large proportion of small enterprises were excluded from mainstream banks (Demirguc-Kunt et al., 2008). Of those who are excluded, 85 percent in China, 95 percent in Rusia, and 96 percent in India (Demirguc-Kunt et al., 2008).

Complicated eligibility requirements are a major barrier of low income group to access financial services. Lack of proper documentation can create eligibility barriers especially for low income group in accessing financial institutions. For identification purposes, financial institution usually require several documents (such as ID, salary slip, land certificate, etc.) in offering the financial services to their customers. Beck, et al. (2008) assert that banks in many developing countries including Bangladesh, Cameroon, Chile, Nepal and Sierra Leone, require at least four documents in order to open the accounts, such as identification card, letter of recommendation, income slip, and valid address. Another barriers to financial inclusion in relating to eligibility is lack of collateral. There might are reluctance most micro-entrepreneurs in developing countries to apply loans as they are required to pledge their personal assets as collateral (Demirguc-Kunt et al., 2008). Armendariz and Morduch (2010) assert collateral with marketable assets can be used to reduce risk if borrower is default as it may be covered by secured assets.

Low accessibility is a key barrier of low income group to access financial services. Physical access is might only one type of accessibility barrier that may exclude potential customers to access financing from commercial banking. Physical access is geographic distance to the nearest branch. It can be hindered by long distance to a bank outlet (Beck et al., 2007). While mainstream banks are close to poor neighbor, some poor people may encounter prejudices (which are being refused admission) to banking offices (Demirguc-Kunt et al., 2008).

Lack of availability of appropriate products and services is another important barrier to access financial services for low-income group and microenterprises (Demirguc-Kunt et al., 2008). Claessens (2005) notes that banks may have problems providing financial services to all households and firms given population density. It may be too costly to provide the physical infrastructure in rural areas. Demirguc-Kunt et al. (2008) argue that dealing with small transactions is also another reason behind reluctance of financial institutions in provision of product and services for the poor and small firms. On the other hand, for low income group and small firm, often limit their demand because of available financial services are not appropriate to their affordability.

Cultural and religious concerns may be a challenge to financial inclusion. They are considered as significant factor to shape individual's attitude towards intention and preference behavior (DeLamater and Myers, 2011). In case of religious concerns for example, it is often as a reason for low income group to use financial service in the context of Middle East, North Africa and South Asia (Demirguc-Kunt, 2012). Even-though some certain low income groups have access but they chose not to use financial service because of religious grounds. In case of Muslim-majority country, some certain low income group perceives conventional financial products as unharmonious with the Islamic financial principles (Karim et al. 2008). This is because the product provided may contain any elements which are prohibited by Islam. These elements include as usury (*riba*), gambling (*maisir*) and excessive ambiguity (*gharar*). However, Figure 1 explains some factors that may hamper low income people to access financing from mainstream banking.

One of the banking studies that concern on financing barrier factor is conducted by Investment Climate Survey (ICS) in 2002 that highlighted about the reason of small firms do not use bank finance (Demirguc-Kunt et al., 2008). The survey revealed that most of the microenterprenuers do not need a financing. Besides that, they are excluded from bank finance because of high interest rate, strict collateral requirement and complicated application procedure. Meanwhile, in terms of reasons for not having a bank account where the survey conducted in the US and Mexico, found that expensive fee and high minimum balance requirement are the major reasons that cause people not to use financial services(Demirguc-Kunt et al., 2008). The other reasons reported are not comfortable with banks, inconvenience location and lack of documentations (Demirguc-Kunt et al., 2008).

Study by Jha et al. (2014) in various countries also discovered that 'natural' barrier which geographic distance to a bank are identified as one of the most important barriers for financial inclusion. However, in another study conducted by Demirguc-Kunt and Klapper (2012) revealed that lack of sufficient money to use is one the most common reason for people not having an account with the bank. Then is followed by services being too expensive, family member already has account, physical distance, lack of required documentation, lack of trust on bank, and religious reasons. Meanwhile, Ashraf and Ibrahim (2013) revealed that fear of getting into risk of loan is found as one of the most important barrier for accessing financial services in Bangladesh. The survey also found that spouse dislike as female head of household, insufficient resources and lack of knowledge are among other factors that hamper them to access financial services. Additionally, study by Sinclair et al. (2009) found that lack of financial product features and expensive fee are perceived as the most barrier factor for financial inclusion. The result also revealed that lack of information about financial issues and lack of financial skills faced by many people in UK are found as an important barrier for financial inclusion.

