

**FACTORS DETERMINING THE SUCCESSFUL  
PERFORMANCE OF BAITUL MAAL WAT TAMWIL  
IN INDONESIA: AN EMPIRICAL INVESTIGATION**

BY

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## ABSTRACT

Baitul Maal wat Tamwil (BMT) has been considered a leading Islamic microfinance institution in Indonesia. The main objective of the establishment is to eradicate poverty and improve the social welfare of society by assisting the poor and micro-enterprises financially. However, despite the success story, several BMTs suffered failure and bankruptcy due to their inability to resolve existing problems such as a lack of capital structure of funding, inadequate human resources, and a lack of governance. Furthermore, the members of the BMT have relatively low income and a lack of business management skills. Hence, the purpose of the study is to determine key factors influencing the successful performance of the BMT in Indonesia. The study also aims to help the BMT managers reduce the risk of failure and enhance the chance of success in their business. This study is a field research with a mixed-method approach. In addition, this study employed triangulation as a data collection method through conducting semi-structured interviews with 3 directors of the BMTs and administering questionnaires to 225 employees of the BMTs. The quantitative data are analysed using several statistical test analyses such as reliability analysis, ANOVA, multiple regression analysis, F-test, and T-test, while the qualitative data use codification and thematic analysis. The findings exhibited five significant issues faced by the BMT in the operation and development in Indonesia, namely a lack of capital, loose regulations, inadequate human resources, a lack of understanding of Islamic transaction contracts, and a lack of financial technology. Moreover, the findings also pointed out that there are only three key factors of the successful performance of the BMT in Indonesia, namely the capital structure of funding, human resource adequacy, and product innovation. This study recommends the BMTs managers to keep practicing the seven principles of the BMTs, provide regular seminars and training programs to the staff and members, and provide more innovative products to fulfil the specific needs of the society.

**Keywords:** *Baitul Maal wat Tamwil, Islamic Microfinance, Poverty, Social Welfare, and Sustainability.*

## خلاصة البحث

بيت المال والتمويل (BMT) هو مؤسسة رائدة للتمويل الأصغر الإسلامي في إندونيسيا، حيث يكون الهدف الرئيس من تأسيسه هو القضاء على الفقر وتحسين الرفاهية الاجتماعية من خلال مساعدة الفقراء والمؤسسات الصغيرة ماليا. ومع ذلك، على الرغم من قصة النجاح التي تم تحقيقها، إلا أن العديد من فرق BMTs كانت تعاني من الفشل والإفلاس بسبب عدم قدرتها على حل المشكلات القائمة مثل الافتقار إلى هيكل رأس المال للتمويل، وعدم كفاية الموارد البشرية وتقصص الحركة. علاوة على ذلك، فإن أعضاء BMT لديهم دخل منخفض نسبيا ونقص في مهارات إدارة الأعمال. وبالتالي، فإن الغرض من الدراسة هو تحديد العوامل الرئيسة التي تؤثر على الأداء الناجح لـ BMT في إندونيسيا. وتهدف الدراسة أيضا إلى مساعدة مديري BMT في الحد من مخاطر الفشل وتعزيز فرصة النجاح في أعمالهم. هذه الدراسة عبارة عن بحث ميداني مع طريقة مختلطة. هناك العديد من العوامل التي تؤثر على أداء BMT، وهي هيكل رأس المال للتمويل، وإدارة BMT، وكفاية الموارد البشرية، وابتكار المنتجات وسداد المنتجات التمويلية. بالإضافة إلى ذلك، من أجل تحديد أداء هذه الدراسة، تم استخدام التثليث (Triangulation) كطريقة لجمع البيانات من خلال إجراء مقابلات شبيهة منظمة مع 3 مديريين من BMTs وإدارة الاستبيانات إلى 200 موظف من BMTs. في حين أن تحليل وفرضية البيانات الكمي باستخدام العديد من تحليلات الاختبار الإحصائي مثل تحليل الموثوقية ANOVA، وتحليل الانحدار المتعددة، واختبار F واختبار T. أظهرت النتائج أن هناك خمس قضايا رئيسة تواجهها BMTs في التشغيل والتطوير في إندونيسيا، وهي نقص رأس المال، واللوائح الفضفاضة، وعدم كفاية الموارد البشرية، وعدم فهم عقود المعاملات الإسلامية ونقص التكنولوجيا المالية. علاوة على ذلك، أشارت النتائج أيضا إلى أن هناك ثلاثة عوامل رئيسة فقط للأداء الناجح لـ BMTs في إندونيسيا، وهي هيكل رأس المال للتمويل، وكفاية الموارد البشرية وابتكار المنتج. توصي هذه الدراسة بمديري BMTs بالاستمرار في ممارسة المبادئ السبعة لـ BMTs، لتوفير حلقات دراسية وبرامج تدريبية منتظمة للموظفين والأعضاء ولتوفير منتجات أكثر ابتكارا بهدف تلبية الاحتياجات المحددة للمجتمع.

## APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Finance).

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## DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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# TABLE OF CONTENTS

Abstract .....	iii
Abstract in Arabic .....	iv
Approval Page .....	v
Declaration .....	vi
Copyright .....	vii
Acknowledgment .....	viii
Tables of Contents .....	ix
List of Tables .....	xii
List of Figures .....	xiv
<b>CHAPTER ONE : INTRODUCTION .....</b>	<b>1</b>
1.1 Background of the Study .....	1
1.2 Statement of the Problem .....	5
1.3 Research Objectives .....	6
1.4 Research Questions .....	6
1.5 Significant of the Study .....	7
1.6 Methodology of the Study .....	8
1.7 Limitations of the Study .....	9
1.8 Structure of the Study .....	10
<b>CHAPTER TWO : LITERATURE REVIEW .....</b>	<b>12</b>
2.1 Introduction .....	12
2.2 The Theory of Microfinance .....	12
2.3 The Concept of Islamic Microfinance .....	16
2.4 The Practice of Baitul Maal wat Tamwil .....	22
2.4.1 The Basic Principles of the BMT .....	27
2.4.2 The Organizational Structure of the BMT .....	27
2.4.3 The Key Products of the BMT .....	28
2.4.3.1 Saving Products .....	29
2.4.3.2 Financing products .....	32
2.5 Issues affecting BMT operations .....	34
2.6 Empirical Review .....	36

2.7 Critical Success Factors.....	41
2.8 Hypothesis Development .....	44
2.8.1 Capital Structure of Funding .....	45
2.8.2 Governance of the BMT .....	46
2.8.3 Human Resource Adequacy .....	48
2.8.4 Product Innovation .....	49
2.8.5 Repayment of Financing Products.....	49
2.9 Conceptual Framework .....	51
<b>CHAPTER THREE : METHODOLOGY .....</b>	<b>53</b>
3.1 Introduction .....	53
3.2 Research Strategy .....	53
3.3 Research Methodology .....	57
3.3.1 Qualitative Research .....	57
3.3.2 Quantitative Research.....	58
3.3.3 Mixed methods Research .....	59
3.4 Research Design .....	61
3.5 Research Method .....	64
3.5.1 Data Collection Methods .....	64
3.5.1.1 Quantitative data collection method: Questionnaires .....	66
3.5.1.2 Qualitative data collection method: The Semi-structured Interview ..	70
3.5.2 Sampling .....	72
3.5.2.1 Research Population .....	73
3.5.2.2 Sample Frame.....	74
3.5.2.3 Sampling Method .....	74
3.5.2.4 Sample Size .....	76
3.5.2.5 Data Collection Process .....	76
3.5.2.6 Reliability and Validity .....	77
3.5.3 Data Analysis Methods.....	84
3.5.3.1 Statistical Analysis for the Questionnaires .....	85
3.5.3.2 Semi-structured interviews data analysis .....	90
3.6 Limitations and Difficulties.....	91
<b>CHAPTER FOUR : ANALYSIS AND FINDINGS .....</b>	<b>92</b>
4.1 Introduction .....	92
4.2 Response Rate .....	92

4.3 Demographic Analysis of the respondents .....	93
4.4 Descriptive Analysis .....	99
4.5 Testing Hypothesis .....	105
4.5.1 Two-sample Hypothesis Test .....	105
4.5.2 Analysis of Variance (ANOVA) Test .....	110
4.5.3 Multiple Linear Regression Analysis .....	120
4.6 Qualitative Analysis .....	125
4.6.1 Forming the coding .....	126
4.6.1 Research Analysis of interviews .....	127
<b>CHAPTER FIVE : DISCUSSION, CONCLUSION AND RECOMMENDATIONS .....</b>	<b>138</b>
5.1 Introduction .....	138
5.2 Summary of Research Hypotheses Findings .....	139
5.3 Discussion .....	139
5.4 Conclusion and Recommendations .....	147
References .....	149
APPENDIX A: QUESTIONNAIRES .....	157
APPENDIX B: SEMI-STRUCTURED INTERVIEW .....	161
APPENDIX C: SPSS OUTPUT .....	172