Meanwhile, studies on financing barriers of formal financial services in Indonesia remain limited. Previous study is restricted in scope of descriptive study. Survey conducted in East Java by Bank Indonesia (2005) for example which is descriptive in nature found that access to finance for micro-small medium enterprises remain a problematic by some reasons including complicated document requirement, lack of collateral, and higher interest rates (World Bank, 2011). World Bank's Rural Investment Climate Assessment (RICA) survey in 2006 found that cost of credit is the most constraint of access to finance faced by micro and small enterprises in rural Indonesia. Other constraints such as collateral requirements, complexity and cost of application procedures, and lack of documentation are also identified (World Bank Report, 2010). With same technique analysis, an empirical study of Mahmud and Huda (2010) revealed that almost half of SMEs surveyed have no access to finance because transaction costs are so expensive, collateral requirements are insufficient and lack of good administration. However, the outcomes of these studies should be undertaken with caution particularly with regards to the generalization of findings. Even though, there are many studies about barrier access to finance, there is little study that utilizes a theoretical underpinning toward identifying the financial exclusion barriers using a CFA to validate the instruments.

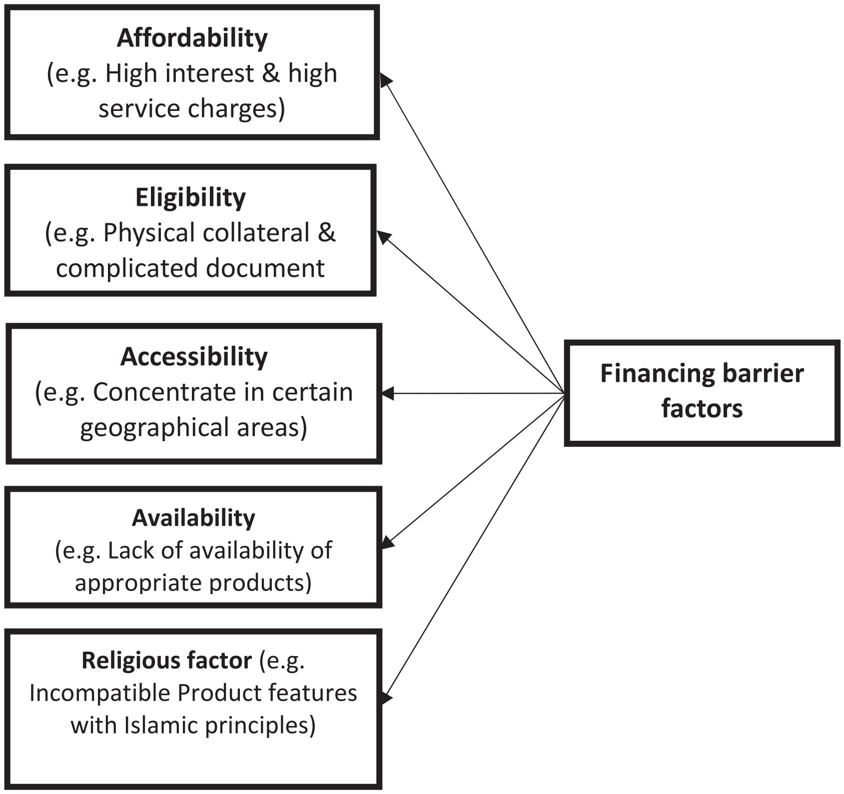

Figure 1 Financing barrier factors

BMT as Islamic microfinance and its roles in addressing barrier access to finance

Concept of BMT

Meaning of BMT is divided into two models; *Baitul Maal* and *Baitul Tamweel* (Obaidullah et al., 2014). The former refers to a pool of various kinds of Islamic charity funds such as *zakah-infaq-sadaqah* and *waqf* funds while the latter reflects a pool of funds directed at profit-seeking financing using *Shari'ah*-compliant modes such micro-savings and investment deposits.

Instead of charging interest rates, BMTs usually deal with principle of profit-loss sharing and practice Islamic moral values and group solidarity to boost repayment of loans (Juwaini et al., 2010). Regular meetings and counseling reflect group solidarity that is practiced by most BMTs in Indonesia. Overtime, according to ProFI (2005), there were around 3,038 BMTs established across the country with 1,200,000 number of loans disbursed and amounting IDR 152 million (Hamada, 2010).

The roles of Islamic microfinance in addressing barriers access to finance

In terms of addressing affordability barriers, Islamic microfinance institutions (MFIs) can be a suitable alternative. The institutions have the potential to not only respond to unmet demand but also to combine the Islamic social rule of caring for the poor with benefiting the strengths of microfinance to offer financial access to those who excluded from mainstream banking (Karim et al.,2008). The institutions may utilize Islamic philanthropy funds such as *zakat* and *waqf*, to absorb high operational costs which were always faced by MFIs. Obaidullah (2014) stated that Islamic charity such as *zakat* and *waqf* provides for a sustainable source of funds. According to the Islamic

Social Finance Report (2014), zakat collections have experienced a steady growth over time. As case in Indonesia, it has increased by 32 times over the last 10 years while in Malaysia, it increased by 27 times over the last 20 years (Obaidullah, 2014).

Given on this development, Islamic MFIs like Akhuwat microfinance in Pakistan hence have paid more attention on philanthropy funds such as *zakat* and *waqf* as one of the way in absorbing operational costs and ultimately lower price to affordable levels (Obaidullah, 2014). However, it should be noted that at the same time Akhuwat has no issue with sustainability. Besides *zakat, waqf* and *shadaqah*, corporate charity or CSR funds also can be used as source of absorbing operational costs. By using CSR funds in absorbing cost, Islamic Bank Bangladesh with its Rural Development Schemes (RDS) has been successfully providing financing at below-market and affordable rates to the poor (Obaidullah, 2014). It offered financing at 10 percent flat rate which is lower as compared to a Grameen loan was priced at 20 percent flat rate.

Meanwhile, in terms of addressing eligibility barriers, the growth of Islamic MFIs which particularly target low income groups may be seen as suitable alternative to enhance financial inclusion. Islamic MFIs are still consistent with poverty alleviation objective without compromising the issue of institutional viability and sustainability. Islamic MFIs remain using the technique of group-based lending and short period of collections in order to overcome the credit risk issue (Adewale et.al, 2011). The key factor of Islam here is trust devoid of social status. Islamic concept of brotherhood along with religious obligation of debt settlement can more enhance the relationship among group members and support fast settlement of the installments.

According to Mohieldin et al. (2012) *Waqf*-based Islamic MFIs can be benefited as source of funds to facilitate social collateral of group and weekly repayments in order to mitigate credit risk. Islamic mode of financing such as *Murabahah* or *Bay Mu'ajjal* or *Ijarah* (leasing) can be used to minimize moral hazard problem. These instruments involve real transaction which are the opportunity of misuse of funds for consumption may be reduced (Mohieldin et al., 2012). Thus, it is clear that with leading to social capital and involving real transaction to tackle the risks and moral hazard problem, Islamic MFIs may be expected able to exclude some eligibility barriers such as complicated documentation requirement, physical collateral and irregular income when dealing with their client.

Islamic MFIs serving the poor may have potential to overcome this accessibility barrier in particular ways. With integrating of philanthropy funds such as *zakah, waqf* and *shadaqah*, Islamic MFIs can easily reach the poorest of the poor. Islamic MFIs can employ zakat funds and be distributed to the poor and destitute for consumption as well as financing purposes (Saad, 2012). This is because zakat is perceived as important instrument for enhancing financial inclusion and economic growth. Evidence shows that 20 Muslim-majority countries can reduce poverty with giving Zakat collection (Mohieldin et al., 2012). Mohieldin et al argue that proper collection, streamlining, accountability, prioritization, and allocation of zakat to productive activities can have significant impact on enhancing access and opportunity for the poor segment of the society which will ultimately lead to reduction in poverty. Thus, with integrating zakat, Islamic MFIs can be easier to be accessed by the poor as the scheme only allocated to them.

Addressing availability barrier factor, Islamic MFIs might can be an alternative. This is based on core principles of Islam itself that lay great emphasis on social justice, inclusion and the sharing of resources between the haves and the haves not (Kazi, 2014). The way of Islamic MFIs which combine two missions: profit seeking and also social mission have exclusively an advantage which might conventional MFIs have not. As mentioned earlier, Islamic financial products are available a wide range of financial services including non-financing instruments such as *Waqf, Zakah* and

Sadaqah. Islamic MFIs, directly dealing with the poor, can use these products as their instrument. As discussed in the previous chapter, some Islamic financial products such as *murabahah, musharakah* and *mudarabah,* which deal with margin and profit loss-sharing, are more suitable financing for those who have a good track record and business experience. While, *qard al-hasan* financing is most appropriate for new clients that have no or less good track record and considered very risky (Obaidullah and Khan, 2008). Thus, Islamic microfinance is arguably as the best place of micro-financing to the poor since it provides diverse range of microfinance products.