## LIST OF TABLES

<b><u>Table No</u></b>	<b><u>Page No</u></b>
2.1 The Summary of Deterioration of the BMTs in Indonesia in 2008	34
3.1: Validity Test of Variable X <sub>1</sub> Result	80
3.2: Validity Test Variable of X <sub>2</sub> Result	80
3.3: Validity Test Variable of X <sub>3</sub> Result	81
3.4: Validity Test Variable of X <sub>4</sub> Result	81
3.5: Validity Test Variable of X <sub>5</sub> Result	82
3.6: Validity Test Variable of Y Result	82
3.7: Reliability Test Result	83
3.8: Normality Test Result	87
3.9: Multicollinearity Test Result	88
3.10: Heteroscedasticity Test Result	89
4.1: Summary of Demographic Analysis	93
4.2: Frequency Analysis of Gender	94
4.3: Frequency Analysis of Marital Status	95
4.4: Frequency Analysis of Age	96
4.5: Frequency Analysis of Education	96
4.6: Frequency Analysis of Job Titles	97
4.7: Frequency Analysis of Working Experience	98
4.8: Frequency Analysis of Training or Seminar	98
4.9: Descriptive Statistic of Capital Structure of Funding	99
4.10: Descriptive Statistic of Governance of the BMT	101

4.11: Descriptive Statistic of Human Resource Adequacy	102
4.12: Descriptive Statistic of Product Innovation	103
4.13: Descriptive Statistic of Repayment of Financing Products	104
4.14: Two-sample test between Gender and Capital Structure of Funding	106
4.15: Two-sample test between Gender and Governance of the BMT	106
4.16: Two-sample test between Gender and Human Resource Adequacy	107
4.17: Two-sample test between Gender and Product Innovation	108
4.18: Two-sample test between Gender and Repayment of Financing	109
4.19: ANOVA result of Qualification and Capital Structure of Funding	110
4.20: ANOVA result of Qualification and Governance of the BMT	111
4.21: ANOVA result of Qualification and Human Resource Adequacy	112
4.22: ANOVA result of Age and Product Innovation	113
4.23: ANOVA result of Age and Repayment of Financing Product	114
4.24: ANOVA result of Age and Capital Structure of Funding	114
4.25: ANOVA result of Job Titles and Governance of the BMT	115
4.26: ANOVA result of Job Titles and Human Resource Adequacy	116
4.27: ANOVA result of Length of Working and Product innovation	117
4.28: ANOVA result of Length of Working and Repayment of Financing	118
4.29: ANOVA result of Frequency of Training and Capital Structure	118
4.30: ANOVA result of Frequency of Training and Human Resource	119
4.31: Multiple Linear Regression Result	120
4.32: Simultaneous F-test Result	124
4.33: Coefficient of Determination Result	125
5.1: Summary of Research Hypotheses Findings	139

## LIST OF FIGURES

<b><u>Figure No</u></b>	<b><u>Page No</u></b>
2.1 General Framework of the BMT in Indonesia	25
2.2 Hypothesized Model for the Study	50

# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

In the global economic system, the deployment of Microfinance institutions (MFI) has achieved remarkable expansion throughout the world in the last three decades (Karim, Tarazi & Reille, 2008). This growth was due to a meaningful contribution of microfinance to the improvement of social welfare by providing affordable financial access for the poor and low-income groups (Vento, 2004). Fascinatingly, Bizri (2014) supported that its market share has shown supported that its market share has shown impressive growth at an annual rate of 16.61 percent in the global economy for the years 2012-2016.

As one of the most significant sectors in the global economy, microfinance is currently considered a new paradigm of poverty alleviation approach that attracts attention not only the academicians and practitioners, but also enchants the policymakers in both developing and developed countries. Ledgerwood and White (2006) ascertained that many politicians worldwide have considered microfinance as a panacea for poverty eradication in which microfinance is able to promote sustainable financial services to the bottom of the society.