Cultural and religious concerns may be a challenge to financial inclusion. They are considered as significant factor to shape individual's attitude towards intention and preference behavior (DeLamater and Myers, 2011). In case of religious concerns for example, it is often as a reason for low income group to use financial service in the context of Middle East, North Africa and South Asia (Demirguc-Kunt, 2012 cited in Jha et al., 2014). Even-though some certain low income groups have access but they chose not to use financial service because of religious grounds. In case of Muslim-majority country, some certain low income group perceives conventional financial products as unharmonious with the Islamic financial principles (Karim et al. 2008). This is because the product provided may contain any elements which are prohibited by Islam. These elements include as usury (*riba*), gambling (*maysir*) and excessive ambiguity (*gharar*).

As an empirical study conducted by Ashraf (2014), found that attitudinal mode of the rural people which predominantly Muslim has a negative impact on participation in conventional MFIs. The results indicated that religious values appear to be important issues to shape the attitudes of the rural clients who are predominantly Muslim women. As the religious values are contrary to the formal operations of conventional interest-based MFIs, significant percentage of the rural poor especially Muslim women have been remained reluctant to participate in microfinance programs in Bangladesh (Ashraf, 2014). In this case, however, Islamic MF could be a suitable alternative in the countries where the Muslims are predominant in society. This asserted by some Islamic scholars who argue that religious and cultural norms in Muslim countries may drive the preference of Islamic microfinance over conventional microfinance (Karim et al., 2008). Saad (2012) who support this argument found that majority of AIM members who participated in the survey are interested in Islamic financing products.

According to International Finance Corporation (IFC) studies as compiled by Karim et al. (2008), revealed that around 43 percent of respondents in Syria considered religious reasons as major obstacle to apply microcredit. In Muslim-majority countries such as Afghanistan, Indonesia, Syria, and Yemen, some conventional micro-borrowers tend to switch over once Islamic products become available (Karim et al., 2008). However, some evidences indicated that survey respondents may verbally express a preference for Islamic products simply to demonstrate religiousness.

2. Research Methods

It has two approaches due to its mixed mode nature regarding collecting the data for this study. The study used both quantitative and qualitative approaches to achieve the research objectives. The first objective which is to examine barrier access to finance is best achieved by using quantitative method while the second objective of assessing to what extent Islamic microfinance can be as an alternative is best achieved by using qualitative data approach.

In quantitative data, convenience sampling, a non-probability sampling technique is employed in data collecting process. This is due to insufficient information about the specific list of customers of Islamic microfinance (BMT) in East Java. The study employs questionnaire as survey instrument in quantitative approach. In terms of sampling size, from a total of 450 questionnaires distributed, 300 were returned, out of which 243 were usable, thereby indicating a response rate of about 54 percent, which is considered sufficiently large for statistical reliability and generalizability (Tabachnick and Fidell, 1996).

The responses obtained were analyzed employing SPSS. This is used to perform factor analysis on the response to financing barrier factor criteria. Factor analysis is a technique which is used to refine and reduce a large number of scale items to a more manageable number (Pallant, 2017). This technique was considered to be appropriate for this particular analysis because financing barrier factors have many connotations. With this technique, these observable variables can be grouped into factors, each reflecting an underlying variables, which is commonly shared by a certain group of variables (De Vaus, 2001). Moreover, this technique analysis also helps to validate that respondents can distinguish between the various constructs in spite of the similarity of the indicators questioned (Hair et al., 2010).

Meanwhile, in qualitative data, judgement sampling which is a non-probability sampling technique used in this study. An interview used to generate information in respect of qualitative data from the respondents. The interview covers the second objectives and involves seven experts in microfinance including practitioner and academicians. The interview was semi-structured in nature. The justification for adopting semi-structured is the technique allows the researcher to arrange questions based on the themes of study and focus on the questions to be discussed. Moreover, it also enables the researcher to design the inverview in a systematic manner and ask the interviewee to participate (Morse and Richards, 2002). The respondents will be asked questions with regard to Islamic microfinance as an alternative to enhance financial inclusion.

3. Findings and Discussions

3.1. Barrier access to finance

The finding reports the result of factor analysis used to define factors that exclude Muslim micro-entreprenuers to access finance from mainstream banking services. For this purpose, exploratory factor analysis with varimax rotation was conducted to outline patterns of financing barrier factors based on microenterprenuers' perceptions more obviously.

The Kaiser-Meyer-Olkin (KMO) measure of the sampling adequacy (MSA) shows an acceptable value of 0.75 and the Bartlett's Test of sphericity also come up with statistical significance (0.000), indicating the factorability of the correlation matrix. On these basis, factor analysis proceeds to perform principal component analysis (PCA) and varimax rotation with Kaiser Normalization. Varimax orthogonal rotation is used in this study as the study seeks to make sure that the factors provided will be unrelated to each other. Variables which most highly correlated with the factors are grouped together and arranged in descending order according to the size of their correlations.

As presented in Table 1 the rotated solution shows the presence of five factors with a number of strong loadings. However, there is no found for cross loading and eigenvalue indicators are within the guidelines as recommended by (Hair et al., 2010). The communality indices are acceptable with ranging between 0.50 and 0.84. The results also indicate that five latent factors have been successfully extracted on 19 items with eigenvalues greater than 1; explaining 64.68 percent of the total variance. Factor 1, 2 and 3 have four significant loading while both factor 4 and 5 have three respectively. The factor loadings are between 0.63 and 0.89.

As presented in Table 2, first factor comprises 4 following items; 'providing financial product that contains *maisyir,* 'providing financial product that contains *gharar,* and 'no fairness of the product'. The nature of the highly loaded variables on this factor suggests that it can be named as religious ground. This factor contributes around 24 percent of the reasons for excluding of conventional banking services. Since factor 1 has the highest eigenvalue and variance, it necessarily represents the most barrier factor that has influenced micro-entprenuers to access financing from banking services.

This result indicates that religious grounds appears as the most barrier factor to access financing in banking services. This is actually not a surprising result since the majority in East Java are Muslim which covers almost 96 percent of its population (BPS, 2010). This finding is consistent with earlier financing barrier studies like Demirguc-Kunt et al. (2008) who revealed that some certain low income groups have access but they chose not to use financial service because of religious grounds (Demirguc-Kunt et al., 2008). Some Muslim people for example, perceive that conventional financial products contain interest or usury (*riba*), *Maisyir, Gharar* which something prohibited by Islamic financial principles (Karim et al., 2008).

Table 1 Factor Analysis For Barrier Factor Criteria

Variables	Factor 1 Religious	2 Affordability	3 Accessibility	4 Eligibilty	5 Availability
Providing financial product that contains *Maisyir*	.890				
Providing financial product that contains *Gharar*	.868				
Offering financing with interest (*Riba*)	.721				
No fairness of the product	.637				
Imposing fixed transaction costs and annual fees		.830			
Imposing fixed fees and high cost of open & maintaining acc.		.824			
Imposing high interest rate		.709			
Requiring a minimum amount to open an account		.620			
Having prejudice (being refused admission to bank offices)			.765		
Distance from bank branch			.722		
Not having knowledge about banking procedures			.694		
Having no ATM outlet in nearby area			.633		
Requiring collateral (e.g.valuable assets such motorcycle etc.)				.835	
Requiring complicated documentation				.827	
Age discrimination (e.g. young people below 21 years excluded from financial services)				.741	
Not providing loan for small amount					.823
Not providing payment services for small amount					.741
Insufficient product for low income group					.672
Eigenvalue	4.410	2.531	2.039	1.403	1,259
Percent of variance	24.499	14.063	11.329	7.797	6.995
Cumulative (%)	24.499	38.562	49.891	57.688	64.682

The second factor defining barrier factor criteria relates to 'imposing fixed transaction costs and annual fees', 'imposing fixed fees and high cost of opening &maintaining account', 'imposing high interest rate', and 'requiring a minimum amount to open an account'. For this, the suggested term is 'affordability barrier' factor. The results of the factor analysis ranked as the second important factor behind the religious ground factor, since it explains 14 percent of the total variance for the variables in the data set. This finding is somehow consistent with the previous studies (Demirguc-Kunt et al., 2008: 48) that found that small firms are excluded from bank finance because of high interest rate, expensive fee and high minimum balance requirement.