Historically, the microfinance framework is not a new concept, as it was practiced a century ago in several parts of the world based on mutual trust and traditional systems. Hearth (2018) ascertained that *Banco Solidario* (BancoSol) in Bolivia, for instance, a well-known microfinance in Latin America, offered non-profit

microfinancing to the poor people on mutual trust and informal system in 1720. Furthermore, numerous informal and traditional credits have also spread all over the world since the 1895s, such as *the Priyayi* bank in Indonesia, *Susu* in Ghana, *Chit* Fund in India, and *Trantriers* in Mexico. In the Asian region, Seibel (2005) further asserted that the descent of microfinance in India had existed around three millenniums earlier, but the transcript is yet to be documented.

Moreover, Visconti (2016) emphasized that the predecessor of microfinance began from various traditional kinds of civil society movements such as rural moneylenders, group lending mechanisms, and cooperatives. Armenda´riz and Labie (2011) also stated that the main reason of microfinance attracted so many poor people and the microenterprises was because when they were in need of funds, they prefer to borrow money from friends, family-members, moneylenders, and other informal financial institutions due to the easy and simple mechanism of loans. Hence, the unique features of microfinance meet the appropriateness and the excitement of the poor and the microenterprises by building strong social relationship.

Meanwhile, the revival of the microfinance movement in the last three decades started with the establishment of an action-research project initiated by Professor Muhammad Yunus in 1976 in Bangladesh, currently known as the Grameen Bank (Kasim, 1999). Furthermore, Islamic Microfinance’s development has also shown rapid progress throughout the Muslim countries due to the high demand of many Muslim customers for Islamic financial products (Karim *et al.*, 2008). For instance, the emergence of *Akhuwat* in Pakistan, interest-free microfinance launched by Dr. Saqib Amjad and his colleagues in 2001 (Harper, 2011).

In Indonesia, tremendous movement of Islamic microfinance began with the establishment of Baitul Maal wat Tamwil (BMT) in 1995 (Seibel & Agung, 2005).

Darsono, Astiyah, Darwis, Sakti, and Suryanti (2016) also emphasized that the BMT is referred for two important dimensions: firstly, *Baitul Maal* (the house of social) acts as a social function, whereby the Islamic social charities such as *Zakat, Infaq, Sadaqa and Waqf* collect and disburse funds to the respective categories of the recipients; secondly, *Baitul Tamwil* (the house of business) acts as a business function, where collection of various types of savings from the shareholders and the members based on Shariah compliance, then manages it in profitable and permissible business activities.

This rapid growth of the BMT was spawned by its ability to meet the dire need of the Indonesian Muslim community towards an access to Islamic financial inclusions and contribute significantly to Indonesian economic development (Rusydia & Devi, 2013). KNKS<sup>1</sup> (2019) further highlighted that the BMT had experienced incredible growth within these 30 years, whereby currently there are over 3,000 BMTs established, 600,000 members of the BMTs, and over 3,000 staff employed.

Despite the significant impact on the provision of various employments and the nation's economic development, several unresolved challenges could jeopardize the effectiveness and sustainability of the BMTs. Unfortunately, that several BMTs ended up bankrupt due to the inability to overcome issues that they faced in operation. The lack of capital funding and inadequate human resources were considered the major challenges affecting the sustainability and outreach of the BMTs (Nasution & Ahmed, 2015). Rusydia and Devi (2013) further emphasized that BMTs generally faced several problems in four significant aspects: a lack of human capital, inadequate legal support, poor supervision and guidance, and weak competitiveness.

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<sup>1</sup> National Committee of Islamic Finance, Komite Nasional Keuangan Syariah (KNKS)

Meanwhile, previous studies on Islamic microfinance, particularly on factors determining the successful performance of the BMTs in Indonesia, are minimal. Based on prior studies, there is a research gap, namely, to investigate the in-depth, extensive, and empirical analysis of factors determining the BMT's successful performance. Hence, to fill the gap, this research examines five key variables to capture those factors determining the successful performance of the BMT. This study also utilizes a broader sample than prior studies as it collects the data from about 225 respondents from 5 BMTs in Wonosobo city. Moreover, other differences are on the triangulation of the data that are analysed quantitatively and qualitatively. The results of the study might be useful to formulate a better resolution related to the development and sustainability of the BMT.