Third factor defining barrier factor criteria with regards to 'having prejudice (being refused admission to bank offices)', 'distance from bank branch', 'not having knowledge about banking procedures', and 'having no ATM outlet in nearby area'. The nature of the highly loaded variables on this factor suggests that it can be labelled as 'accessibility barrier' factors. This factor contributes around 11.32 percent of the reasons for excluding of banking services. This is in line with the finding of Jha et al. (2014) study that discovered that geographic distance to a bank are identified as one of the most important barriers for financial inclusion

The results of the factor analysis as presented in Table 1 showed that the variables which have loadings on the fourth factor are 'requiring collateral (e.g. valuable assets such motorcycle etc.)', 'requiring complicated documentation', and 'age discrimination (e.g. young people below 21 years excluded from financial services)'. The combination of these variables can be grouped together under the proposed name of 'eligibility barrier' factor. Interestingly, the results of the factor analysis ranked as the fourth important factor behind the religious ground factor, affordability factor and accessibility factor, since it explains only 7.79 percent of the total variance for the variables in the data set.

This result is somehow inconsistent with the previous barrier access to finance studies since eligibility factors such strict collateral and documentation have often emerged as most common and important factors among barrier financing criteria. For example, BRI's MASS Survey in 2002 found that lack of documentation appears as main constraints faced by the poor in accessing financing from banking services in Indonesia (World Bank, 2010). Beck, et al. (2008) assert that banks in many developing countries including Bangladesh, Cameroon, Chile, Nepal and Sierra Leone, require at least four documents in order to open the accounts, such as identification card, letter of recommendation, income slip, and valid address. Consequently, only a small proportion of the people that can produce these documents and as a result, mostly excluded from financial services.

Last factor defining barrier factor criteria relates to 'not providing loan for small amount', 'not providing payment services for small amount', and 'insufficient product for low income group'. For this, the proposed term is 'availability barrier' factor. This factor contributes around 7 percent of the reasons for excluding of banking services. This finding is somehow consistent with earlier financing barrier studies like Demirguc-Kunt et al. (2008) that indicated that lack of availability of appropriate products and services is another important barrier to access financial services for low-income group and microenterprises (Demirguc-Kunt et al., 2008). Claessens (2005) notes that banks may have problems providing financial services to all households and firms given population density. It may be too costly to provide the physical infrastructure in rural areas. Demirguc-Kunt et al. (2008) argue that dealing with small transactions is also another reason behind reluctance of financial institutions in provision of product and services for the poor and small firms.

3.2. Financial inclusion and Islamic microfinance

Qualitative data analysis used to achieve the second objectives of the study that related to the experts' views on the possibility of Islamic microfinance can integrate commercial and social objective in one-time in order to enhance financial inclusion . Four academicians specialized in Islamic microfinance and three practitioners from BMT agreed to be the interviewees. Their profiles are listed under Table 2. Each interviewees quotation is numbered (R1-R7) for ease of reference to the respondents profile.

Table 2. Profile of Respondents

No.	Qualification	Specialization/Position	Working Experience
R1	Master	Ass. Manager	5 years in BMT
R2	Master	Manager	5 years in BMT
R3	Master	*Fiqh* and Islamic banking and finance	6 years research and consultation in Islamic banking and finance
R4	PhD	Islamic banking and Finance, *Waqf*	10 years in teaching and research in Islamic banking and finance, Islamic economics
R5	PhD	Manager	8 years in BMT
R6	Master	Islamic banking and finance	15 years in teaching Islamic banking and finance and research
R7	PhD	Islamic finance, *Zakat, Waqf,* Islamic microfinance	10 years in teaching Islamic banking and finance, Islamic economics

As described by Sekaran & Bougie (2010), the qualitative data analysis of this study is divided data reduction, data display and the drawing of a conclusion. These feature the themes that were explored from the research respondents interviewed. The themes were formed based on responses and opinions aimed at providing holistic stance of the possibility of Islamic microfinance can integrate commercial and social objective in order to enhance financial inclusion. These themes consist of two noble missions: combination of social mission (*Baitul Maal*) and commercial seeking (*Baitul Tamwil*); and suitable and acceptable alternative to enhance financial inclusion.

Theme 1: Dual missions of Islamic microfinance (or BMT) establishment in Indonesia; incorporating social and commercial seeking

The respondents agreed that key initial objectives for establishment of BMT are incorporating the concept of social and commercial seeking. The viewpoint of the first respondent with regard to two objectives of BMT establishment is that

> Their scope is micro financial institutions but they are still running the finance function in accordance with *Shariah* […]. There are several models of Islamic microfinance in Indonesia […] and one of them is popularly known as BMT (*Baitul Maal wat Tamwil*) which was initially owning two objectives: social and commercial objectives (R1).

The fourth respondent viewed that the establishment of BMT is a good initiative as long as it is done with good governance.

> Generally, BMT has two objectives; business objective which called as *Tamwil* or financing and social mission which known as *Maal*. I think this mission is very good as long as it is done with good governance. […] BMT with its *Baitul Tamwil* can provide financing and on other side with its *Maal* can provide social funds through training program, education and so forth (R4)

Moreover, the fifth respondent focused on BMT which is characterised as an Islamic cooperative institution. It is more flexible in providing the services since it is operated under cooperative law. He cited that:

> Islamic microfinance is more flexible in providing the services as compared to financial institution in the context of banking system. […] Islamic microfinance that is known as BMT or Islamic financial cooperative is under cooperative laws which it is not as strict as banking rules. […] So, credit union and BMT are two institutions that jointly can create ideology. Such model that is worried by capitalist system. This capitalist does not look at small number but this involving of large society that is worried by them (R5).

In addition to the above points, according to the seventh respondent's understanding, most BMT clients or members are those who have small business but excluded from conventional bank.

> […] Islamic microfinance is a financial service that is targeted to finance micro and small enterprises which are usually perceived by conventional banking as unbankable (R7).

However, respondent two revealed that although BMT has two noble objectives but the idealism are relatively different in the current practice of BMT. He stated that:

> BMT was developed in Indonesia has two mission, social or called as *Baitul Maal* and profit mission or called as *Baitul Tamwil* […]. […] If they are under foundation, they cannot do business and as a result when they was under cooperative law, the management of BMT is almost similar to Islamic saving and financing cooperative. So, at the end of the day, current BMT is different with BMT when they was initially established (R2).

Agreeing with the second respondent, the third respondent viewed that the current BMT is highly more commercial dominated rather than a social program. He mentioned that:

> […] Islamic microfinance is an intermediary institution that is operated like bank in form of a micro scale. […]BMT stand for *Baitul Maal wat Tamwil*. It comes from two words, namely *Baitul Maal* which means collecting fund for social program and *Baitul Tamwil* which mean providing financing for business. […]So, although it is named of BMT but actually *Tamwil* function is more dominant rather than *Maal* function (R3)

The central goal of establishing BMT is to incorporate between *Baitul Maal* (a process of social role) and *Baitul Tamwil* (as commercial role) and at the end of day, it is beneficial for the welfare of the people. This is the same view mentioned by respondent six as follows:

> […] Islamic microfinance has been already longstanding and even they become initiated development of Islamic finance in Indonesia before commercial bank emerged. […] we can combine *Baitul Maal wat Tamwil* where *Baitul Maal* itself is a process of social role which it can be collected from social fund such as *zakat, waqf*, charity, etc. while *Baitul Tamwil* has functioned as business role or managing of microfinancing is based on profit-loss sharing (R6).

As mentioned earlier, the first theme that emerges is featuring dual missions of establishment of BMT i.e., incorporating social (*Baitul Maal*) and commercial (*Baitul Tamwil*) seeking. The majority of the respondent believe that the characteristics of establishment of BMT is based on those two objectives. The response above indicated that BMT constitutes Islamic financial cooperatives which have a business mission as a financial intermediation which offers financial services such as savings and financing and their target market are a very small micro-entrepreneurs who are excluded from conventional banks while the social mission of BMT are presumed as *amil* which collect and distribute *zakat* and in one time collect and distribute *infaq, sadaqah* as well as provide *qard al-hasan* financing.

Although the respondents have viewed BMT has dual missions i.e., business and social, two respondents claimed that the business function is dominant which shifts from the idealism when BMT was initially established. The issues arose by respondents regarding business domination such as providing *Murabahah* financing as the dominant contract. According to them, this type of financing contract has high margins which are sometimes higher than conventional microfinance.