There is a small number of previous studies on factors determining the successful performance of microfinance in Indonesia. For instance, Hartungi (2007) studied the "Understanding the success factors of Bank Rakyat Indonesia (BRI) in a developing country", where the result showed that the factors determining the success of BRI are the innovation of products and services, quality of staff, transparency, internal supervision, audit capacities, and financial risk management. In addition, Zubair (2016) also conducted a study on factors determining the BMT sustainability in Yogyakarta. This study indicated that three external factors and two internal factors significantly affected the sustainability of BMT, namely regulation, supervision, the structure of institutions, quality of human resources, and capital, respectively.

Accordingly, the study adopted a theoretical framework derived from the studies conducted by Zubair (2016). Simultaneously, the study utilized Multiple Regression analysis and demographic analysis to identify and measure empirically the selection factors determining the successful performance of the BMT. Moreover, the result of the

study also provided a solution and suggestion to the Islamic finance practitioners and regulators in order to improve the effectiveness and sustainability of Islamic Finance institutions.

## **1.2 STATEMENT OF THE PROBLEM**

The BMT is an important Islamic Microfinance institution that has been expanded rapidly throughout Indonesia since its establishment in 1995. It has a valuable contribution to the society's economic and social development by providing the necessary solution form of lending to the poor and microenterprises, whereby inducing them to become reliable borrowers and more independent (KNKS, 2019). Among their services are collateral-free loan, convenient instalment payments, and provision of business management skills (Masyita & Ahmed, 2011). Therefore, the poor and micro enterprises can extend their business and keep them away from the illegal moneylenders who exploited them by charging high interest and severe penalties for those who are unable to pay the debts. However, they face several issues obstructing the effectiveness and sustainability of the BMT.

Hamzah, Rusby, and Hamzah (2013) identified that the BMT is currently facing approximately ten major issues, whereby five issues are internal dimensions such as inadequate human resources, a lack of managerial skill, a lack of IT facilities, lack of Innovation in marketing product and service and issue of capital. In contrast, other five issues are external dimensions such as a lack of public trust, a lack of the public's understanding toward, borrower case of default, a lack of supervision, and the absence of specific regulations in governing the BMT.

Moreover, Ascarya (2017) also stated that the BMT members are relatively low income earners and they lack business management skills that influence their income and social welfare. The purpose of the study is to assist BMTs in reducing the risk of failure of their operation and improving their successful management by determining the significant factors of the successful performance of the BMT using mixed methods research design.

Hence, it is important to conduct this study to determine the real determinants of the successful performance of the BMT by examining the five selected independent variables, namely the capital structure of funding, the governance of the BMT, human resource adequacy, the product innovation and the repayment of financing products.

### **1.3 RESEARCH OBJECTIVES**

This study aims to investigate and assess factors influencing the successful performance of the BMT in Indonesia. In line with the statement of the problem, this study attempts to achieve the following objectives:

1. To analyze the issues faced by the BMT in the operation and development in Indonesia.
2. To determine the key factors of the successful performance of the BMT in Indonesia.
3. To make the recommendations for improvement of the BMT in Indonesia.

### **1.4 RESEARCH QUESTIONS**

Following the research objectives, the researcher focuses the study to attempt the following research questions:

1. What are the issues faced by the BMT in the operation and development in Indonesia?
2. What are the key factors of the successful performance of the BMT in Indonesia?
3. What are the recommendations for improvement of the BMT in Indonesia?

### **1.5 SIGNIFICANT OF THE STUDY**

The findings of this study are expected to provide a significant contribution to the Islamic microfinance industry in Indonesia and the global Islamic finance generally.

This study has several advantages, which are:

1. It contributes to the microfinance field literature. Whereby this study enriches the literature of microfinance includes Islamic microfinance, by exploring and providing comprehensive insight into significant factors determining the successful operation and performance of microfinance institutions, in particular the successful performance of the BMT as one of the Islamic microfinance institutions in Indonesia.
2. It contributes to the development and sustainability of the BMT in Indonesia by providing a comprehensive explanation to the BMTs' managers and staff about the pivotal factors that influence their operations, especially on the capital structure of funding, the governance of the BMT, human resource adequacy, the product innovation, and repayment mechanism. Accordingly, the BMT's performance becomes more sustainable and competitive than its conventional counterpart, particularly in their products and services.
3. It assists the government on the issues faced by the BMT. This study will help the government make monetary policy in supporting Islamic microfinance,

including the BMT by providing several appropriate solutions and considerations to current issues.