Theme 2: Suitable and acceptable alternative for enhancing financial inclusion

Most of the respondents agree that BMT can be a suitable alternative to enhance financial inclusion. In relation to this statement, respondent one viewed that BMT can be an alternative institution for people who previously sought moneylenders for microfinancing. He stated that:

Let say in the past, if they want to make a loan, they sought moneylenders but now BMT can

> be as an alternative. If you ask about the role of BMT in promoting financial inclusion, I say yes... One of an effective way is conducted to provide training program. Some BMT already conducted this type of program. There is relatively much developed regarding training program, etc. (R1)

Similarly, respondent six affirmed that in order to enhance financial inclusion, BMT could apply lending based on groups which may be an effective way to create awareness among members. He said:

> […] of course, it is not instantly process and it must be combined with working of Islamic banking in general to put jointly working with the microfinance. […] there is a good BMT with their conducting peer group... this will be an effective way to educate each other. With this forming lending based group, the level of success is higher than individual lending (R6)

In addition to the above, respondent two supports that access to BMT is easier as it is concentrated in lower income neighbourhoods. He mentioned that:

> I think so, because poor people if they wish to conduct financial transaction with the bank, they must go to bank directly. On other hand, the poor look at bank building is exclusively concerned for rich people. […]But if they come to BMT, they are more comfortable with BMT even wearing sandals can come to BMT. […]Therefore, we, of course undertake what bank cannot do, we do. Thus we can say BMT and Bank can complement each other (R2)

Another respondent also addresses the potential to overcome the accessibility barrier and mentioned that:

> I think so, BMT have own model to offer financing to those are excluded from conventional bank, so that their agenda to enhance financial inclusion have important role (R3)

Depending on collateral is needed when financial institutions dealing with poor contractual. Consequently, they often depend on their relatives or local moneylenders who sometimes charge high interest rates. Therefore, BMT can be a suitable alternative to address this kind of financial exclusion by providing financing without complicated collateral. This was what was said by respondent four in his words:

> Yes, I think that BMT have already been suitable alternative to enhance financial inclusion… Most bank are not interested to deal with them as they have no valuable collateral, have low education so that for bank perceives them as risky customer (R4).

To strengthen the above opinions, respondent five adds the applicability of BMT to enhance financial inclusion due to its ideology movement which provides more flexible movement. He stated:

> My view is Islamic microfinance is precisely as suitable alternative for financial inclusion… BMT is not only viewed as Islamic microfinance but as an ideology movement which may perform a better justice but also conduct more flexible movement. […]. Meanwhile, in the capitalism system who has a big capital has a power. But it is different with BMT that has a power and will be controlled by large number of small capital group (R5)

Moreover, respondent seven reemphasised on the role of BMT to enhance financial inclusion as follows:

> Yes, as nature of BMT is interacted to microenterprises, the role of BMT is certainly very crucial for financial inclusion (R7)

The second theme addresses BMT as an alternative and suitable institution to enhance financial inclusion. The feature of the BMT model in enhancing financial inclusion has satisfied the experts. Most of them viewed that BMT can be easily accessed by all segments of the society since the institutions are concentrated in lower income neighbourhoods. By integrating of philanthropy funds such as *zakah, waqf* and *sadaqah*, BMT can easily reach the poorest of the poor. Saad (2012) maintains that Islamic MFIs can employ *zakat* funds and be distributed to the poor and destitute for consumption as well as financing purposes.

Some respondents also note that some BMTs in Indonesia also apply the group-based lending technique in order to overcome the credit risk issue. With the technique, inflexible or even no collateral required while providing microfinancing. Mohieldin et al. (2012) advocate that *Waqf*-based Islamic MFIs can serve as a source of funds to facilitate social collateral of groups and weekly repayments in order to mitigate credit risk.

4. Conclusion

The first objective of this study is to determine the factors that impede micro-entrepreneurs to access financing from banking services. The most important fact revealed by this study is barrier access to finance may depends on the religious ground that inherent on Muslim micro-entrepreneurs. Besides, financing barrier factor that faced by most micro-entrepreneurs in East Java includes such as expensive rates, distance from bank branch, complicated procedure to get loan, lack of collateral, etc. are some constraints of getting financing that also impede them to access financing. The important insights identified on the ranking of various financing barrier criteria implies the need for integration of microfinance with Islamic finance certainly required in building inclusive financial systems with respecting the cultural and religious sensitivities of a Muslim society. The second objective is thus to examine the role of Islamic Microfinance as a model of integrating the social and commercial seeking in order to enhance financial inclusion. Based on the interview results, the study indicates that BMT that incorporates dual missions, i.e., social and business can be an alternative platform to enhance financial inclusion. To strengthen the role of BMT as model of commercial and social integrating, the study suggests the need to utilise and maximize potential funds from Islamic philanthropy source of funds such as *zakat, waqf*, and charity.

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