## **1.6 METHODOLOGY OF THE STUDY**

To meet the research objectives and answer the research questions, this study adopted mixed methods methodology. In order to address the complexity of social and health science phenomena, mixed methods are more appropriate to adopt because they use both qualitative and quantitative approaches (Creswell, 2009). Moreover, Almalki (2016) further emphasized that these methods provide more depth and comprehension of understanding that are not feasible using a single approach. Hence, these mixed methods were adopted to obtain more valid and comprehensive findings.

This study used quantitative approach to investigate the perception and opinion of the respondents about the factors determining the successful performance of the BMT through administering the questionnaires and by conducting semi-structured interviews in order to obtain a better understanding, more comprehensive information and explore research subjects' experiences.

Accordingly, this study was developed based on the deductive approach by testing the existence theory towards an analysis of the successful performance of microfinance. In comparison, the research design of this study is in accordance with the research questions adopted from a combination of various research designs such as exploratory, descriptive, and explanatory design and some research strategies such as survey and case study strategy.

Moreover, this study also used triangulation on various sources of the research data such as primary and secondary quantitative and qualitative data. The primary quantitative data were collected by distributing self-administered questionnaires to the

several managers and staff of the BMTs in Wonosobo city, Central Java. The demographic questions were adopted from the book written by Sekaran (2003) and a previous study conducted by Haque, Osman, and Ismail (2009), whereas the design of the questionnaires was adapted from the previous study conducted by Zubair (2016). The questionnaires consisted of two parts: firstly, querying demographic information such as gender, marital status, age, qualification, job titles, length of experience, and frequency of seminars attended. Secondly, investigating the respondents' opinion about the factors determining the successful performance of the BMT, which involves one dependent variable and five independent variables.

Finally, the quantitative data collected from 225 completed questionnaires were analysed using Statistical Package for Social Sciences (SPSS) version 24.0. Other statistical analysis includes descriptive analysis, validity and reliability test, T-test, ANOVA, and regression analysis. On the other hand, the qualitative data collected from three semi-structured interviews were analysed using codification and thematic analysis.

## **1.7 LIMITATIONS OF THE STUDY**

Basically, this study has an issue of time and budget constraints in collecting the primary data. Hence, this study focuses and restricts the investigation on the BMTs in Wonosobo, Central Java, Indonesia. The respondents were the staff and managers of the BMTs in Wonosobo, and the sample of the study is about 225 staffs and 3 managers of the BMTs in Wonosobo. Some reasons for determining Wonosobo as the city of investigation as follows:

- i. Wonosobo is a city in Central Java with a total population of about 790,504 in 2019 in which its annual population growth rate is approximately 4.34% (BPS Jawa Tengah, 2020).
- ii. According to 2019 data, the number of cooperatives in Wonosobo was 350 cooperatives, whereby 40% of them or 100 cooperatives experienced instability and unhealthy performance (Sunandar, 2019).
- iii. According to 2019 data, Wonosobo ranks as the second poorest city in Central Java, with around 16,63% of the total population were living below the poverty line (Suara Merdeka, 2020).

It is necessary to investigate the challenges and issues faced by cooperatives such as the BMT as an Islamic cooperative in Wonosobo city. Moreover, it is crucial to determine success factors of microfinance performance for enhancing its role and its contribution in alleviating poverty and improving social welfare in Wonosobo city.

## **1.8 STRUCTURE OF THE STUDY**

The structure of this study is divided into five chapters, which are as follows:

### **Chapter One: Introduction**

This part provides the background of the study, a statement of the problem, research objectives, research questions, the significance of the study, followed by the structure of the study.

### **Chapter Two: Literature Review**

In this part, the study will review the literature used for theory basis of study, existing studies, and theoretical framework of conduction this study.

### **Chapter Three: Methodology**

This part describes the methodology on data collection, population and sample, source of data, and research design.

### **Chapter Four: Data Analysis and Findings**

This part deliberates the data analysis, which were collected from several resources. In the qualitative part, the data were collected by interviewing the managers of the BMTs, whereas in the quantitative part, data were collected through a survey given to members of the BMTs. Finally, the researcher will also provide findings and clarify the different views on the data analysis.

### **Chapter Five: Discussion, Conclusion, and Recommendation**

The last part of the study focused on the discussion, conclusion, and suggestions.